Employee Benefit Trusts

- Employee Benefit Trusts (**EBTs**) are trusts which can be established by companies to help with the operation of their employee share plans;
- EBTs can be established onshore or offshore and can be funded by loans or contributions from group companies.

WHAT IS AN EBT?

An EBT is a special form of discretionary trust established for the benefit of employees of a company and its subsidiaries. They are usually set up in conjunction with a particular share incentive arrangement but can be used for a number of purposes.

"An EBT can acquire and hold shares for the purpose of satisfying the exercise of incentive awards granted to employees"

Why do companies use EBTs?

Employee trusts have received negative publicity when used as part of tax-avoidance schemes. The vast majority of EBTs are, however, set up for commercial purposes that are unrelated to tax. The most common reasons for establishing an EBT are:

- **to act as a mechanism to deliver free shares to employees**. Companies cannot generally issue shares for less than their nominal value so an EBT can be used as a source of shares where an award has a low or nil exercise price;
- **to acquire shares from employees (often those who are leaving employment)**. Where an employee is required to sell his or her shares on leaving employment, the EBT can purchase them and re-use the shares in providing benefits to other employees;
- **to acquire and hold a 'warehouse' of shares and prevent shareholder dilution.** An EBT can acquire and hold shares for the purpose of satisfying the exercise of incentive awards granted to employees. If the EBT acquires shares in the market, this guards against the dilutive effect that subscription share schemes can have. This is an advantage that EBTs have over treasury shares which, although an alternative means of sourcing shares for incentive arrangements, usually count towards any limits on dilution; and

- **to provide an internal market**. For private companies, an EBT can solve the problems that a lack of liquidity creates. Even for quoted companies where such issues do not usually arise, the EBT can represent a financially attractive market for employees' shares.

How does a company establish an EBT?

A company establishes an EBT by transferring funds (in the form of loans or contributions) to a trustee to hold on the terms of the EBT deed. If the EBT is to be UK resident, the trustee will often be a subsidiary company. To establish an offshore EBT, the sponsoring company must appoint an offshore trustee. EBTs and trustees of EBTs are likely to be subject to international information exchange requirements such as those deriving from the US Foreign Account Tax Compliance Act.

What is the UK tax status of an EBT?

The UK tax treatment of EBTs depends on whether they are UK or offshore tax resident.

An onshore EBT (where the trustee is UK resident or where the EBT is effectively controlled and managed in the UK) is subject to UK income and capital gains tax in the usual way. In limited circumstances, an onshore EBT can avoid a capital gains tax charge on transferring free shares to employees who are liable to UK income tax on their receipt.

"An offshore EBT is not generally subject to UK income and capital gains tax unless it receives income from a UK source"

An offshore EBT (where the trustee is non-UK resident and the EBT is not effectively controlled and managed in the UK) is not generally subject to UK income and capital gains tax unless it receives the income from a UK source.

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