COLLAS CRILL

A practical guide to Employee Benefit Trusts (EBTs) in Guernsey

FEBRUARY 2022

Employee Benefit Trusts (EBTs) have been a feature of the Guernsey trust landscape for many years now. EBT is something of an umbrella term that can be used to describe lots of different styles of employee benefit arrangements and EBTs are often not specifically mentioned in Guernsey legislation or regulation.

The purpose of this guide is to share some of our experience and provide a practical guide for trustees, employers and employees as to how EBTs are established and operated in Guernsey.

Background

The evolution of the EBT helps to explain the current landscape.

Guernsey's involvement with EBTs is down to the UK.

UK companies have used EBTs for several decades to incentivise and retain staff – a commonly cited example being John Lewis Partnership.

UK companies frequently used offshore-resident trustees (such as Guernsey trust companies) in order to operate the scheme outside the scope of UK capital gains tax while still benefitting from UK IHT relief.

Prior to the Finance Act 2003, EBTs for UK companies which were administered offshore attracted significant tax savings but these savings became seen as an abuse of legislation and significant changes were made.

That said, we continue to see significant numbers of English law EBTs being set up in Guernsey as they still carry some appealing UK tax advantages as well as multiple other benefits (as outlined below).

Also, with Guernsey having gained several decades of experience in administering EBTs, Guernsey has developed its own Guernsey law EBT offering which can also attract tax savings and many other advantages.

What is an EBT?

High level

An EBT is a trust which is used to provide benefits to the employees of a company.

This note is a summary of the subject and is provided for information only. It does not purport to give specific legal advice, and before acting, further advice should always be sought. Whilst every care has been taken in producing this note neither the author nor Collas Crill shall be liable for any errors, misprint or misinterpretation of any of the matters set out in it. All copyright in this material belongs to Collas Crill.

Those benefits can be varied as can the way those benefits are provided. As such, no two EBTs may look the same. That said, some things remain common to all EBTs, as follows.

The main parties involved will always be:

- the employer;
- the trustee; and
- the employees, former employees and their dependants (often collectively called "participants").

The core document recording the relationship between these parties will always be a **trust instrument** (or trust "deed" if the EBT is written under the law of a jurisdiction that recognises or prefers deeds such as English law).

Core functionality and documentation

EBTs will always be used to provide benefits to a company's employees but the nature of those benefits and the manner in which they are provided and managed can vary considerably from scheme to scheme.

The most common structure for an EBT is for it to hold shares in the employer company as well as cash to buy shares and settle expenses such as trustee fees and legal fees.

As previously stated, at a very basic level there will be a **trust deed** (if English law) or **trust instrument** (if Guernsey law) which will contain the core trust terms of the EBT.

There will also often (but not always) be a separate **scheme or plan document** which sets out more detail as to the eligibility of employees, and how and when shares are dealt with. In the absence of a separate scheme or plan document, the employer may simply write to the trustee to deal with awarding and vesting shares.

In terms of the **trust deed/instrument** itself, this will be a discretionary trust in very similar form to a standard discretionary trust but with the following nuances:

- the employer and any companies within its corporate group will usually be excluded from benefit except that the employer will be able to:
  - be repaid any loans that the trustees of the EBT owe to the employer; or
  - receive payment from the trustees when the employer sells shares in the company to the trustees;
- the definition of "beneficiary" will usually be tightly drafted and relate to employees (or former employees) and sometimes their dependants;
- the trust deed/instrument will often refer to legislation that the EBT must be operated within (this is because the trust will often need to fulfil certain criteria in order to achieve tax reliefs);
- the trust deed/instrument will usually contain a waiver by the trustee of its entitlement to dividends on the shares that it holds;

This note is a summary of the subject and is provided for information only. It does not purport to give specific legal advice, and before acting, further advice should always be sought. Whilst every care has been taken in producing this note neither the author nor Collas Crill shall be liable for any errors, misprint or misinterpretation of any of the matters set out in it. All copyright in this material belongs to Collas Crill.

- the trust deed/instrument will usually contain a provision that the trustee shall abstain from voting at general meetings in its capacity as shareholder;
- the trustee's investment powers are usually more specific such as the power to acquire or dispose of shares in the employer to or from anyone;
- the trustee's power to make a trust-to-trust transfer will often prescribe that the recipient trust must also fall within the same statutory constraints or regime as the paying EBT (for example, the recipient scheme must also comply with *section 86 of the Inheritance Act 1984 (IHA 1984)* ;
- the trust deed/instrument will usually contain a provision that the trustee is not bound to accept any offers to acquire shares that it holds;
- as well as having its usual indemnity from the trust fund (except in the event of fraud, wilful misconduct or gross negligence), the trustee and its directors will often have an indemnity from the employer in the trust deed/instrument to the extent that the trust fund is insufficient to indemnify the trustee in full;
- similarly, the trustee will be entitled to take its reasonable costs and expenses from the trust fund with the employer picking up any shortfall (this is particularly useful where the EBT mainly holds shares and has very little liquidity); and
- the trustee is often given the power to consider recommendations from the board of the employer but is not bound by them.

In addition to the trust deed/instrument and the scheme or plan, there will often be an **operating agreement** as well.

The **operating agreement** is a contract between the employer and the trustee and records, at a more granular level, the day-to-day manner in which the parties will work together to operate the scheme – matters such as:

- how the employer will notify the trustee about awards that it proposes to grant;
- what information the employer needs to provide the trustee in respect of those awards (such as the number of participants receiving awards, when they are to receive them and so on);
- that the employer will not provide the trustee with the identities of the participants receiving the awards nor the number of shares per participant (this can assist the compliance burden on the trustee in terms of customer due diligence (CDD) and reporting[1]);
- the ability of the employer to make gifts or loans and how those contributions are accounted for (for example, separate accounts for each group company's contributions);
- limited recourse wording to ensure that the trustee is only liable to the value of the trust fund less liabilities in respect of any loans into the EBT; and
- the employer's obligation to notify the trustee when awards vest and the trustee's obligation and timeframe for satisfying those awards.

During the life of the EBT, the employer will write to the trustee giving **notice of proposed grants of awards** and, subsequently, **notice of when share awards vest**. These notifications will usually be in the form of a simple letter.

This note is a summary of the subject and is provided for information only. It does not purport to give specific legal advice, and before acting, further advice should always be sought. Whilst every care has been taken in producing this note neither the author nor Collas Crill shall be liable for any errors, misprint or misinterpretation of any of the matters set out in it. All copyright in this material belongs to Collas Crill.

There is usually a deliberate delay on the part of the employer between granting awards and vesting awards and this is to incentivise employees to remain with the company. For example, shares may be awarded after three years of good service but title to the shares will only vest in the employee after five years of good service. That way, the employee is discouraged from leaving in that three- to five-year window. This methodology is really the crux of what EBTs are all about; attracting and keeping good people.

Who will want an EBT?

Any organisation wanting to attract and retain talent.

That organisation may be a Guernsey company, a multinational company with a Guernsey base or a multinational company without a Guernsey connection at all.

Funding an EBT

As with most trusts, the EBT will be funded with a nominal amount (for example £100) in order to constitute the EBT and bring it into existence. Further funding will be added later and this may either come from (i) the employer adding capital to the trust outright; (ii) the employer lending capital to the trust; or (iii) the trustees taking out a loan from a third-party lender (which may be guaranteed by the employer).

The trustee will open a bank account in its capacity as trustee of the EBT. This process can often be the lengthiest aspect of the client mandate (for example, four to six weeks) so it can be a good idea to start discussions with the bank at an early stage once the parties are known and the draft scheme documents are being negotiated.

The contribution of funds into the EBT can be recorded in a variety of ways. Loans will usually be recorded in a loan agreement and the trustee should ensure that there is adequate limited recourse wording in the loan agreement to ensure that its liability is limited to the assets in its hands. Outright voluntary contributions from the company into the EBT may be recorded in a contribution agreement or a letter.

Advantages of an EBT

There are many advantages to establishing an EBT. Some of the key drivers are as follows:

- Attracting and retaining good people;
- Tax mitigation (see below);
- Asset protection – assets held in an EBT are bankruptcy remote which means that, should the employer go bankrupt, the employer’s creditors cannot gain access to the EBT's assets. For greater protection and robustness, the employer (and any group companies) is also usually expressly excluded from benefit under the EBT;
- An EBT can be used to create an internal market in shares which is particularly useful for private companies, where there is no ready market for shares which are forfeited or required to be sold by leavers.

This note is a summary of the subject and is provided for information only. It does not purport to give specific legal advice, and before acting, further advice should always be sought. Whilst every care has been taken in producing this note neither the author nor Collas Crill shall be liable for any errors, misprint or misinterpretation of any of the matters set out in it. All copyright in this material belongs to Collas Crill.

In an internal market, the trustees can acquire such shares (whether or not for consideration) and recycle them for future awards; and

- The use of an independent trustee. It is common for companies to appoint an independent third party, typically a professional trust company, to act as the trustee of an EBT. Since trustees are required to act in the interests of the beneficiaries, the participants can gain comfort that their interests are being looked after. It also avoids potential conflicts of interest (real or perceived), which can arise if an entity related to the company acts as trustee.

Tax

An EBT can be tax-resident anywhere in the world but the choice of residence is an important consideration as it impacts the tax treatment of the scheme.

UK tax landscape

UK companies will often establish EBTs under the laws of England & Wales but appoint a Guernsey- (or other non UK-) resident trust company as the sole trustee in order to ensure that the EBT is resident outside the UK for tax purposes.

Most English law EBTs are set up to fall within the following statutory provisions:

- the definition of a trust for the benefit of employees in *section 86 of the Inheritance Act 1984 (IHA 1984)* – this provides exemptions from inheritance tax for certain transactions involving qualifying EBTs;
- the definition of an employees' share scheme in *section 1166 of the Companies Act 2006 (CA 2006)* – this provides exemptions from certain company law requirements for arrangements which are employees' share schemes; and
- the definition of an employee share scheme in the Financial Services and Markets Act 2000 – this allows an EBT to benefit from exemptions from certain financial services requirements for activities in connection with employee share schemes.

As English law EBTs are often tax-driven, it is critical that they are set up with the benefit of English tax and legal advice and that any variations to the terms of the EBT throughout the life of the structure (no matter how small) are blessed as valid from an English tax and legal perspective to preserve the tax treatment of the EBT.

Usually, the employer will have driven the project and will have taken its own tax and legal advice. UK-centred employers will usually take that advice from a UK law firm or accountancy practice and it will normally follow that the choice of law for the EBT will be England & Wales. These EBTs can be administered in Guernsey by a regulated Guernsey trustee.

Theoretically, it may be possible to have a Guernsey proper law EBT which complies with the above UK statutes but the trust instrument/deed would need input from both English and Guernsey lawyers so the usual approach is for an English tax-driven EBT to be written under the laws of England & Wales.

This note is a summary of the subject and is provided for information only. It does not purport to give specific legal advice, and before acting, further advice should always be sought. Whilst every care has been taken in producing this note neither the author nor Collas Crill shall be liable for any errors, misprint or misinterpretation of any of the matters set out in it. All copyright in this material belongs to Collas Crill.

If the employer has obtained tax and legal advice, the trustee will not be able to rely or sue on that advice unless it is co-addressed to the trustee so the trustee should ensure that it has the benefit of the employer's advice or insist on getting its own when the EBT is set up and also throughout the life of the EBT. The trustee should also take care to ensure that the trust deed/instrument provides for the costs and expenses of that advice to be payable from the trust fund of the EBT and ideally also agree this with the employer in advance.

That tax advice should cover all jurisdictions where the EBT has a connection (for example, an English company with a Guernsey-administered EBT should have tax advice which covers England and Guernsey).

The participants should also be advised to seek their own independent tax and legal advice – particularly prior to accepting any awards when they vest.

Guernsey tax landscape

If the EBT has no Guernsey-resident participants (for example, an EBT for a UK company with no Guernsey office or employees), the scheme can accrue income and capital value free from Guernsey tax.

If the employer is subject to Guernsey income tax, for example if the employer is a domestic Guernsey company or a multinational with a Guernsey office and staff, the employer's contributions can be tax-deductible for Guernsey income tax purposes under *section 159A of the Income Tax (Guernsey) Law, 1975* (**Guernsey Tax Law**) in certain circumstances such as:

- where awards vest and Guernsey income tax is paid by the participant;
- the scheme is for the sole purpose of granting share options to employees; or
- where the scheme has been "approved" by the Director of Income Tax in Guernsey (approved schemes are looked at more closely below).

EBTs for employers with a Guernsey nexus (domestic Guernsey companies or multinationals with a Guernsey office and staff) will usually be written under Guernsey law, again because Guernsey lawyers are more familiar with the Guernsey tax and regulatory landscape.

Registration, reporting and regulation

Irrespective of the proper law of the EBT, the administration of any trust and acting as trustee is a "regulated activity" in Guernsey under *section 2(1) of The Regulation of Fiduciaries, Administration Businesses and Company Directors, etc (Bailiwick of Guernsey) Law, 2020* which means, in broad terms that the Guernsey trustee must have a licence.

In terms of the GFSC, for some schemes in the employee benefits space, the Guernsey-regulated trustee needs to file regular reporting with the GFSC under the *Pension Scheme and Gratuity Scheme Rules and Guidance 2021* (**2021 Regulations**). However, the 2021 Regulations only bite on "pensions" and "gratuity schemes" as defined in those 2021 Regulations. EBTs frequently fall outside of both definitions as they often don't provide retirement

This note is a summary of the subject and is provided for information only. It does not purport to give specific legal advice, and before acting, further advice should always be sought. Whilst every care has been taken in producing this note neither the author nor Collas Crill shall be liable for any errors, misprint or misinterpretation of any of the matters set out in it. All copyright in this material belongs to Collas Crill.

benefits and are not always set up as gratuity schemes . In these cases, the Guernsey trustee has no reporting obligations to the GFSC.

In establishing a new EBT or taking on an EBT from another service provider, the Guernsey-regulated trustee needs to consider (and, if necessary, take Guernsey legal advice) and record in its resolutions that it has considered whether the EBT falls within the scope of the 2021 Regulations.

In terms of reporting to the Guernsey tax office – known as The Revenue Service – if a scheme meets certain requirements, an application can be made to the Director of Income Tax in Guernsey for "approval" under the relevant section of the Guernsey Tax Law.

If approval is obtained, both employers and employees can, in broad terms, deduct the value of contributions into the scheme from their Guernsey income tax bill.

Approval of EBTs in Guernsey is not mandatory.

As set out above, section 159(A)(3) of the Guernsey Tax Law envisages that EBTs can be "approved schemes" – such approval would be conditional upon the EBT satisfying the criteria for a pension under section 150 of the Guernsey Tax Law.

This can be quite difficult for EBTs to satisfy as follows:

- section 150 requires the sole or main purpose of the scheme to be the provision of retirement benefits – EBTs are usually performance-based with awards typically being provided ad hoc throughout service rather than at retirement; and
- section 150 requires all participants to benefit equally – again, this is usually at odds with the ethos of an EBT which is performance-based.

Tax advice should be sought as to whether approval is necessary and, if so, on what basis it should be sought.

It is also worth undertaking a cost-benefit analysis between the light reporting requirements for an EBT which falls outside of the 2021 Regulations and the potential tax savings of falling within the definition of a "pension" in order to obtain the potentially favourable tax treatment of an approved scheme.

In terms of Common Reporting Standards (CRS) in the employee benefits space in Guernsey, some approved pensions benefit from an exemption from CRS reporting under the *Income Tax (Approved International Agreements) (Implementation) Common Reporting Standard Regulations* but, as seen above, simple EBTs are often not "pensions" for the purposes of the Guernsey Tax Law and, therefore, will not be approved schemes nor able to benefit from the CRS exemption.

An EBT written under English law may need to complete registration on HMRC's online Trust Registration Service (TRS). Again, English law advice should be taken to confirm this.

This note is a summary of the subject and is provided for information only. It does not purport to give specific legal advice, and before acting, further advice should always be sought. Whilst every care has been taken in producing this note neither the author nor Collas Crill shall be liable for any errors, misprint or misinterpretation of any of the matters set out in it. All copyright in this material belongs to Collas Crill.

For more information about EBTs, pensions and gratuity schemes contact Angela Calnan, Partner and head of Collas Crill's multi-award winning International Private Client and Trusts team in Guernsey.

[1] It is worth noting specifically here that pursuant to Chapter 7.12.2 of the Guernsey Financial Services Commission (GSFC) Handbook on Countering Financial Crime and Terrorist Financing of November 2021 that the trustee of an EBT administered in Guernsey will not be required to obtain CDD on the participants "*throughout the life of the business relationship*" as long as the contributions to the EBT have come from the employer in the usual way);

This guide gives a general overview of this topic. It is not legal nor tax advice and you may not rely on it. If you would like Guernsey legal advice on this topic, please get in touch with the author of this article. Collas Crill does not advise on matters of English or Guernsey taxation and the references to the same in this article are by way of background and context only.

This note is a summary of the subject and is provided for information only. It does not purport to give specific legal advice, and before acting, further advice should always be sought. Whilst every care has been taken in producing this note neither the author nor Collas Crill shall be liable for any errors, misprint or misinterpretation of any of the matters set out in it. All copyright in this material belongs to Collas Crill.

COLLAS CRILL

For more information please contact:



Angela Calnan

Partner (Advocate) | Guernsey

t: +44 (0) 1481 734233 | **e:** angela.calnan@collascrill.com

This note is a summary of the subject and is provided for information only. It does not purport to give specific legal advice, and before acting, further advice should always be sought. Whilst every care has been taken in producing this note neither the author nor Collas Crill shall be liable for any errors, misprint or misinterpretation of any of the matters set out in it. All copyright in this material belongs to Collas Crill.