

EMPLOYER-FINANCED RETIREMENT BENEFITS SCHEMES (EFRBS)

INTRODUCTION

The concept of EFRBS was introduced in April 2006 when a lifetime cap (currently £1.8m) was introduced on the funding of UK approved pension schemes. Prior to then, it was possible to top up pensions using FURBS (Funded Unapproved Retirement Benefit Schemes) but FURBS are no longer as tax-efficient.

An EFRBS, which is a trust, is a highly-flexible alternative to a UK-registered pension scheme. The annual and lifetime allowances on contributions applicable to UK-registered pension schemes do not apply, while the permissible investment choices are much wider.

INCENTIVISATION AND RETENTION

Through using an EFRBS, an employer is able to incentivise and retain key personnel, by providing potentially unlimited retirement benefits. Employers can be either companies or incorporated businesses. Owner-managers need not be excluded, although there are additional Inheritance Tax considerations to be considered where owner-managers are intended to benefit.

TAX-EFFICIENCY FOR THE EMPLOYEES

If the member is UK-domiciled for tax purposes, an offshore EFRBS can provide an investment fund which is able to grow in a tax-free environment outside of the member's estate for Inheritance Tax purposes.

For non-UK domiciled employees, an offshore EFRBS can be structured as a direct substitute for an international pension plan but without any requirement for there to be a non-UK employer.

ACCESSING RELIEFS

In some cases it may be difficult for an owner-manager to utilise his entitlement to Business Asset Holdover Relief for Capital Gains Tax purposes or Business Property Relief for Inheritance Tax purposes due solely to the level of cash held in the company. A contribution of the surplus cash to an EFRBS can potentially overcome this problem.

CORPORATE TAX DEDUCTIONS

Generally speaking, the UK employer will not be able to claim Corporation Tax relief at the time when the

contributions are made to fund the EFRBS. Instead, Corporation Tax relief will usually be deferred until benefits are actually provided to the beneficiaries.

CONTRIBUTIONS

The level of permitted contributions to an EFRBS is not subject to either the annual allowance or lifetime allowance restrictions which affect UK-registered pension schemes. However, the quantum of contributions made to an EFRBS should take general account of the overall level of profits of the employer and of the total pool of remuneration and bonuses payable by the employer.

When contributions are made to the EFRBS, the employee should not be subject to Income Tax, nor should any National Insurance Contributions be payable either by the employer or by the employee.

INVESTMENT OF THE FUND

The fund is able to be invested in a very flexible manner, including but not limited to open-ended and closed-ended mutual funds, equities, bonds, real estate, private company shares, chattels etc.

Non-UK income and capital gains can accumulate tax-free within an offshore EFRBS, while UK-source income generally suffers UK tax at 40% (50% from 6th April 2010) although UK-source dividends suffer UK tax at 32.5% (42.5% from 6th April 2010).

ACCESSING THE FUND PRIOR TO RETIREMENT AGE

Generally, if a member receives a benefit from the EFRBS, including a benefit-in-kind, then he will be liable to Income Tax and NIC on the value of that benefit in the same way as if he had received that same benefit directly from the employer company.

However, if the member takes a loan from the EFRBS at a commercial rate of interest equal to or higher than the official HMRC rate of interest (currently 4.75%) then no tax liability would result from such a loan.

On the member's death, any loan balance outstanding from him to the EFRBS would have the effect of reducing his taxable estate for Inheritance Tax purposes.

Unlike for UK-approved pension schemes, there is no restriction on making loans to the employer company.

TAKING RETIREMENT BENEFITS

When certain types of retirement benefits are paid from the EFRBS, such benefits are not subject to either employers' or employees' National Insurance Contributions.

The taxation of lump sum benefits will depend on the tax residency of the member when benefits are taken. Likewise, the taxation of pensions or annuities will depend on the member's residency status when such benefits are taken. Generally, if the member is resident in the UK at the relevant time, then all such benefits will be subject to Income Tax at the rate of 90% of the member's marginal income tax rate (i.e. a maximum of 36%, rising to a maximum of 45% from 6th April 2010).

There is no obligation to purchase an annuity when taking benefits from an EFRBS.

SUMMARY

An EFRBS can therefore satisfy multiple objectives in a tax-efficient manner, including:

- acting as a top-up pension scheme;
- providing access to a wider spread of investments than is available from approved pension schemes;
- avoiding any purchased annuity obligations;
- protecting assets from future creditors;
- assisting with access to Business Asset

Holdover Relief and Business Property Relief;

- permitting arms-length loans to the member or to the employer company in appropriate circumstances;
- mitigating the exposure to NIC for both the employer company and the employee.

The employer company must carefully consider the impact of the long-term deferral or potential loss of Corporation Tax relief in respect of the contributions that it makes to an EFRBS. For loss-making companies and/or companies with substantial accumulated losses this factor may be less of an issue.

Particular care must be taken in relation to EFRBS established by "close" companies and where it is intended that "participator employee/shareholders" may benefit from the EFRBS. In such circumstances there are additional Inheritance Tax and possibly other tax factors to take into account on a case-by-case basis.

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