

Welcome to Bandstand. This issue features an article by Alan Judes on the potential for interaction between share schemes and pension funds that I am sure you will find of interest. We have worked with Alan on various share trust schemes over a number of years when he was a partner with Bacon & Woodrow, later Hewitt Associates, in London. Alan now works as an independent consultant on pay and employee benefits having founded Strategic Remuneration. We consider the points Alan has raised to be of great interest and we would be pleased to discuss with you the opportunities Alan refers to. Please contact Mike Perrett or Charles Cooper if you require any further information.

Offshore Employee Share Trusts – more interaction with pension plan trustees predicted

Alan Judes – Strategic Remuneration – www.StrategicRemuneration.com

Employee Share Trusts (ESTs) have been set up offshore for UK companies for many years. Initially the main reason for the offshore location was the desire to avoid a double tax charge to UK taxes arising on the same shares: UK capital gains tax in the hands of the Trustees when they disposed of the shares to the employee and UK income tax in the hands of the employee when the shares are received. By Extra-Statutory Concession D35 the capital gains tax charge was removed, but only in cases where the employee is liable to UK income tax. If employees are resident outside the UK the double tax charge remains, so offshore ESTs are the norm for UK multinationals that want to use the EST to benefit their employees outside the UK. BWCI has considerable experience of acting as Trustee, Record Keeper and Administrator of EST's located in the Channel Islands but benefiting employees globally.

Where appropriate, and sometimes there are significant UK tax advantages, an EST can be formed in the UK to receive shares from the offshore share warehouse EST. A typical example is the UK's Share Incentive Plan (SIP) under which UK employees can receive £7,500 a year in shares in their employer completely free of income taxes and gains taxes, provided that the SIP is approved by HMRC. Part of the requirement for approval of the SIP is that the trustees of the SIP must be resident in the UK. There is no difficulty at all in the SIP trustees acquiring the necessary shares from the offshore EST and indeed BWCI, as EST trustee, transfers shares to many such arrangements. Recent changes in UK tax legislation lead me to predict that there will soon be a transfer of shares between the trustees of EST's and the trustees of Registered Pension Plans.

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The changes in the legislation are changes in Finance Act 2004 in conjunction with the A-Day Pensions implementation of April 2006. Employees are no longer limited to pension contributions of 15% of pay in a year, and 100% is now permitted. Further, for the vast majority of employees it will be almost impossible to overfund their pensions as the limit is a monetary value of £1,500,000 capital value or a pension of £75,000 a year in 2006 rising to £1,800,000 capital value and a pension of £90,000 a year in 2010. So what is this to do with EST's and a SIP? Simply put, a transfer of shares from the SIP to a Registered Pension Plan is treated as though it was the payment of a contribution by the individual employee.

The amount of the contribution for tax relief purposes is the market value of the shares on the date of transfer. Income tax relief is given in two stages. In the first stage the market value of the shares transferred is deemed to be a contribution net of basic rate income tax (currently at 22%). The Pension Plan administrator gets a cash payment from HMRC of 22% of the gross sum: 22/78ths is in excess of 28% of the net value of shares transferred in. The second stage of tax relief is given to the employee on making a claim by filing a tax return at the end of the income tax year. A 40% taxpayer will receive an additional 18% of the gross value of the shares (or 23% being 18/78ths of the net value transferred into the Pension Plan from the Stock Plan).

In summary, everyone gets tax relief at 22% of the gross value. The Pension Plan administrator reclaims 22/78ths from the UK Revenue authorities and higher rate taxpayers get relief at up to 40% of the gross value of the shares by assessment. When the UK basic rate of tax is reduced to 20% in 2008/09 the relief will be reduced accordingly to 20/80ths. Higher rate taxpayers will still get relief at 40% with a further 20% relief on assessment.

These additional UK tax reliefs can make a significant increase to the value of the pension pot that employees are building up during their careers. It also gives the company the opportunity to enhance and communicate the value of the EST and SIP Plans that are available to employees. It is quite easy to use overseas listed shares so this technique is appealing to global employers with UK employees.

Not every employer can afford it, but some UK companies make full use of the SIP legislation. The UK SIP allows employees to acquire up to £7,500 a year in SIP shares and a further £1,500 a year in dividend reinvestments.

This is how it is made up:

- The employer can give shares as a Bonus (maximum of £3,000 a year per employee)
- The employee can use pre-tax pre-NIC income to buy shares (maximum of £1,500 a year per employee)
- The employer can match each employee's share purchase at any fraction up to a maximum of 2 matched shares for every purchased share (maximum of £3,000 a year per employee) – thus if all three components of the Share Incentive Plan are used some £7,500 a year can be set aside in the Plan
- Employees can take dividends paid on their shares in the form of reinvested shares instead of cash and hold these shares tax free in the plan (maximum of £1,500 a year per employee)
- If shares are held for a qualifying period (generally 5 years) then they can leave the plan completely tax free – no UK income tax and no UK capital gains tax irrespective of their value at date of leaving.
- The market value of the shares can be transferred into a Registered Pension Plan with up to a further 40% tax break for the employee

We thus expect to see a growing interest in offshore ESTs using the shares they have in a tax effective manner for their UK employees, and transfers of shares from ESTs to Pension Plan trustees becoming commonplace.

The opinions expressed above are those of the author and not necessarily those of the BWCI Group