

EFRBS – a solution for “high earners”

EFRBS (Employer-Financed Retirement Benefits Scheme) allow employers to provide retirement benefits to their executives with fewer restrictions than traditional company pension schemes. An EFRBS is set up as a standalone trust receiving contributions from the employer but is not a registered pension scheme. The establishment of an EFRBS must be reported to HMRC and an annual tax return would be required.

The pensions aspects of the Finance Act 2009 and the Pre-Budget Report 2009 mean that pension provision for “high earners” is likely to be less tax efficient in coming years. This adds to retirement planning issues already caused by the Lifetime Allowance, particularly as plans made by individuals become less compatible with the options available under current limits and legislation. We can help “high earners” and their employers to consider alternatives to traditional pension provision that will reduce the tax burden.



From April 2010 the highest marginal rate of income tax will increase to 50% on earnings above £150,000 and both employer and employee National Insurance Contributions will also rise by 1% from April 2011. In addition, from April 2011 tax relief on pension contributions will be restricted to 20% for individuals whose gross earnings (which include employer pension contributions/input value) exceed £180,000, tapering down from the full rate for those with gross earnings between £150,000 and £180,000. The tapering in tax relief will not apply to individuals with earnings, net of employer contributions/input value, below £130,000.

The traditional incentive of encouraging pension saving by granting tax relief on contributions (and taxing the benefits when drawn) has, therefore, changed. High earners’ pension savings will now be taxed twice – on the contributions paid as well as on the emerging benefits - or even three times if the Lifetime Allowance charge is incurred. In many cases an EFRBS is worth considering as an alternative to traditional pension provision.

Although there is no immediate corporation tax deduction available to the employer on contributions to an EFRBS, there is no immediate income tax or National Insurance liability for the executive as the contributions are not taxable as a benefit-in-kind. Rather, the executive pays income tax when benefits are drawn from the EFRBS and the employer can claim corporation tax relief as each instalment of benefit is drawn.

Advantages of an EFRBS

- Can be more tax efficient than paying bonuses or pension contributions to traditional vehicles
- Income tax deferred until benefits are drawn and tax could be at a lower rate
- No Annual Allowance test, so no limit on contributions
- No Lifetime Allowance tax, so no limit on benefits
- No National Insurance Charge
- EFRBS allow the whole fund to be taken as cash (net of income tax at the appropriate rate)
- No investment restrictions
- Can have Inheritance Tax advantages

Other advantages of EFRBS

There are few investment restrictions within an EFRBS so, in addition to investing in say equities and gilts, the trustees can invest in residential property (in the UK and overseas), as well as works of art and fine wine. Personal loans are also permitted subject to commercial terms.

Monies held within an EFRBS are treated in a similar manner to those held in other discretionary trusts. This means that tax charges will be paid on income and capital gains generated by the funds subject to the normal allowances.

Benefits drawn from an EFRBS do not need to be in the form of an annuity – ad hoc amounts can be drawn.

If the executive no longer works for the company at the point that benefits are drawn then no National Insurance contributions will be incurred. HMRC's Lifetime Allowance and Annual Allowance tests do not apply to an EFRBS, so there is no additional tax on contributions or benefits above a certain threshold.

Death benefits paid from an EFRBS are not generally liable to Inheritance Tax (IHT) charges although there are some exceptions to this. However, periodic IHT charges will arise on the tenth anniversary of the setup of the arrangement on any remaining funds. IHT charges on contributions made by close companies in respect of one of the shareholders will only arise on the death of the executive within 7 years of the contribution being made.

Barnett Waddingham is able to provide all the relevant paperwork to establish an EFRBS. We can also act as a Trustee and provide all ongoing administration services for the scheme. This includes the completion of the relevant tax returns and notification requirements.



CASE STUDIES

Situations in which EFRBS may be particularly beneficial are:

- If an executive has benefits expected to exceed the Lifetime Allowance of £1,800,000 before retirement.
- If a pension contribution would lead to a Pension Input charge (for example if the employer wants to begin contributing more than £20,000 per annum in respect of an executive).
- If an executive wishes to use bonus payments to increase their retirement funds.
- If an executive wishes to draw on their retirement savings before age 55.
- If an executive wishes to set aside funds to be paid to other beneficiaries after their death.

Example 1

In 2011/12, an executive is paid a salary of £180,000 and the employer has set aside £100,000 as a performance-related reward. Some possible options are described below and summarised in tables from both the employer's and the executive's point of view:

1. Pay additional salary

The employer will reduce the payment by 13.8% to cover its additional National Insurance liability - it therefore pays £87,873 as additional salary. This payment will be subject to income tax at 50% and employee National Insurance of 2.0%. The net amount the executive receives is **£42,179**.

2. Pay a pension contribution

This payment will be subject to a personal tax charge of 30% payable through self-assessment. The executive can take up to 25% of the fund as tax-free cash up to lifetime allowance limits and use the residual funds to provide taxable pension income. Assuming a marginal rate of income tax of 50% in retirement and allowing for 25% tax-free cash, the net worth to the executive is **£32,500**.

Executives must ensure that contributions do not exceed the annual allowance and that their aggregate pension funds do not breach the lifetime allowance, otherwise further tax charges may be incurred.

3. Pay an EFRBS contribution

The payment would not attract immediate corporation tax relief, but this could eventually be claimed when benefits are drawn. If the executive's marginal rate of income tax in retirement is 50% and benefits are drawn within 10 years of setting up the EFRBS, the net amount received by the Executive is **£50,000**.

Tax would be payable on income and capital gains generated by investment returns within the EFRBS but at rates similar to those applying to personal assets of the executive.

Summary of above examples:

Employer's point of view	Option 1 – Salary	Option 2 – Pension	Option 3 – EFRBS
Salary	£87,873	-	-
Pension/EFRBS contribution	-	£100,000	£100,000
Employer's NICs (13.8%)	£12,127	-	-
	£100,000	£100,000	£100,000
Less Corporation Tax relief	(£28,000)	(£28,000)	(£28,000) ¹
Employer's net cost	£72,000	£72,000	£72,000

Notes: ¹ Corporation tax relief claimed as benefits are drawn.

Executive's point of view	Option 1 – Salary	Option 2 – Pension	Option 3 – EFRBS
Tax-free benefit	-	£25,000 ¹	-
Taxable benefit	£87,873	£75,000 ¹	£100,000
Executive's NICs (2.0%)	(£1,757)	-	-
Executive's pension input charge	-	(£30,000)	-
Executive's income tax – immediate	(£43,937)	-	-
Executive's income tax – throughout retirement	-	(£37,500)	(£50,000)
Executive's net benefit	£42,179	£32,500	£50,000

Notes: ¹ Received at/in retirement.

Example 2

In 2011/12, an owner-manager of company whose total earnings are £180,000 wishes to use company funds of £100,000 as a dividend payment to himself. Some possible options are described below and summarised in tables from both the company's and the individual's point of view:

1. Pay as Dividend

The employer will reduce the payment by 28.0% to cover its additional corporation tax liability - it therefore pays £72,000 as the dividend. This payment will receive a tax credit of 10% but is then subject to income tax at 42.5%. The net amount the executive receives is **£46,000**.

No corporation tax relief is available to the employer and so the total cost to the company is higher than using the funds as a contribution to an EFRBS. All other shareholders might also need to receive a dividend, which may not be ideal for the company.

2. Pay a pension contribution

This payment will be subject to a personal tax charge of 30% payable through self-assessment. The executive can take up to 25% of the fund as tax-free cash up to lifetime allowance limits and use the residual funds to provide taxable pension income. Assuming a marginal rate of income tax of 50% in retirement and allowing for 25% tax-free cash, the net worth to the executive is **£32,500**. Again, annual allowance and lifetime allowance limits apply to the contributions and aggregate funds.

3. Pay an EFRBS contribution

The payment would not attract immediate corporation tax relief, but this could eventually be claimed when benefits are drawn. If the executive's marginal rate of income tax in retirement is 50% and benefits are drawn within 10 years of setting up the EFRBS, the net amount received by the Executive is **£50,000**.

Summary of above examples:

Employer's point of view	Option 1 – Dividend	Option 2 – Pension	Option 3 – EFRBS
Dividend	£72,000	-	-
Pension/EFRBS contribution	-	£100,000	£100,000
Corporation tax (28.0%)	£28,000	-	-
	£100,000	£100,000	£100,000
Less Corporation Tax relief	-	(£28,000)	(£28,000) ¹
Employer's net cost	£100,000	£72,000	£72,000

Notes: ¹ Corporation tax relief claimed as benefits are drawn.

Executive's point of view	Option 1 – Dividend	Option 2 – Pension	Option 3 – EFRBS
Tax-free benefit	-	£25,000 ¹	-
Taxable benefit	£72,000	£75,000 ¹	£100,000
Tax credit received	£8,000	-	-
Executive's pension input charge	-	(£30,000)	-
Executive's income tax – immediate	(£34,000)	-	-
Executive's income tax – throughout retirement	-	(£37,500)	(£50,000)
Executive's net benefit	£46,000	£32,500	£50,000

Notes: ¹ Received at/in retirement.

To discuss EFRBS in more detail, contact Bhargaw Buddhdev on 01494 788100, or your usual Barnett Waddingham consultant.