

OLD SQUARE TAX CHAMBERS
TRUSTS SEMINAR OCTOBER 31ST 2018
EMPLOYEE BENEFIT TRUSTS - ARE THEY STILL WORTHWHILE?
ROBERT VENABLES Q.C.

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1. IHT Advantages post Barker v Baxendale-Walker²

1.1 Inheritance Tax Section 86 (Trusts for benefit of employees)

1.1.1 The Statute

“(1) Where settled property is held on trusts which, either indefinitely or until the end of a period (whether defined by a date or in some other way) do not permit any

¹ Chairman of the Revenue Bar Association 2001-05, Bencher of the Middle Temple, Fellow of the Chartered Institute of Taxation, Chartered Tax Adviser, (Council Member 1999-2011), TEP. Author of Non-Resident Trusts (9th edition forthcoming), The Taxation of Trusts 2010 (published by Key Haven June 2010, new edition with Oliver Marre entitled The Taxation of Trusts 2018 in preparation) The Taxation of Foundations (published by Key Haven 2010), Inheritance Tax Planning and numerous other works on trusts and tax. Senior Q.C. of Old Square Tax Chambers, Lincoln’s Inn.

² [2017] EWCA Civ 2056. Permission to appeal to the Supreme Court has been refused.

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of the settled property to be applied otherwise than for the benefit of-

(a) persons of a class defined by reference to employment in a particular trade or profession, or employment by, or office with, a body carrying on a trade, profession or undertaking, or

(b) persons of a class defined by reference to marriage to or civil partnership with, or relationship to, or dependence on, persons of a class defined as mentioned in paragraph (a) above,

then, subject to subsection (3) below, this section applies to that settled property or, as the case may be, applies to it during that period.

(2) Where settled property is held on trusts permitting the property to be applied for the benefit of persons within paragraph (a) or (b) of subsection (1) above, those trusts shall not be regarded as outside the description specified in that subsection by reason only that they also permit the settled property to be applied for charitable purposes.

(3) Where any class mentioned in subsection (1) above is defined by reference to employment by or office with a particular body, this section applies to the settled property only if-

(a) the class comprises all or most of the persons employed by or holding office with the body concerned, or

(b) the trusts on which the settled property is held are those of a profit sharing scheme approved in accordance with Schedule 9 to the Taxes Act 1988, or

(c) the trusts on which the settled property is held are those of a share incentive plan approved under Schedule 2 to the Income Tax (Earnings and Pensions) Act 2003, or

(d) the settled property consists of or includes ordinary share capital of a company which meets the trading requirement and the trusts on which the settled property is held are those of a settlement which-

(i) meets the controlling interest requirement with respect to the company, and

(ii) meets the all-employee benefit requirement with respect to the company.

(3A) For the purpose of determining whether subsection (3)(d) is satisfied in relation to settled property which consists of or includes ordinary share capital of a company-

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- (a) section 236I of the 1992 Act applies to determine whether the company meets the trading requirement (with references to “C” being read as references to that company),
 - (b) sections 236J, 236K, 236M and 236T (but not 236L) of the 1992 Act apply to determine whether the settlement meets the all-employee benefit requirement and the controlling interest requirement (with references in those sections to “C” being read as references to that company), and
 - (c) “ordinary share capital” has the meaning given by section 1119 of the Corporation Tax Act 2010.]5
- (4) Where this section applies to any settled property-
- (a) the property shall be treated as comprised in one settlement, whether or not it would fall to be so treated apart from this section, and
 - (b) an interest in possession in any part of the settled property shall be disregarded for the purposes of this Act (except section 55) if that part is less than 5 per cent of the whole.
- (5) Where any property to which this section applies ceases to be comprised in a settlement and, either immediately or not more than one month later, the whole of it becomes comprised in another settlement, then, if this section again applies to it when it becomes comprised in the second settlement, it shall be treated for all the purposes of this Act as if it had remained comprised in the first settlement.”

1.1.2 Advantage of Trusts being Section 86 Trusts

Not “relevant property”. See Inheritance Tax Act 1984 section 58(1)(b). But see also section 58(1B) and (1C) for limited exceptions.

Hence no general periodic and exit charges to Inheritance Tax on the settled property.

But watch special exit charge imposed by Inheritance Tax Act 1984 section 72 (Property leaving employee trusts and newspaper trusts).

1.1.3 Comments

Is the section 86 heading misleading?

Given that the class of beneficiaries needs to include “all or most of the persons employed by or holding office with the body concerned” does that mean all must benefit?

Can persons not within the permitted categories benefit?

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1.2 Inheritance Tax Act 1984 Exemption for transfers of value by Individuals to Employee Trusts

1.2.1 The Statute.

Inheritance Tax Act 1984 section 28(Employee Trusts) provides:

“(1) A transfer of value made by an individual who is beneficially entitled to shares in a company is an exempt transfer to the extent that the value transferred is attributable to shares in or securities of the company which become comprised in a settlement if-

(a) the trusts of the settlement are of the description specified in section 86(1) below, and

(b) the persons for whose benefit the trusts permit the settled property to be applied include all or most of the persons employed by or holding office with the company.

(2) Subsection (1) above shall not apply unless at the date of the transfer, or at a subsequent date not more than one year thereafter, both the following conditions are satisfied, that is to say-

(a) the trustees-

(i) hold more than one half of the ordinary shares in the company, and

(ii) have powers of voting on all questions affecting the company as a whole which if exercised would yield a majority of the votes capable of being exercised on them; and

(b) there are no provisions in any agreement or instrument affecting the company's constitution or management or its shares or securities whereby the condition in paragraph (a) above can cease to be satisfied without the consent of the trustees.

(3) Where the company has shares or securities of any class giving powers of voting limited to either or both of the following-

(a) the question of winding up the company, and

(b) any question primarily affecting shares or securities of that class,

the reference in subsection (2)(a)(ii) above to all questions affecting the company as a whole shall be read as a reference to all such questions except any in relation to which those powers are capable of being exercised.

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(4) Subsection (1) above shall not apply if the trusts permit any of the settled property to be applied at any time (whether during any such period as is referred to in section 86(1) below or later) for the benefit of-

(a) a person who is a participator in the company mentioned in subsection (1) above; or

(b) any other person who is a participator in any close company that has made a disposition whereby property became comprised in the same settlement, being a disposition which but for section 13 above would have been a transfer of value; or

(c) any other person who has been a participator in the company mentioned in subsection (1) above or in any such company as is mentioned in paragraph (b) above at any time after, or during the ten years before, the transfer of value mentioned in subsection (1) above; or

(d) any person who is connected with any person within paragraph (a), (b) or (c) above.

(5) The participators in a company who are referred to in subsection (4) above do not include any participator who-

(a) is not beneficially entitled to, or to rights entitling him to acquire, 5 per cent or more of, or of any class of the shares comprised in, its issued share capital, and

(b) on a winding-up of the company would not be entitled to 5 per cent or more of its assets.

(6) In determining whether the trusts permit property to be applied as mentioned in subsection (4) above, no account shall be taken of any power to make a payment which is the income of any person for any of the purposes of income tax, or would be the income for any of those purposes of a person not resident in the United Kingdom if he were so resident.

(7) Subsection (5) of section 13 above shall have effect in relation to this section as it has effect in relation to that section.

1.2.2 Commentary

Note limited to gifts of shares but only where trustees of employee benefit trust have control.

When will the relief be most useful given 100 business property relief?

To what extent is (1)(b) a serious limitation?

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Note width of (4).

Note that (4) applies even as regards a time in future when the trusts no longer fall within section 86.

Yet note important exception from (4), contained in (6).

At what time does one ask whether a person falls within (4)(d) as being “any person who is connected with any person within paragraph (a), (b) or (c) above”?

(A) Is it the time of the original disposition?

(B) Or is it the time of the permitted application of settled property for the benefit of such a person?

Can one draft one’s way out of *Barker*?

1.3 Inheritance Tax Act 1984 Section 13 (Dispositions by Close Companies)

1.3.1 The Statute

“(1) A disposition of property made to trustees by a close company whereby the property is to be held on trusts of the description specified in section 86(1) below is not a transfer of value if the persons for whose benefit the trusts permit the property to be applied include all or most of either-

- (a) the persons employed by or holding office with the company, or
- (b) the persons employed by or holding office with the company or any one or more subsidiaries of the company.

(2) Subsection (1) above shall not apply if the trusts permit any of the property to be applied at any time (whether during any such period as is referred to in section 86(1) below or later) for the benefit of-

- (a) a person who is a participator in the company making the disposition, or
- (b) any other person who is a participator in any close company that has made a disposition whereby property became comprised in the same settlement, being a disposition which but for this section would have been a transfer of value, or
- (c) any other person who has been a participator in any such company as is mentioned in paragraph (a) or (b) above at any time after, or during the ten

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years before, the disposition made by that company, or

(d) any person who is connected with any person within paragraph (a), (b) or (c) above.

(3) The participators in a company who are referred to in subsection (2) above do not include any participator who-

(a) is not beneficially entitled to, or to rights entitling him to acquire, 5 per cent or more of, or of any class of the shares comprised in, its issued share capital, and

(b) on a winding-up of the company would not be entitled to 5 per cent or more of its assets.

(4) In determining whether the trusts permit property to be applied as mentioned in subsection (2) above, no account shall be taken-

(a) of any power to make a payment which is the income of any person for any of the purposes of income tax, or would be the income for any of those purposes of a person not resident in the United Kingdom if he were so resident, or

(b) if the trusts are those of a profit sharing scheme approved under Schedule 9 to the Taxes Act 1988, of any power to appropriate shares in pursuance of the scheme, or

(c) if the trusts are those of a share incentive plan approved under Schedule 2 to the Income Tax (Earnings and Pensions) Act 2003, of any power to appropriate shares to, or acquire shares on behalf of, individuals under the plan.

(5) In this section-

“close company” and “participator” have the same meanings as in Part IV of this Act;

“ordinary shares” means shares which carry either-

(a) a right to dividends not restricted to dividends at a fixed rate, or

(b) a right to conversion into shares carrying such a right as is mentioned in paragraph (a) above;

“subsidiary” has the meaning given by section 1159 of and Schedule 6 to the Companies Act 2006;

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and references in subsections (2) and (3) above to a participator in a company shall, in the case of a company which is not a close company, be construed as references to a person who would be a participator in the company if it were a close company.”

1.3.2 Comments

What of a disposition by a non-close company?

Is section 13 always needed?

What of Inheritance Tax Act 1984 section 10 (Dispositions not intended to confer gratuitous benefit)?

What of Inheritance Tax Act 1984 section 12 (Dispositions allowable for income tax or conferring benefits under pension scheme)?

To what extent is (1)(b) a serious limitation?

Note width of (2).

Note that (2) applies even as regards a time in future when the trusts no longer fall within section 86.

Yet note important exception from (2), contained in (4)(a).

At what time does one ask whether a person falls within(2)(d) as being “any person who is connected with any person within paragraph (a), (b) or (c) above”?

(A) Is it the time of the original disposition?

(B) Or is it the time of the permitted application of settled property for the benefit of such a person?

Can one draft one’s way out of Barker?

1.3.3 Planning

2. CGT Advantages post Barker v Baxendale-Walker

2.1.1 Automatic holdover relief.

2.1.2 Taxation of Chargeable Gains Tax Act 1992 section 239 (Disposals to trustees of employee

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trusts)

“(1) Where-

(a) a close company disposes of an asset to trustees in circumstances such that the disposal is a disposition which by virtue of section 13 of the Inheritance Tax Act 1984 (employee trusts) is not a transfer of value for the purposes of inheritance tax, or

(b) an individual disposes of an asset to trustees in circumstances such that the disposal is an exempt transfer by virtue of section 28 of that Act (employee trusts: inheritance tax),

this Act shall have effect in relation to the disposal in accordance with subsections (2) and (3) below.

(2) Section 17(1) shall not apply to the disposal; and if the disposal is by way of gift or is for a consideration not exceeding the sums allowable as a deduction under section 38-

(a) the disposal, and the acquisition by the trustees, shall be treated for the purposes of this Act as being made for such consideration as to secure that neither a gain nor a loss accrues on the disposal, and

(b) where the trustees dispose of the asset, its acquisition by the company or individual shall be treated as its acquisition by the trustees.

Paragraph (b) above also applies where section 149(1) of the 1979 Act applied on the disposal of an asset to trustees who have not disposed of it before the coming into force of this section.

(3) Where the disposal is by a close company, section 125(1) shall apply to the disposal as if for the reference to market value there were substituted a reference to market value or the sums allowable as a deduction under section 38, whichever is the less.

(4) Subject to subsection (5) below, this Act shall also have effect in accordance with subsection (2) above in relation to any disposal made by a company other than a close company if-

(a) the disposal is made to trustees otherwise than under a bargain made at arm's length, and

(b) the property disposed of is to be held by them on trusts of the description specified in section 86(1) of the Inheritance Tax Act 1984 (that is to say, those in relation to which the said section 13 of that Act has effect) and the persons for whose benefit the trusts permit the property to be applied include all or most of either-

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- (i) the persons employed by or holding office with the company, or
- (ii) the persons employed by or holding office with the company or any one or more subsidiaries of the company.

(5) Subsection (4) above does not apply if the trusts permit any of the property to be applied at any time (whether during any such period as is referred to in the said section 86(1) or later) for the benefit of-

- (a) a person who is a participator in the company (“the donor company”), or
- (b) any other person who is a participator in any other company that has made a disposal of property to be held on the same trusts as the property disposed of by the donor company, being a disposal in relation to which this Act has had effect in accordance with subsection (2) above, or
- (c) any other person who has been a participator in the donor company or any such company as is mentioned in paragraph (b) above at any time after, or during the 10 years before, the disposal made by that company, or
- (d) any person who is connected with a person within paragraph (a), (b) or (c) above.

(6) The participators in a company who are referred to in subsection (5) above do not include any participator who-

- (a) is not beneficially entitled to, or to rights entitling him to acquire, 5 per cent or more of, or of any class of the shares comprised in, its issued share capital, and
- (b) on a winding-up of the company would not be entitled to 5 per cent or more of its assets;

and in determining whether the trusts permit property to be applied as mentioned in that subsection, no account shall be taken-

- (i) of any power to make a payment which is the income of any person for any of the purposes of income tax, or would be the income for any of those purposes of a person not resident in the United Kingdom if he were so resident, or
- (ii) if the trusts are those of a profit sharing scheme approved under Schedule 9 to the Taxes Act of any power to appropriate shares in pursuance of the scheme.

(7) In subsection (4) above “subsidiary” has the meaning given by section [1159 of and Schedule 6 to the Companies Act 2006 and in subsections (5) and (6) above “participator” has the meaning given by section 454 of CTA 2010, except that it does not include a loan creditor.

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(8) In this section “close company” includes a company which, if resident in the United Kingdom, would be a close company as defined in section 288.”

3. Taxation of Employees on Contributions to Trust post *Rangers*

3.1 The Supreme Court Decision in *RFC 2012 Plc (in liquidation) (formerly The Rangers Football Club Plc) v Advocate General for Scotland* [2017] UKSC 45

3.2 Critique

3.3 Can one ensure it does not apply?

4. Provision of Capital Sums for Employees without Disguised Remuneration Charge

Income Tax (Earnings and Pensions) Act 2003 Part 7A

Need to ensure no “relevant step” taken by any “relevant third person”, in effect, any one other than the employer or the employee.

Pre April 6th 2017 much easier.

E.g. employer lends money to employee and then contributes creditor’s rights to employee benefit trust.

Post Finance Act 2017 traditional methods won’t work. A problem if the employee comes to owe money to the trustees.

Are there ways round the Finance Act 2017 changes?

5. The April 5th 2019 Employee Loan Charge

5.1 The Charge

Imposed by Finance (No 2) Act 2017 Schedule 11.

Very broadly speaking, if

an employee (or related person) is indebted to the trustees at the end of April 5th 2019 if, on the basis he had become so indebted post April 5th 2017, he would have been charged to tax under Income Tax (Earnings and Pensions) Act 2003 Part 7A

then he is to be charged to income tax for 18/19 on the amount “outstanding”.

NB there may be an “amount outstanding” even though nothing is owed in reality!

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5.2 Compatibility with the Human Rights Act?

5.3 Painless Ways of Ensuring Nothing Outstanding?

6. Deductibility of Contributions to Trust for Employer

6.1 Employee Benefit Contribution Rules

Corporation Tax Act 2009 sections 1290 - 1296³

6.2 Summary

Deny deductibility for corporation tax purposes of “employee benefit contributions” unless and until certain conditions, in particular, a charge to income tax and national insurance contributions on an employee.

6.3 Planning

Is it possible for an employer to fund an employee benefit trust and still obtain a tax deduction for the contribution without the Employee Benefit Contribution Rules applying?

³ And corresponding provisions contained in Income Tax (Trading and Other Income) Act 2005 as regards employers within the charge to income tax.