RDG Fiduciary Services

BASIC GUIDE: Employee Benefit Trusts

Employee Benefit Trusts (“**EBT**s”) are used to attract, retain, reward and incentivise employees of a company or group. The expectation is that this will also increase profitability of the company. It also enables the company to provide for future funding of bonus payments.

EBTs can be set up at any time but are frequently established before a listing or funding event. That said, an EBT can be beneficial to any company and would also make sense in the event of a take private or management buyout scenario. An EBT could also be adapted for a developed family business as a way to create a market for shares for family members.

Most EBTs are what can be described as “discretionary trusts” in the sense that no beneficiary has any absolute entitlement at the outset. The potential beneficiaries are typically employees (current, future and previous) of a company / group but in certain cases be wider (e.g. including family members) or narrower (senior management). If specific to a company, the EBT should contemplate future events which may happen to a company such as a takeover, a merger or a change of domicile.

The Trustee of the EBT will typically be a professional trust company or, with appropriate care, a trustee set up for the purpose of acting as the trustee.

The EBT would be established with cash or shares from the company itself or from the founder(s). Where share options are part of the EBT arrangements, the company will need to ensure that it has sufficient unissued shares at the time when any options are exercised. From an employee's perspective it is preferable that the trust is ring-fenced from the company's creditors – particularly if the EBT contains cash. However, this is not always the case and some EBTs are funded via loan!

Typically, the company – or its remuneration committee- will determine which employees become entitled to what and in what circumstances. In most cases, awards are subject to certain conditions – usually some form of time period during which the specific employee must remain with the group, together with specified performance targets. Prior to vesting of awards relating to specific shares, it needs to be set out who can control the votes in respect of any shares held by the trustee and for whose benefit any dividends are held.

Once awards are vested, the relevant beneficiaries could become entitled to receive shares in the company, could be granted share options capable of being exercised (and therefore receive shares) or could receive cash[1]. Each beneficiary's tax and reporting obligations need to be considered. It is also important to note that vested awards do form part of the employee's assets in the event of death, divorce or bankruptcy.

No two structures are the same so appropriate advice should be taken.

For further information please contact:

Richard Grasby

RDG Fiduciary Services Limited[2], Hong Kong

E: rdg@rdgfiduciary.com

T: 852 6596 7517

www.rdgfiduciary.com

https://www.linkedin.com/in/richard-grasby

https://twitter.com/GrasbyRD

Wechat: grazza73

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[1] To facilitate a sale of shares the mechanics of this would need to be stipulated to deal with matters such as pricing risk & currency risk.

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