

STRATEGIC TAX PLANNING

International & UK Tax Consultants

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EMPLOYEE BENEFITS TRUSTS (“EBTs”) AND EMPLOYEE FUNDED UNAPPROVED RETIREMENT BENEFIT SCHEMES (“EFURBS”) COME HOME TO ROOST!

There was a headline in Sky News on 1st November 2012 highlighting the fact that JP Morgan, a major U.S Bank (with a large operation in the City of London) had in September contacted many current employees and ex-employees with regard to Income Tax liabilities arising out of the use of EBTs and EFURBS for a number of tax years dating back essentially to 1999 and as recently as 2010.

The reason why this announcement is so shocking is HMRC made a Settlement offer in 2011 to those who had used EBTs prior to the Disguised Remuneration Legislation coming into force in the Finance Act 2011. The consensus amongst those promoting such products was that the matter should be litigated as the Settlement offer was too unattractive – it offered no incentives or discounts.

Most of those who had bought into EBTs and in particular those in Small and Medium Enterprises (“SME’s”) where the Employees/Director/Shareholders had used EBTs and EFURBS as a way of extracting money tax efficiently and in particular in 2010 following the introduction of the 50% income tax rate when these schemes were sold in their thousands. It is hard to estimate how much tax is at stake in SME’s where the Employees/Director/Shareholders extracted large amounts of money, but HMRC’s own estimate of £1.7 billion including National Insurance and Interest would seem to be way on the low side.

My own estimate is that excluding the City Banks (like J.P Morgan) and Football Clubs who made extensive use of these schemes for their high earners, the total tax at stake amongst profitable SME’s, is probably in the region of £4 billion alone. This represents a tax bonanza for HMRC. The significance of the JP Morgan approach is that when HMRC first announced their Settlement offer it was basically met with derision; firstly by the scheme sellers and providers and by many advisers saying that the best approach for Clients would be to await a Court decision which would be many years down the line, the only issue at risk was interest, (penalties would probably not be in point) and so with current interest rates currently being very low a Client’s best strategy would be to wait it out for the 3 – 7 years for a Supreme Court decision on this matter and even if they lost, all that was at risk was to pay the tax back plus interest.

HMRC seems to have taken this on board and quietly on 25th August this year they issued a very detailed and revised Question and Answer’s on their approach to Settlements for EBTs and EFURBS.

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The huge amount of detail in this document demonstrated that HMRC had mastered the complex law in this area and understood the huge variety and types of EBTs and EFURBS out there and also the extent to which they were being used. It has also showed a significantly hardened approach and clarity of vision.

If a large global investment bank like JP Morgan had taken advice and decided that they didn't see any viability in fighting HMRC on this matter then even if SME's can group together (via their scheme seller or provider) and start a Group Litigation, then the outcome is unlikely to be successful.

This realisation will come as news to a lot of these people who have been reassured by scheme sellers and advisers that the best strategy is to wait and see and suggesting that they have a chance of success in the Courts!

What is clear is that HMRC have substantially backed down on what appear to be their principal way of attacking these EBTs and EFURBS on the grounds that they create a taxable transfer for Inheritance Tax purposes. Their focus is clearly now on the fact that the effect of allocating funds unconditionally to Individuals either directly or via sub-trusts is a point at which Income Tax and National Insurance liabilities accrue. They now have some case law in their favour. *HMRC v. PA Holdings Ltd (2011)* EWCA Civ 1414 currently being appealed to the Supreme Court and *UBS AS and DB Group Services (UK) v. HMRC (2012) UKU 320 (TCC)*.

They also are pressing harder on disallowing a Corporation Tax Deduction as this creates a Corporate Liability. In addition they are assessing Companies for Employers National Insurance and pursuing both amounts vigorously.

The history of EBTs, (and I have been advising on them personally for over 25 years), is that EBTs were once viable means of rewarding employees but all that changed when scheme sellers and promoters got hold of these devices (often with money being literally washed through EBTs in as little as 2 or 3 days). Payments in from the Company to the EBT and then to payment out via loan to the relevant Employee/Shareholder/Director was so fast that it could open up an argument from HMRC that the EBT Trustees never had control of or "Legal Title" to the monies and that the reality that this was a pre-ordained transaction whereby the EBT was a mere *Conduit* for money to be passed to the Employees/ Director/Shareholders, i.e. it was always a way of paying salary and bonuses and the methodology proved that!

Of course, each EBT and EFURBS had its own particular methodology and nuances and depending on who established it and how it was run will ultimately determine what the outcome will be. However, the reality is that most of the EBTs and EFURBS that were *Hard Sold* by Scheme Sellers and promoters will not have any substantial tax viability.

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There is another issue in that even if a Client's best course of action is to make a Settlement with HMRC (as the JP Morgan employees are being advised to do), there may also be a case for suing the Advisers in Negligence who have advised on particular EBTs and EFURBS since there is usually no independent or proper legal advice!

Again, in view of their practice of regularly Liquidating entities (this may not be viable) but in other cases it may be an approach worth considering that may produce the best result for those unfortunate Employee's/Shareholders/Directors who are now facing the tax liabilities. In my view, apart from the cases where the EBT and EFURBS have been set up properly and has actually performed its function of providing Benefits to all the Employees in a Company and has not made immediate loans to the Employees/ Directors/Shareholders and instead invested money; this may be the best course of action.

I cannot emphasise enough though that each Individual case needs a careful analysis and evaluation to determine the best way forward for each Individual Client. There is no *one size fits all* approach. Certainly, many of the so-called *Solutions* which are effectively a further tax product, will not produce a solution!

Strategic Tax Planning has substantial expertise in EBTs and EFURBS having been involved with EBTs for over 25 years.

If you are aware of Clients or Groups of Individuals who need advice on the best way to proceed and also making sure they obtain the best deal (if they are going to go ahead and accept the HMRC Settlement offer), then please contact us.

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