Employee Benefit Trusts

Employee benefit trusts (EBTs) are discretionary trusts set up by employers for the benefit of their employees. The employer contributes, through gifts or loans, to the trustees which in turn make distributions to employees. The assets and liabilities of the trust are legally owned by the trustees, but in practice the trustees normally exercise their discretion in accordance with the wishes of the employer.

EBTs can be used to deliver any form of deferred pay. However, they are most commonly used in conjunction with share plans. Some of the main reasons for using them are:

- As a means of delivering shares purchased on the market to employees. Institutional investors set limits on the amount of dilution of listed companies' share capital by issue of new shares. These limits can be legitimately avoided by buying shares on the market instead. (The alternative of the company acquiring shares itself and holding them in treasury will not work, as reissued treasury shares also count towards the dilution limits.)

- As a means of delivering the full value of shares to employees. New shares cannot normally be issued to employees at below their nominal value. It is therefore often more convenient for companies to fund the trustees of an EBT to acquire shares (either by subscription or purchase on the market) so that the trustees can deliver the shares to employees.

- As a "warehouse" for shares. Particularly in the case of a private company, a large block of shares may become available for example on the retirement of a founder shareholder. The EBT can acquire the shares, using a loan, and gradually pass them on to employees using share plans over a number of years. In some cases, EBTs have been used as the vehicle for an employee buy-out of the company.

- To provide an internal market for shares in a private company.

EBTs are often established offshore, for example in one of the Channel Islands. This is in order to avoid double taxation. With an onshore trust, the employees may be subject to income tax on the shares they receive and the trustees may be subject to capital gains tax on their deemed gain on the disposal of the shares. Locating the trust offshore is not in itself regarded as tax avoidance by HMRC.

However, EBTs have sometimes been used for arrangements for deferring or avoiding tax. The legislation relating to "disguised remuneration" in the Finance Act 2011 was one of a number of measures taken by the Government in recent years intended to remove the effectiveness of certain of these arrangements.

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