EBTS AND FBTS AFTER *SEMPRA*

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Background

Sempra Metals Ltd v. The Commissioners of Her Majesty's Revenue & Customs[1] is the latest case to consider the tax treatment of payments into an employee benefit trust – but with an added twist, since it also considers the deductibility of payments into a "family benefit trust" by reference to the provisions of FA 2003 Schedule 24, which took effect from 27th November 2002. The *Sempra* case is a natural progression from the *Dextra* case (*Dextra Accessories Ltd & Others v. MacDonald*[2]) which has been considered previously in the *Review*[3]. At first blush, it raises a deceptively straightforward question: if payments to an EBT are not deductible, what is the position concerning payments to a family benefit trust?

The question is deceptively easy (that is to say it is difficult), because the facts of *Sempra*, as it turned out, very much played into the hands of the Revenue. Prior to the use of the family benefit trust by Sempra Metals Ltd, there had already been an employee benefit trust in "traditional" form. The decision was made to use a *single* family benefit trust rather than separate trusts for separate employees. The family benefit trust had much the same features of the old EBT, and a similar pattern was adopted in the hands of the relevant parties (employer, employee and trustees) as to how amounts to be paid into the trust should be quantified and then paid over. Whilst there were differences in relation to the drafting of the trust document (employees were excluded), nevertheless the overall effect was as if very little had changed. It would have been interesting to see what the outcome would have been had there been a series of separate family benefit trusts for each of a number of individual employees (rather than one single family benefit trust). I return to this point subsequently.

New readers join here

There now follows a brief resumé of how EBTs have evolved and how they have been viewed from time to time by the revenue authorities.

In the beginning

Given the difficulties, as a matter of company law, of effecting buybacks of shares, EBTs became in the 1980s a useful vehicle to achieve a similar result. Companies could make payments from time to time to the trustees of EBTs and the trustees could hold the cash received as a sort of treasure chest, ready as and when the need arose to acquire the shares of a retiring shareholder. In due course, such a shareholder could offer to sell his shares to the trustees of the EBT, who could then use the capital in the trust fund to pay him out. The case of *Mawsley Machinery Ltd v. Robinson*[4] shows that even this had its hazards, but on the face of it, in the writer's view, the original rationale of EBTs was to provide a means of buybacks or their equivalent. One of the attractions, as it turned out, was that the sponsoring company would obtain a deduction when it made the payments into the EBT, even though there was no tax to pay in the hands of any beneficiary of the EBT, for until such time as a payment was made out no receipt had occurred. So, as is mentioned in the

Dextra case itself, a form of tax "asymmetry" appeared: *early deduction; late taxable receipt*.

Time moves on

This asymmetry made EBTs very popular in their own right, and, in addition, the workforce of the sponsoring company could see that they would benefit from working hard, because the EBT trustees would, in due course, pay out sums effectively by way of bonus remuneration. The company would have received a deduction long beforehand, and although there was tax to pay in the hands of the recipient upon receipt, that seemed entirely fair.

The usual tax opinion that was given at this time by advisers would describe how it was felt that deductions would be available pursuant to Taxes Act 1988 s.74, but only if the payments were wholly and exclusively for the benefit of the paying company's trade; there would be warning about how the capital element of any payment into the trust (see *Atherton v. British Insulated & Helsby Cables Ltd*[5] would not be deductible; there might be a warning that care should be taken to make sure that there were regular payments into the EBT to emphasise the income nature of the payments. And typically a reference was made to the wording of Finance Act 1989 s.43, together with a caveat drawing the reader's attention to the fact that if the payments received by the EBT trustees amounted to "potential emoluments held by an intermediary" within s.43, then no deduction would be available until emoluments had been paid out. However, almost invariably this caveat included a "placebo" to the effect that so far as the adviser was concerned the Revenue as a matter of practice never invoked s.43, and – in any event – it seemed hard to see how trustees could be *intermediaries* on behalf of the employer (as s.43 would require) when the reality was they were independent trustees dealing with money comprised in the trust fund, not by reference to any direction from the employer, but by reference to the independent powers founded in them by virtue of the trust document itself.

The going gets tough

Since it proved relatively easy to obtain a deduction for payments into EBTs, advisers began to see them as a first step in a number of planning techniques: at least a deduction could be "guaranteed". Indeed, their popularity grew to such an extent that at the time the disclosure rules were introduced there were approximately 1300 EBTs under review by the Revenue. They were becoming a "nuisance", and the Revenue's obvious attack was to challenge the deductibility of the employer's contributions. The principal objections which the Revenue raised at this time were by reference to UITF 13 and 32, on the basis – in a nutshell – that the employing company did not relinquish control over the assets because of the apparent relationship which the employer had with the trustees, and therefore the contributions, in effect, had never been paid away but remained under the control of the company. So no deduction was available.

To this writer, at least, these arguments always seemed unmeritorious. But they became time-consuming to shift. They are now long since forgotten

anyway, for the reasons which follow.

Dextra

Finally, we come to the *Dextra* case (see the previous article in *GITC Review*), where – broadly speaking – the Revenue ran for the first time an argument that FA 1989 s.43 had application after all. More particularly, so the argument went, the trustees *were* intermediaries, and the payments into the trust were potential emoluments held by those intermediaries with a view to their becoming relevant emoluments. On this basis no deduction was available until such time as these payments were paid out (FA 1989 s.43(11)).

The Revenue were unsuccessful with this argument both before the Special Commissioners and in the High Court, but won their appeal to the Court of Appeal and were upheld in the House of Lords. The decision of the Special Commissioners was given on the 3rd September 2002, and – presumably – as a precaution – the law was changed on 27th November 2002, by changing the wording of Finance Act 1989 s.43 itself and by introducing Finance Act 2003 Schedule 24 with effect from 27th November 2002. This date is relevant in the *Sempra* case, as will be seen, since after that time it was decided to adopt a family benefit trust, rather than an EBT in the hope to circumvent the new law.

So what were they trying to achieve in the *Sempra* case?

After this reminder of the background, it is appropriate to look at the facts of the *Sempra* case. The company had made payments into an EBT and had done so up to the end of 2000. Following the change in the law described above, a new strategy was adopted. Instead of payments being made into an EBT, the company as settlor executed a deed of trust establishing a "family trust" called the Guardian Trust. An Isle of Man trustee was appointed. There was an initial fund of £1000, the trust period was eighty years or less, and the beneficiaries were members of the family of the present or former directors, officers or employees of the settlor and any charitable body, but neither the settlor nor any present or future employee of the settlor could be a beneficiary. The intention was that the trust would not fall within the definition of an *employee* benefit trust, since it would be a *family* benefit trust thus, so it was hoped, circumventing the provisions of Schedule 24 and the revised FA 1989 s.43.

However, as is described in the decision at paragraph 51, the family benefit trust was operated in a way very similar to the way in which the employee benefit trust had been operated. Each year a decision was made about the total amount of the bonus pool, which was usually the same percentage of the amount of the pre-tax profits for that year. Each employee would be asked if he would like his bonus pool paid into the family trust, or whether he would prefer to take it in cash through the payroll, or whether he would prefer a mixture of the two. Once the bonus pool had been approved, the directors of the appellant company decided how it was to be allocated amongst the employees depending upon performance. Each year, the appellants sent to the trust an amount equal to the amount of the bonuses awarded to the employees. Beneficiaries were nominated and they could choose to receive either a loan from the trust or to have allocated funds invested by the trustees. Out of the 32 beneficiaries, 31 opted for loans. So the question arose as to whether the use of a family benefit trust meant that the contributions fell outside the provisions of FA 2003 Schedule 24; and

as an aside questions arose in relation to the previous treatment of the contributions which had been made to the EBT prior to the change in law which occurred with effect from 27th November 2002.

What the *Sempra* case tells us

The Special Commissioners considered firstly the position concerning the earlier payments that had been made into the EBT, prior to the introduction of Schedule 24. In other words, they considered precisely the same statutory wording which had been considered by the House of Lords and below in the *Dextra* case – the old form of FA 1989 s.43. Perhaps not unsurprisingly, they came to the same conclusion as the Court of Appeal and the House of Lords, which was that the contributions were properly to be treated as potential emoluments, because they were held by intermediaries "with a view to" becoming emoluments. So no deduction could occur until an outgoing payment had been made.

It had been hoped that the Special Commissioners would consider more carefully whether trustees could properly be described as "intermediaries". Whilst it had been *conceded* in *Dextra* that trustees were intermediaries, this concession was effectively withdrawn in the *Sempra* case, and it was agreed by the parties that where a Court assumes a proposition of law to be correct without addressing its mind to it, the decision of that Court is not binding authority for that particular proposition. (*Baker v. The Queen*[6] and *Barrs v. Bethell*[7]. What was difficult for the appellant, however, was that in the High Court the view had been expressed that it had *rightly* been conceded the trustee was an intermediary, and the Court of Appeal reached the same view. Not surprisingly, therefore, the Special Commissioners held that the trustees were intermediaries for the purposes of s.43, and said they could see nothing to distinguish the facts in *Sempra* from those in *Dextra*. Whilst the writer of this article has not *quite* given up on this point (mainly because he thinks that – as a matter of common sense – trustees are *not* intermediaries), it would seem a very difficult argument to win. Nevertheless it would be one which could be raised as part of a general appeal if relevant, because as an intellectual matter it has merit.

The Special Commissioners also considered whether the payments were held with a view to becoming relevant emoluments under the old form FA 1989 s.43. The appellant argued that, because loans had been made to beneficiaries on what was intended to be an indefinite basis and would not be repayable if an employee left the company, and because on death the loans were renewed to members of the employee's family, there could never be any possibility of there being an emolument: there would be *benefits* but not *emoluments* – so s.43 did not apply. However, the Special Commissioners held that the trustees did have power to pay emoluments and had done so in favour of one individual. So it was reasonable to assume they would do this again. Consequently, in effect the *Dextra* decision was repeated. The payments were held with a view to becoming emoluments.

Transfers into the family benefit trust

The Special Commissioners then considered how FA 2003 Schedule 24 operated in the particular circumstances – where the sponsored trust in question was described as a *family* benefit trust, rather than what might be called a traditional *employee* benefit trust. The starting point is that Schedule 24 has application to restrict

deductions for *employee benefit contributions*. Such a contribution is made if as a result of any act or omission property is held under an employee benefit scheme. The definition of an employee benefit scheme is "a trust, scheme or other arrangement for the *benefit* of persons who are or include present or former employees of the employer". The appellant argued that the so-called family benefit trust was not an employee benefit scheme, as employees were excluded under the terms of the trust. Whilst the appellant accepted that the payments to the trust were beneficial to the employees (and so were deductible under general principles), this was only because it was in the interest of the employees that members of their families should benefit. However, in the context of Schedule 24, the word "benefit" – so it was argued – meant a settlement or some other enforceable arrangement which had as its beneficiary the employee. It was not enough that it was just beneficial to the employee for a payment to go into the trust. So it followed, in the appellant's submission, that the provision of benefits to a named member of an employee's family was not for the benefit of that employee.

The Revenue argued a number of points, including the point that, on a wider view, the family benefit trust was an arrangement for the benefit of employees. It could be demonstrated, so they said, that there was an established practice of the payment of bonuses. Each employee was given the choice of taking his bonus in cash or by way of payment into the trust. Each employee could nominate a beneficiary and most chose their spouses. The arrangements worked in such a way that the employees could benefit, so the Revenue argued, directly (through payments out of the trust into joint bank accounts or for the purchase or discharge of loans on joint properties) and the full amount of each bonus to an employee was allocated to his nominated beneficiary.

In the end, the Special Commissioners sided with the Revenue. Since the relevant definition was by reference to a "trust *scheme or other arrangement for the benefit of employees*" the whole phrase indicated that a much wider meaning was to be given to the words used. The employees benefited indirectly where the payments were made to their families, and directly where the loans by the trustees to the nominated beneficiary were paid into joint accounts with the employee or to discharge loans on jointly owned property. There was an arrangement for the benefit of employees.

Conclusion

In many ways as a result of what might be called rather unhelpful facts, there must be a concern that the use of *any* family benefit trust runs the risk of falling within the EBT legislation. But this would seem to be harsh. After all, imagine that instead of there being *one* single family benefit trust for *all* employees, by contrast each of the employees had set up their *own* family benefit trust exclusively for the benefit of their own family, and let us also imagine that some of these trusts were already in existence. Let us assume also that the steps involved would be, in effect, a bonus payment *once and for all* being made into an *existing* separate family benefit trust which would then continue to be run as it had been previously (as a family benefit trust) *with no involvement* of the company, and with no *special trustees* running other trusts. Let us also assume that no further payments were envisaged. In this situation, there are good arguments for saying, given that there must be a distinction between a family benefit trust on the one hand and an EBT on the other,

that this situation would not fall within Schedule 24.

One can put it this way: before the decision in *Sempra*, there was no reason why a bonus that could have gone to an individual but went to a family trust would be an EBT contribution. Whilst it is probably precarious to do this for the future, if you have already done it then you certainly should stick to your guns: such a payment on the right facts is capable of falling outside FA 2003 Sch.24.

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[1] [2008] STC (SCD) 1062 (SpC 698).
[2] 77 TC 146.
[3] Vol 5 No.1.
[4] SpC [1998] SCD 236 (SpC 170).
[5] 10 TC 155.
[6] (1975) AC 774.
[7] [1982] Ch.294.