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December 2009

# TAXATION BRIEFING

# EMPLOYER FINANCED UNAPPROVED RETIREMENT BENEFIT SCHEMES

With the imminent introduction of the 50% top band of income tax and the restriction of higher rate tax relief on contributions to pension schemes, high earners and senior executives, as well as their employers, will want to consider alternative ways of reducing the immediate tax deductions on earnings and bonuses, as well as promoting saving for retirement in an effective manner. An attractive option which provides an effective tax deferral whilst providing flexible pension provision is an Employer Financed Unapproved Retirement Benefit Scheme (EFURBS).

Previously called unapproved pension schemes, or Funded Unapproved Retirement Benefit Schemes (FURBS), these are occupational schemes that build up retirement benefits in excess of those allowed under approved pension schemes. Such schemes do not receive the tax reliefs available to approved pension schemes.

An EFURBS is a discretionary trust created by an employer, typically in an offshore jurisdiction to provide retirement and death benefits for an individual and their family. They are usually bespoke arrangements set up for just one executive and their family although multi-member schemes could be set up.

The EFURBS is usually funded at the outset by funds being placed into it by the employer, and this could be part of the agreed pension strategy or as part of a salary sacrifice agreement as contributions direct from the employee are not permitted. Unfunded arrangements are possible and in this situation the employer simply undertakes to provide funds at some stage in the future.

### The Benefits of EFURBS

The benefits of using an EFURBS include:

- For employers, it provides an effective mechanism to incentivise and retain staff.
- Unlike contributions into registered pension plans, contributions into an EFURBS are not subject to income tax, irrespective of the amount of the contribution or the level of the executive's income.
- There are no National Insurance contributions (NIC) on contributions into an EFURBS.
- The EFURBS is outside the annual and lifetime allowance limits that apply to regulated pensions, so allowing benefits to build up in a tax neutral environment without being subject to the 55% penal tax charge.
- An EFURBS is completely flexible as none of the registered pension scheme restrictions apply and there is no limitation on investment classes available.

- It may be possible for EFURBS funds to be loaned to the employee on commercial terms and there is no requirement to buy an annuity. There is no specific retirement age (although after 6 April 2010, benefits can be taken only from age 55 onwards).

- An offshore EFURBS is not subject to capital gains tax or income tax on foreign source income allowing investments within the EFURBS to roll up tax free.

- EFURBS can invest in residential property, requested shares (including the employers company) i.e. assets that approved pensions scheme can not invest in.

- Pensions and lump sums from the EFURBS will generally be subject to income tax at the employee's marginal rate in the year that benefits are drawn. Payments received by an entity who is not an individual are taxed at 40% increasing to 50% from 6 April 2010. However, depending on the employee's residence position at the time of distribution, it may be possible for these to be taken free of UK income tax. This would need to be examined on a case-by-case basis.

- There will be no NIC on a lump sum payment from the EFURBS provided that it does not exceed 25 percent of the value of the fund. Neither will there be NIC on pensions from the EFURBS provided that they are paid before the executive reaches age 75 and his or her employment has ceased.

- Assets within the EFURBS are ring fenced from claims by creditors in the event of the employer's insolvency.

Although the above benefits apply, there is no corporation tax deduction for the employer until the benefits are drawn from the EFURBS. However, in the current economic climate, the corporation tax deduction may not be of primary importance.

From an inheritance tax perspective normally the creation of a discretionary trust by an individual will incur an inheritance tax liability at the rate of 20%, and this applies also where the funds are transferred in by a close company (in which event the transfer is apportioned to the participators (i.e. broadly the shareholders) and liability arises on them).

A transfer to an EFURBS is however an exempt transfer for inheritance tax purposes unless the EFURBS is not being operated as a genuine retirement benefit scheme, in which case HMRC may well seek inheritance tax liability on the participators for the funds transferred in. There is no general six-year limitation period for past inheritance tax liability, and HMRC can seek to enforce an inheritance tax charge for a date long before six years previous. HMRC have stated that they may also seek to treat the trust as a settlor-interested trust, with income tax liability on the company directors, presumably on the basis that the directors have allowed their earnings to be diverted into the trust of which they are indirectly the settlors. The trust might also be caught by the inheritance tax gift with reservation provisions, although there are arguments against this treatment. On the basis that the EFURBS is structured and operated correctly as a genuine retirement benefits scheme it should however be possible to avoid any UK inheritance tax charges.

In conclusion, the EFURBS may be considered a suitable tool in terms of retirement planning for UK residents in an increasingly punitive personal tax environment.

Specific advice should always be taken prior to implementing any retirement planning according to individual circumstances.

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