Using Trusts for Tax & Financial Planning

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Speakers

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On the agenda...

1. What are Trusts and how do they work?
2. Trust Registration Service
3. Types of Trusts
4. How are different types of Trusts taxed?
5. Trusts in Will Planning
6. Lifetime Trust Planning
7. Trusts as a key part of your financial planning
8. Other solutions are available.

What are Trusts and how do they work?

Speaker

Katriona McEwan

What are Trusts and how do they work?

- A ***trust*** is a relationship between persons and property under which property is invested in persons known as ***trustees***, who hold the property for the benefit of other persons known as ***beneficiaries***.
- **Settlor** – the person who provides assets to the trust and advises how they assets are to be held by the terms of the trust deed.
- **Trustees** – own and control the assets but this must be done as per the terms of the trust deed for the benefit of the beneficiaries.
- **Beneficiaries** – have a beneficial entitlement to the assets but the extent of their entitlement to income and capital depends on the type of trust and terms and conditions in the trust deed.

Trust Registration Service

Speaker

Katriona McEwan

Trust Registration Service

- Since September 2022 almost all UK express trusts were required to be registered on HMRC's Trust Registration Service (TRS) unless specifically excluded.
- Previously only required by Taxable Trusts from January 2018.
- Trustees need to declare that the TRS data is correct and up to date on each taxable event.
- Relevant persons are obliged to report material discrepancies on the TRS to HMRC.
- The Trustees should be told to fix the discrepancy in the first instance but if not completed within a reasonable time (30 days per HMRC manuals) a discrepancy report should be made.

Types of Trusts
Speaker
Katriona McEwan

Types of Trust

Bare Trust

- Beneficiary (aged over 18) - absolutely entitled to the asset and the income.
- Trustees - nominees in whose name the assets are held and must follow the lawful instruction of the beneficiary in relation to the asset.
- Bare Trusts for Minors – beneficiary has absolute beneficial ownership, but trustees have active powers & duties to invest & manage the assets.
- TRS – Registerable unless specifically excluded – such as bank accounts for minors

Discretionary Trust

- A flexible Trust under which no beneficiary has a right to income or capital.
- Trustees have the power to decide (from the beneficiaries named in the deed, or a class defined in the deed) who should receive a distribution of income or capital from the trust and when.
- TRS – Registerable unless specifically excluded. Even if excluded from registration as an express trust they could need to register for tax purposes.

Types of Trust

Interest in Possession Trusts

- Also known as Life interest trusts
- Beneficiary has an immediate right to the income or enjoyment of trust capital. Often called the ‘Life Tenant’.
- Remainder Beneficiaries – when the ‘life tenant’s’ interest ends the capital passes to the remainder beneficiaries.
- TRS – Registerable unless specifically excluded. Even if excluded from registration as an express trust they could need to register for tax purposes

Accumulation & Maintenance Trusts

- A mix of Discretionary, while the beneficiaries are under a certain age, and IIP.
- Mainly established pre–March 2006 as they received beneficial Inheritance Tax treatment.
- The income tax treatment follows the type of trust it is at the time. If there is more than one beneficiary different shares of the trust would be taxed differently.
- TRS – Registerable unless specifically excluded. Even if excluded from registration as an express trust they could need to register for tax purposes

Types of trust

Trusts for Vulnerable Beneficiaries

- **Trusts for Bereaved Minors**
  - Created by the Will of a deceased parent. While the beneficiary is under 18 the trust is discretionary and then on attaining 18 the beneficiaries becomes absolutely entitled to the assets. The Trust is liable to income and capital gains tax like a normal discretionary trust while the beneficiary is under 18. However there is beneficial IHT treatment as the assets are outside of the Relevant Property Regime and deemed to form part of the beneficiaries estate.

- **18 to 25 Trust**
  - Created by the Will of a deceased parent but the child does not become absolutely entitled until an age after 18 but before 25. While under 18 the Trust is discretionary and then changes to an IIP (similar to an A&M trust) and the income and capital gains tax treatment is the same as normal settlements. For IHT the assets are outside of the Relevant Property Regime while the beneficiary is under 18, and there will be no ten-year IHT charge but there will be an exit charge when the beneficiary becomes absolutely entitled between 18 and 25 years or age.

- **Disabled Persons Trust**
  - Trusts created for the benefit of a disabled person, as defined by the Welfare Reform Act 2012, and meeting specific conditions on benefiting others receive beneficial tax treatment for Income Tax, Capital Gains Tax and Inheritance Tax.

How are different types of Trusts taxed?

Katriona McEwan

Income Tax

Bare Trust

- Beneficiary absolutely entitled to the income as it arises
- Taxed at their marginal rates of tax based on the source of the income
  - Non-Savings and Savings @ 20% basic rate, 40% higher rate and 45% additional rate – Dividends @ 8.75% basic rate, 33.75% higher rate and 39.35% additional rate.
- Entitled to the personal allowance (PA), Personal Savings Allowance (PSA), Dividend Allowance (DA), property and trading allowances against the income as appropriate.
- The trustees do not generally have to pay tax on the trust income but can do so in certain circumstances.

Income Tax

Discretionary Trust

- Trustees are liable to tax on income at the Rate Applicable to Trusts:
  - 45% on savings and non-savings income and 39.35% on dividends.
- £1,000 starting rate band where the income is taxed at basic rates (20% and 8.35% respectively),
  - This is being removed from 6 April 2024 and replaced with a £500 exemption.
- The tax paid goes into a **tax pool** to frank income distributions to beneficiaries. If insufficient tax paid to frank the income distributions, there will be a 'tax pool charge'.
- Income distribution are made with a 45% tax credit attached; so, a £55 net income distributions has a £45 tax credit = £100 gross income for the beneficiaries.
- The distribution and tax credit is reported to the beneficiary on form R185 (Trust Income).
- This income is taxed as non-savings income in the hands of the beneficiaries.
- Beneficiary can claim a refund of the additional tax paid by the trustees.

Interest in Possession

- Trustees pay tax on income at the basic rates
  - 20% on savings and non-savings income and 8.75% on dividend income.
- The trustees do not have a PA, PSA or DA nor the property or trading allowance.
- The beneficiary is entitled to their share of the income as it arises. This is reported on form R185(Trust Income).
- Beneficiaries are taxed based on the original type of income received, i.e., non-savings, savings or dividend income. Their PA, PSA and DA can be set against this; as well as the property and trading allowance.
- Higher or additional rate taxpayers need to pay further tax due. A non-taxpayer can claim a refund of tax paid by the trustees.
- In some cases, the trustees can Mandate the income to the beneficiaries removing the obligations for the trustees to pay income tax.

Bare Trusts

- Beneficiaries are liable to report and pay the CGT due on the sale of trust assets.
- Can set their annual exemption (£6,000 in 2023/24; £3,000 in 2024/25) and personal capital losses against the gain.
- Taxable gains are taxed at the lower rates of 18% on residential property and 10% on other assets to the extent the gain falls within the beneficiary’s basic rate band, then the higher rates of 28% and 20% respectively where the gains fall in the higher and additional rate bands.
- Trustees cannot report and pay capital gains tax or the tax due on gains on life insurance policies and these continue to be only the responsibility of the beneficiary.

Capital Gains Tax (CGT)

Discretionary Trusts and Interest in Possession Trusts

- Trustees liable to CGT on chargeable gains at the higher rates, 28% on residential property and 20% on other assets.
- Trustees' annual exemption is £3,000 in 2023/24; £1,500 in 2024/25.
- Trust capital losses from the current or prior years these can be offset against the gains.
- There is no relief for the beneficiary's annual exemption or personal losses available to the trustees.
- The appointment of assets in specie to beneficiaries is a taxable event for CGT for the trust/trustees and CGT can be payable on the gain inherent on the asset. Holdover relief may be available to defer the gain to the beneficiary if conditions are met and the trustee and beneficiary make the required election.
- *Nb. Gains arising on the sale of residential property must be reported to HMRC and the tax due paid within 60 days on a CGT on UK Property Return. (This applies to individuals, trustees and estates)*

Disabled Persons Trust/Vulnerable Persons Relief

- Can be Discretionary or IIP and initially the tax will follow the rules above.
- Where conditions are met a Vulnerable Person Election can be made and Vulnerable Person's Relief can be claimed in the tax returns.
- The relief reduces the Trustee's tax liability, both income tax and capital gains tax, to what it would be if the beneficiary had received the income directly.

Bare Trusts

- As with the income and CGT treatment, the beneficiaries have an absolute entitlement to the assets and so these form part of their estates for IHT purposes.

Inheritance Tax (IHT)

Discretionary Trusts

- Fall within the Relevant Property Regime (RPR) for IHT.
- IHT event when trust is created, on each ten-year anniversary and when assets are appointed out to beneficiaries.

Principal Charge/Ten Year Charge

- IHT charged at max 6% on capital value of the fund on the anniversary date.
- Actual rate is dependent on NRB, capital distributions, related trusts or same day additions.
- Undistributed income over 5 years old is also included in the calculation and liability to IHT despite this being a capital tax.

Proportionate Charge/ Exit Charge

- An effective IHT rate based on the trust value on trust creation or prior TYA (max 6%) is prorated for complete quarters since creation or TYA.
- The prorated IHT% is applied to the value of the assets ceasing to be held in the trust.

Rysaffe Principle/Pilot Trusts

- Affects the calculation of the IHT rate applying on a trust's Principal Charge/TYA.
- The initial value of Related Settlements affects the IHT rate on TYA and exit charges as they utilise the NRB.
- By creating multiple settlements on sequential days, the trusts were not related, and the value not included in the TYA tax calculation and each trust has its own NRB.
- Planning with regards to Pilot Trusts has been somewhat limited by the Same Day Addition rules so where assets are added to separate trusts on death the value of these is included in the IHT rate calculation.
- However, they can still be effective for holding separate life assurance policies to keep the policy proceeds in separate trusts with their own NRB.

Rysaffe Principle/Pilot Trusts

Whole of Life sum assured	£1.5million	£375,000(x4)
Annual premium	£36,976.04	£9,364.80 each plan
Total 10yrs' prems	£ 369,760.40	£93,648 each plan
NRB	£325,000	£325,000
Total of prems above NRB	£ 44,760.40	£0
Periodic Charge 6%	**£ 2,685.62**	**£0**
Total 20yrs' prems	£ 739,520.80	£187,296 each plan
Total of prems above NRB	£ 414,520.80	£0
Periodic Charge 6%	**£ 24,871.25**	**£0**

- Finance Act 2015 provides specific exemption from the Same Day Additions rules.
- It is important to remember that for this scheme to work, there must be a separate trust created with a separate policy on different days. It is essential that the paperwork is completed properly on different days and that each of the policies can be dealt with independently of the others.

Interest in Possession Trusts

IHT treatment depends on whether the trust is a 'Qualifying' IIP or not. A Qualifying IIP is:

- An interest in a trust for a disabled person.
- An Immediate Post Death Interest (IPDI) – an IIP created by the Will of a deceased settlor.
- A lifetime IIP created/vested before 22 March 2006
- Transitional serial interest

Qualifying Interest in Possession

- The assets of the trust are deemed to be part of the estate of the life tenant.
- The trustees will be liable to IHT on the death on the life tenant at up to 40%.
- If a life interest is terminated during the life of the life tenant IHT could become payable and the trustees will be liable to pay this.

Non-Qualifying Interest in Possession

- A non-qualifying IIP trust falls into the relevant property regime and will be liable to IHT as set out for a Discretionary Trust on each ten-year anniversary and when assets are appointed out of the trust.

Inheritance Tax

Bereaved Minor Trust

The assets of the trust are deemed to be owned by the beneficiary absolutely and form part of their estates for IHT.

There are no ten-year charges of exit charges when the beneficiary turns 18 and becomes absolutely entitled to the assets.

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18 to 25 Trusts

- While the beneficiary is under 18 the assets are deemed to form part of the beneficiary's estate for IHT purposes.
- When the assets are appointed to the beneficiary absolutely there is an exit charge of up to 4.2% prorated for the number of complete quarters between the beneficiary turning 18 and the appointment.
  - *So, if a beneficiary became entitled at 21 the maximum IHT rate would be 1.8%.*
- There are no ten-year charges in an 18-25 trust, even if this falls after the beneficiary turns 18.

Points to Note

- **Reporting Time Limits**
  - 6 months from the end of the month of the chargeable event.

- **Business Property Relief (BPR)**
  - Assets that qualify for BPR can be settled on trust without incurring and IHT charge, no matter the value.
  - Where Trustees hold only BPR qualifying assets at the TYA there would be no IHT due.
  - The Rate of IHT applicable to 'exits' in the next ten years would be 0%. This means even if the BPR assets were sold, and chargeable assets were appointed out there would be no IHT due from the trust.
  - It is different in the first ten years of the trust as the rate of tax applicable in that period is based on the value of the trust immediately after it commenced without taking account of BPR. While BPR assets can be appointed out with relief applying, if the BPR assets are sold there would be IHT on an appointment of taxable assets from the trust in the first ten years.

Points to Note

Principal Charge Planning

- Distribute Assets before TYA -
  - If appropriate the trust assets can be appointed out before the anniversary.
  - Where the effective rate of IHT on creation or prior TYA was 0% there would be no IHT on the appointment out even if the value of the trust now exceeds the NRB or is no longer qualifying for BPR/APR.
  - Even if there will be some tax payable on the appointment this can be significantly lower than the TYA charge if the value of the assets have increased significantly in the last ten years.
  - Whilst this can negate a potential IHT charge it is not always appropriate and the circumstances of the beneficiaries and purpose of the trust should be considered fully before making an appointment of assets to the beneficiaries. Tax is not the only thing to consider.

- Acquire BPR Qualifying Assets
  - The trustees may also wish to consider changing the assets held so that these qualify for Business Property Relief on the anniversary date. This would need to occur at least two years before the anniversary date to be effective (unless replacement relief applies).

Trusts in Will Planning

Speaker

James Kipping

Standard Wills for Spouses

- Standard wills for spouses leave everything to each other on the first death and then typically to their children or others on the second death.
- This means the spouse exemption applies on the first death to mean the IHT charge is deferred to the second death.
- However, clients will usually want the survivor to benefit on the first death, but may want to protect against care home fees and ensure that the estate of the first to die is ring fenced from a second marriage of the surviving spouse.

Immediate Post Death Interest ("IPDI") Trust

- What's the solution?
- The main home is often the most valuable asset so the best advice will typically be for the spouses to sever any joint tenancy and leave their interest onto a Life Interest Trust on the first death.
- This is an Immediate Post Death Interest Trust ("IPDI") in which the surviving spouse is the Life Tenant entitling them to enjoy the Trust Fund during their lifetime, with the children usually being the remainder beneficiaries.
- An IPDI is a 'qualifying interest in possession' so the spouse exemption is available on the first death and the Trust Fund is deemed to be in the estate of the survivor / Life Tenant.

A typical scenario

- Take the following scenario:

  £350K Property

  £650K Cash and Investments

  All jointly owned

- There is no IHT on the first death
- The estate of the survivor is valued at £1M
- That is entirely covered by 2 x NRB and 2 x Residence NRB if assets pass to children on the second death.
- But a typical Flexible Life Interest Trust might name the children as discretionary beneficiaries so the assets pass onto a Discretionary Trust on the second death. In which case the RNRB will not be available in respect of the 50% of the property held on Trust.

IPDI – Other Planning Options

- The life interest trust may be revocable at the discretion of the trustees or the life interest could be terminated by the Life Tenant
- That would create a Potentially Exempt Transfer or Chargeable Lifetime Transfer but the assets will have benefitted from the CGT-free base cost uplift on the first death.

Business Property Trusts

- What will happen to the family business if one spouse dies?
- Will the nature of the business necessarily change? Will it be sold?
- With standard wills the assets will pass to the surviving spouse with no IHT but if the business ceases to qualify for BPR or is sold they will increase the estate of the survivor and the exposure to IHT on their death.
- Therefore, the Wills should be structured to take full advantage of the generosity of BPR because otherwise, an entrepreneur is in danger of wasting the generosity of BPR if they leave on death business assets eligible for BPR to their spouse.

Business Property Trusts

- In the scenario where Mr A and Mrs A have the following principle assets:
- Main residence £1M (jointly owned)
- Shares in family company £1M (owned by Mr A)
- If Mr A dies first leaving everything to Mrs A. There is no IHT on his death as everything passes to Mrs A with the spouse exemption.
- Mrs A sells the business for £1M and on her death the estate of £2M is liable to IHT as follows:

Main residence	£1,000,000
Sale proceeds	£1,000,000
Total Estate	**£2,000,000**
Less NRBs	(£650,000)
Less RNRBs	(£350,000)
Taxable Estate	**£1,000,000**
IHT @ 40%	£400,000

Business Property Trusts

- If instead, Mr A leaves the shares of the family company onto a Discretionary Trust and other assets to Mrs A, the IHT position is as follows.
- There is no IHT on Mr A's death. The shares pass onto the trust with BPR and the other assets pass with the spouse exemption.
- The shares are sold by the trust and the proceeds remain outside of Mrs A's estate. They are within the relevant property regime for IHT.
- On Mrs A's death her estate is principally the main residence of £1M which is covered by the two NRBs and RNRBs so there is **no IHT.**
- This simple solution saves IHT of £400K

Double Dipping

- If the business assets are likely to be retained Wills can be structured so that married couples or civil partners can claim double BPR. This is known as a "double dipping" Will.
- On the first death everything is left upon a trust which will subsequently have two funds: Business Property Fund and Residuary Fund

Double Dipping

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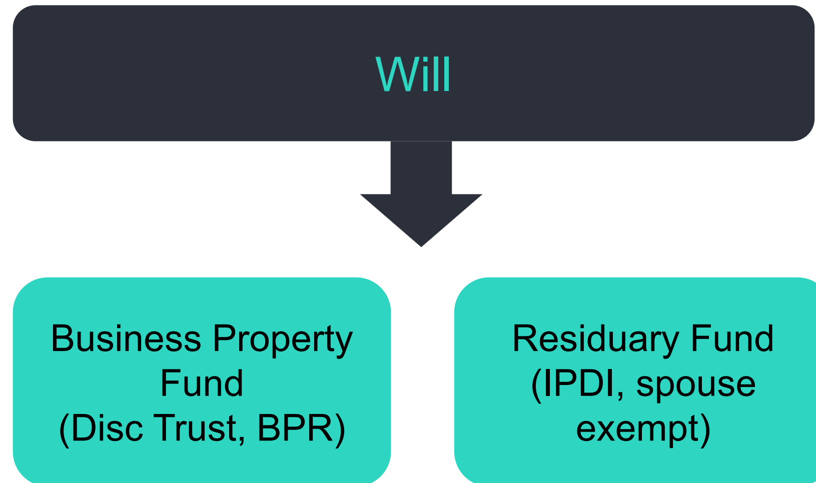
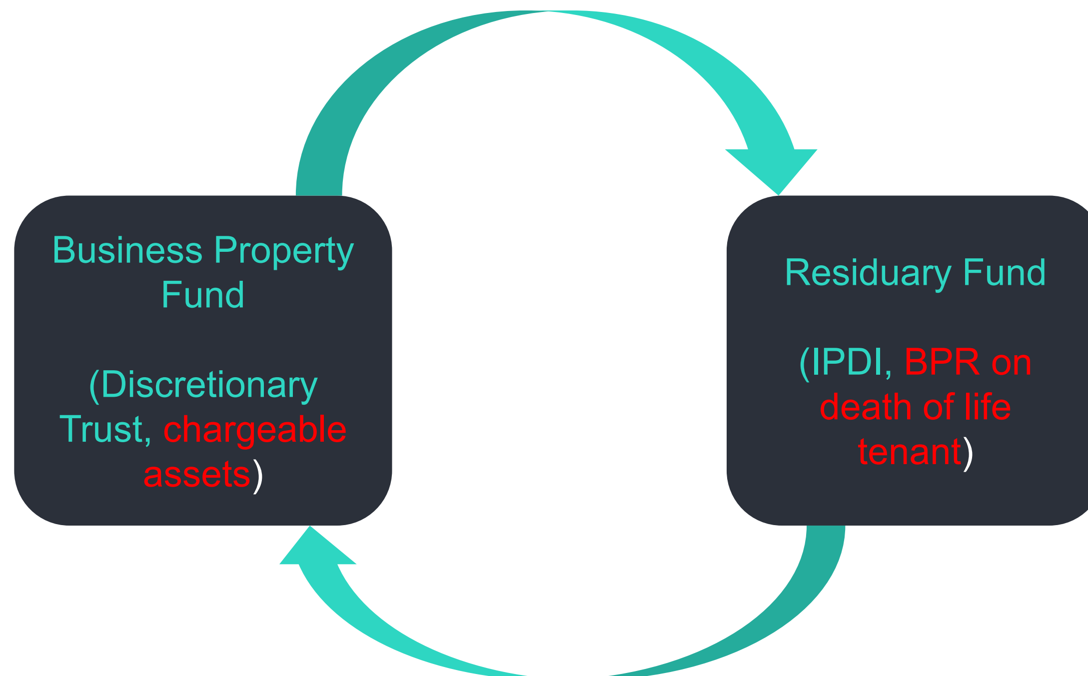
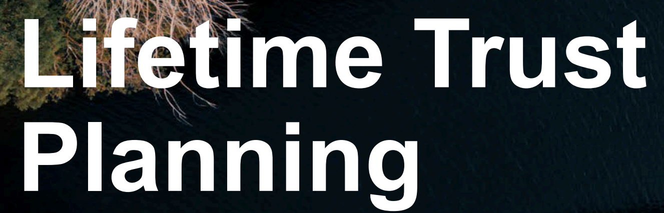


Double Dipping

- The trustees will then – any time after 3 months – sell the BPR assets to the Residuary Fund. It may be that the assets can be swapped.
- This will leave the Residuary Fund with BPR assets so that BPR is available on the death of the surviving spouse.
- The Business Property Fund will hold the chargeable assets outside of Mrs A's estate. It will, however, be liable to relevant property charges.





Lifetime Trust Planning

Speaker

James Kipping

Lifetime Discretionary Trust – IHT and CGT Planning

- Mr and Mrs A want to gift an investment property worth £600K to their adult children
- There is an inherent capital gain of £300K which would create a CGT liability of c.£84K if they transferred the property directly.
- They could instead settle the property onto a Discretionary Trust with no IHT liability and claim holdover relief under s260, TCGA 1992.
- There should be no IHT exit charge if capital is appointed in the first ten years.
- Mr and Mrs A must be excluded from the trust for their gift to be effective for IHT.
- For property disposals made on or after 10 December 2003 it is not possible to claim holdover relief under s260 and then PPR on any later disposal.

Lifetime Discretionary Trust – Income Tax Planning

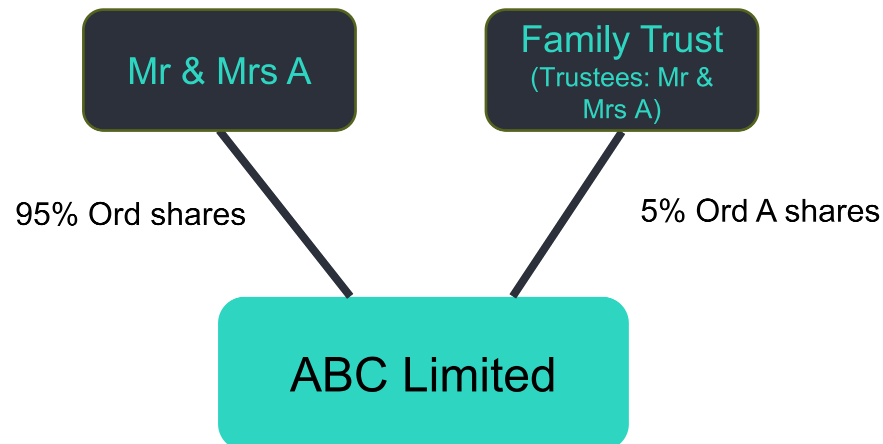
Scenario

- Mr & Mrs A own 100% of the share capital of ABC Ltd, a profitable family company which they founded.
- They are the only directors of the company.
- They wish to draw further profits from the company to pay private school fees of their grandchildren.
- Their personal incomes exceed £125K so they are additional rate taxpayers so dividends will be liable to tax at 39.35%

Lifetime Discretionary Trust – Income Tax Planning

Solution

- Re-designate and settle some shares (say 5%) of ABC Ltd onto a discretionary trust
- Ensure shares qualify for BPR or the transfer of value is < NRBs
- Holdover relief under s260 so no CGT
- The trustees may appoint a revocable life interest in favour of the grandchildren and mandate the dividend income to them.
- Dividends can be paid directly to the grandchildren in accordance with the life interest appointment and the settlements legislation will not apply in this scenario.



Trusts as a key part of your financial planning

David Hume

As a financial adviser, when may I recommend a trust?

- Wealth Succession is often important to our clients.

- Generally, as an independent financial adviser there are two main occasions that I will use a proven trust strategy to meet a client's objectives, and that I will expand on during today's webinar being:

  - **Investment Bonds (Onshore or Offshore)**
  - **Life assurance protection policies**

Why may you consider using a trust with an investment bond?

Financial advisers are able to consider recommending an investment bond structure (Onshore or Offshore) held within a trust wrapper to legally move assets outside the estate. For example, this option may be important to a client who may not want to gift direct cash lump sums as they do not want to lose control to the monies.

Some other reasons to consider these as a potential solution may include:

- There are different types of trusts to meet specific needs as discussed earlier.
- Can provide you with a choice of discretionary/ absolute structure
- IHT tax efficient
- You can identify beneficiaries – if using a discretionary trust, you also have the ability to change the nominated beneficiaries.
- You can specify at what age and in what circumstances your intended beneficiaries can have access to the monies.
- Generally, outside the estate in relation to IHT after 7 years from inception.
- Trustees maintain control of funds rather than outright gift.

Flexibility of Trusts v Inheritance tax efficiency of Trusts

As stated, there are many different types of trusts available, and it may not always be clear which should be used or the best way of setting it up. Trusts have variance in level of flexibility which go hand in hand with the level of IHT tax efficiency. Generally, once you've placed the assets into a trust you can't usually change your mind. So, therefore it is important that you make sure you are using the right trust or combination of trusts for your circumstances.

With today's webinar time constraints, I will be covering a couple of the more popular trusts

Discounted gift trust (DGT)

- Generally, these are considered as a potential solution for more elderly clients aged 65 to 90 years of age who want to reduce their chargeable estate, need a regular fixed payment stream and can forego future access to the capital lump sum.
- A Discounted Gift Trust allows an individual (a Settlor, or joint Settlors) to gift a cash lump sum into Trust using a single premium investment bond while retaining the right to fixed regular payments, and immediately reducing the amount of Inheritance Tax (IHT) that might eventually have to be paid from their estate. The younger you are at implementation of the trust then generally the greater the discount.
- When establishing the DGT, the Settlor requests regular fixed capital payments payable for their lifetime, or until the fund is exhausted. These payments are generated from partial withdrawals from an investment bond via the allowable 5% withdrawal facility.

Discounted gift trust (DGT)

- Importantly at the outset a DGT provider will underwrite the insurance bond by calculating how much of the bond’s value will be needed to provide these withdrawals which will involve an estimation of the Settlor’s life expectancy and may include the need for medical underwriting, health questionnaires and potentially a GP report.

- The capital needed to provide the required withdrawals is known as the discount and this reduces the value of the Settlor’s gift to the DGT for IHT purposes. Although this discount may vary for each client depending on their situation it is one of the main attractions of this trust structure.

- The reduced value of the ‘gift’ may remain within the Settlor’s estate for seven years, unless covered by an exemption.

- Any investment growth in the Trust is immediately outside of the Settlor’s estate and should not be subject to IHT.

Discounted gift trust (DGT) - structure

Example: £722,222 investment with 55% discount

Settlor's Retained Benefits

Immediate Discount- based on mortality & level of withdrawals

Capitalised value of expected regular payments

£722,222 x 55%
£397,222

DGT

Gifted Residual Benefits

Gift potentially exempt (bare) or chargeable (discretionary)

£7222,222 - £397,222
£325,000

Seven-year clock

Discounted gift trust (DGT)

Summary of main advantages of a DGT

- Settlor's retained benefits will provide tax efficient fixed payments for life up to the allowable 5% tax deferred bond allowance or until the fund is exhausted
- Written on single or joint basis and withdrawals remain fixed until second settlor's death
- Investment level can be greater than nil rate band, subject to underwriting
- The capital value of the payments (discount) that are expected to be made during your lifetime is immediately outside of your estate for IHT purposes
- Gifted residual value is outside settlor's estate after seven years
- Investment growth is outside the donor's estate as part of the trust
- Choice of Bare of Discretionary Trust structures
- Discretionary trust version
    - Trustees have control over who benefits
    - Trust assets won't form part of beneficiaries' estate

Discounted gift trust (DGT)

Summary of main disadvantages of a DGT

- Inflexible as withdrawals are fixed and cannot be altered once started
- Payments, where unspent, will accumulate in estate
- Full underwriting at outset
    - Potential delays
- Fixed regular payments may be at risk if the investment strategy if unsuccessful
- Settlor’s retained benefits may run out if you live a long life
- Donor / Settlor cannot access gifted residual fund from the trust
- Beneficiaries can only access trust after the death of donor / settlor
- Discretionary trust-reporting requirements HMRC initial and ongoing

Gift and loan trust

- The gift and loan trust allows you to make potential inheritance tax savings by removing future investment growth from your estate. Although you maintain access to your original loan this will fall back into your estate if not exhausted prior to your death.
- Access original capital: your client can access the original loan capital sum at any time, either as a full lump sum, occasional ad-hoc or regular repayments of the loan, addressing any concerns about losing access to cover any unforeseen circumstances. This type of trust is often therefore considered by clients who may be middle aged upwards.
- Capital growth: any growth on the investment is part of the trust and therefore will not further increase the size of the client's chargeable estate.
- The trust, either bare or discretionary, is established with an initial gift of £10. After making the initial gift, you make an interest-free loan to the trustees, and they invest that amount in an investment bond. You are entitled to receive loan repayments, from the trust fund, but once you have received the entire loan back you cannot receive any further payments.

Gift and loan trust

Example of 5% of loan repaid each year

Value

£300,000
£250,000
£200,000
£150,000
£100,000
£50,000
£0

1 2 3 4 5 6 7 8 9 10 11 12 13 14 16 17 18 19 20 21

Plan Year

Remaining loan (inside estate for IHT)

Growth (outside estate for IHT)

Gift and loan trust

Summary of main advantages of a Gift and Loan trust

- Growth outside investor's estate from day one –free of IHT
- Access to regular loan repayments can be agreed and can be altered
  - Such as 5% tax deferred over 20 years or 4% tax deferred over 25 years
- Full Loan is repayable on demand should investor require
- Loan to trustees is interest-free
- Investor unable or unwilling to make outright gifts but is keen to achieve some IHT savings on future growth
- Choice of Bare or Discretionary trust structures
- Discretionary trust version
  - Trustees have control over who benefits
  - Trust assets won't form part of beneficiaries' estate

Gift and loan trust

Summary of main disadvantages of a Gift and Loan trust

- Outstanding loan remains in the estate for IHT
- Total repayments to investor must never exceed original loan
- Once loan repaid, no more future payments available to investor
- Withdrawals above accumulated 5% triggers chargeable event and income tax may apply
- Repayment of loan on demand
    - Could trigger chargeable event
- Investor’s early death may not achieve much IHT mitigation
- If investment strategy is not a successful approach, then only the actual investments growth is available to the beneficiaries on death
- Waiving the loan will be considered a gift to the trust or to an individual
- Discretionary trust-Reporting requirements for HMRC

Why should you consider using a trust for a life policy?

There are four main reasons why your clients should consider placing their life assurance protection policies in trust:

1. Speed

- Proceeds are paid directly to the trustees without any delay through probate (confirmation in Scotland).

2. Nomination of beneficiaries

- Nominating beneficiaries in the trust form ensures the proceeds go to the intended recipients.

3. Tax planning

- Using a trust can ensure that any proceeds will be held outside of an estate upon death, thereby avoiding the need to pay inheritance tax (IHT) or reducing the amount to be paid.

Why should you consider using a trust for a life policy?

4. Convenience

- If the policyholder is too ill to make a claim, someone may need to act on their behalf. This can take time and money. However, if the plan is written in trust, the trustees may be able to claim on behalf of the plan owner. If critical illness is included in the plan, the trustees can continue to hold the proceeds in trust for their benefit depending on the type of trust used.

Important – there may be other reasons to consider. These will be based on a client's individual needs and circumstances. The value of tax benefits will depend on individual circumstances and current tax laws may change.

Protection – a tax and cost-effective solution

- Types of life assurance policy which we may discuss the use of trusts as financial advisers include:

    - Whole if Life (joint life 2nd death)– Guaranteed or Reviewable
    - Term policy
    - Convertible Term policy
    - Gift inter Vivos policy for PETs
    - Business trusts for shareholder/partnership protection
    - Relevant Life trusts

- The most common type of life policy used for IHT planning is a whole of life plan. This is designed for your clients who want to mitigate an overall IHT liability on their death. The level of cover should be equal to your client's potential IHT liability after you've considered all appropriate allowances and reliefs.

Protection – a tax and cost-effective solution

Funding via a life policy written in trust will help avoid probate delays and ensure money to pay the IHT bill is immediately available to the right people at the right time.

Executors cannot distribute the estate's assets until probate (or letter of administration) granted.

Probate only granted once any IHT owing is paid.

HMRC may charge interest on unpaid IHT from 6 months after the end of the month in which the deceased died.

Case study

- Bob and Maureen have a potential IHT liability on their death of £500k.
- Bob is 62, and Maureen is 60, and both are non-smokers.
- They have a cautious attitude to risk and want to ensure their children receive their full inheritance.
- They want to provide their beneficiaries with the money to pay the IHT bill.

What are their options?

- Guaranteed Whole of Life plan – **£640.20 pm**; Bob and Maureen think the premiums are very expensive
- Separate savings account? – how long would it take to save **£500k?**

Quote is based on a Royal London Joint Life second death Guaranteed Whole of Life cover, £500k lump sum.

Premium includes £2.60 policy fee. Quote taken Jan 23.

Conclusion

- Whole of Life plan provides the full £500k (as plan written under trust) whenever death occurs
- Certainty of full pay out and premiums guaranteed from day 1 as long as premiums are paid in full
- No exposure to market / interest rate volatility – consistent with clients' attitude to risk
- Bob & Maureen's objectives regarding their wishes for children's inheritance achieved

Does £640.20 per month still seem expensive or a cost-effective solution?

Guaranteed Whole of Life plan v savings

- Guaranteed Whole of Life plan (joint life second death) : - £640.20 per month, £500k sum assured
- Based on typical life expectancy[1] a claim under the Whole of Life plan might be expected at 32 years, as indicated by the solid vertical red line on the graph
- Assume Bob & Maureen find a bank account that pays an annual compound interest rate of 3.25%
- It would take 35 years of saving £640.20 per month to accumulate £500k to match IHT liability
- Bob would be 97, Maureen 95
- But what is the position if Bob & Maureen die earlier?
- Also need to consider a 40% IHT charge on savings, as cash forms part of the estate.

Guaranteed Whole of Life value calculator - Royal London for advisers

Chart correct as at Feb 2023 based on Royal London guaranteed whole of life calculator

[1] Life expectancy is based on the Institute and Faculty of Actuaries' Continuous Mortality Investigation "08" series assured lives mortality tables.

Reviewable Whole of Life

- Reviewable premium £67.22

  (GWOL = £640.20)
- Sum assured £500,000
- Reviewed at 10 years and every 5 years thereafter
- Premiums increase is based on: -

  - Client's age at review

  - Return on investments

  - Expenses

Premiums are correct as of February 2023 and includes a £2.60 plan fee. The plan does not have a cash-in value at any time. Based on a joint life second death basis.

Uses for reviewable rate whole of life plans

- Managing a reduction in a client's IHT liability by gifting
- Covering an IHT liability for a short / medium but indeterminate period of time
- Combining with a guaranteed rate whole of life policy to meet a client's budget
    - £250k guaranteed £323.32 [1]
    - £250k reviewable £36.87 [2]
    - Total premium £360.19

[1] Premium is based on guaranteed whole of life plan

[2] Premium is based on reviewable whole of life plan.

The plan does not have a cash-in value at any time. Both premiums are correct as of February 2023 and includes a £2.60 plan fee. Both are based on a joint life second death basis.

Business Relief - Unquoted vs. AIM – What's the Difference?

- Business Relief (BR) qualifying investments can typically be split into two categories: 'AIM listed' or 'Unquoted'. Both qualify for BR after a holding period of 2 years (if held on death) and involve investments into small UK companies that have to meet certain qualifying criteria and, as such, are typically considered 'higher risk' investments. Some examples of the business activities included are renewable energy, short-term property finance, Private Finance Initiative (PFI) projects, and construction finance.

However, there are some key differences:

Unquoted

- Whilst still deemed higher risk by virtue of the underlying investee companies, unquoted BR arrangements generally tend to be designed with capital preservation in mind and with the aim of delivering a predictable or modest level of growth or return (typically aiming for around 3-4% per annum), rather than higher growth with greater associated risks.
- The normal liquidity issues surrounding such assets are largely avoided, due to the marketplace for this type of investment having increased hugely in recent years.
- These investments currently fall within the Capital Gains Tax (CGT) regime, with no tax applying on an ongoing basis and, given that the intention is for these investments to be held until death, any such charge to tax would be avoided.

Business Relief - Unquoted vs. AIM – What's the Difference?

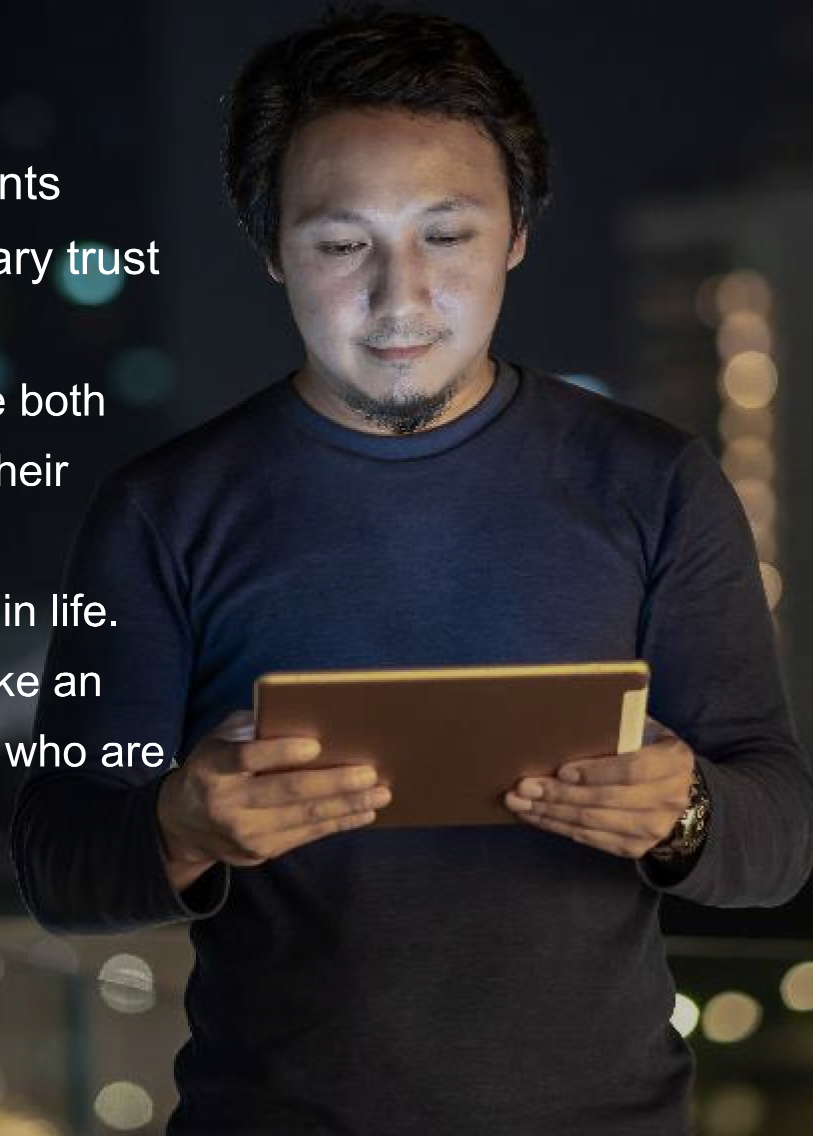
AIM Listed

- This approach has historically demonstrated a much higher degree of volatility than the unquoted route referred to above and can therefore be deemed to be higher risk.
- That said, these arrangements also provide the potential for much higher returns, both during isolated periods and over the longer term.
- AIM shares can be held within an ISA wrapper, and as such investors can combine the IHT benefits of such investments with the Income Tax and CGT benefits of an ISA. Most arrangements can accept investments by way of ISA transfer, meaning cash or investments held in an existing ISA wrapper can be transferred to an arrangement that qualifies for BR without having to remove them from the ISA wrapper.

Case Study

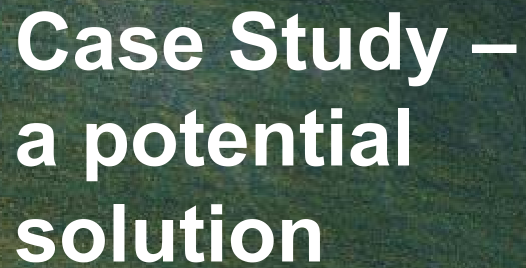
Inheritance tax planning for clients settling assets into a discretionary trust

Mira and her husband Neerav are both 75 and want to set up a trust for their grandchildren to help further their education or to buy a house later in life. However, they are hesitant to make an outright gift to their grandchildren who are still very young.



Case Study

- Mira and Neerav have recently made gifts to their children totalling over £1m.
- Mira has recently had an investment mature worth £500,000.
- Their financial adviser has discussed Mira settling that money into a discretionary trust, as she could use the trust document to set out how the trust assets should be distributed.
- Because of the recent gifts to their children, they have no nil-rate band (NRB) available between them for the next seven years. Their estate is valued at well over £2m, so they won't be eligible for the Residence Nil Rate Band (RNRB).
- Should they settle cash into a discretionary trust, the trust will need to pay a 20% Chargeable Lifetime Transfer (CLT) and if Mira should die in the next seven years, there will be a further charge for inheritance tax (IHT).



Case Study – a potential solution

Inheritance tax planning for clients settling assets into a discretionary trust

Their financial adviser recommends Mira invests £500,000 into a portfolio of investments capable of qualifying for Business Relief (BR).

Case Study – a potential solution

- Their adviser explains that setting up a discretionary trust for their grandchildren will give Mira and Neerav control over how the trustees can distribute the assets.

- Mira and Neerav are also advised that after the BR-qualifying shares have been held for a minimum of two years, they can be settled into the discretionary trust. As the shares qualify for BR at the time they are settled into trust, the trust won't pay a CLT entry charge.

- Provided that the trust continues to hold the BR-qualifying shares, there will be no further charge for IHT, even if Mira passes away within the first seven years of the trust being set up.

£500,000 cash

Settles £500,000 in trust

Chargeable lifetime transfer
£500,000 x 20% = £100,000

Retained benefits

Should Mira pass away within the next 7 years, there will be a further charge for IHT. The Trust will be subject to periodic and exit charges

Invests in BR qualifying shares for 2 years

After 2 years, value:
£500,000

BR-qualifying shared are settled into a discretionary trust

Chargeable lifetime transfer:
£0

Value of trust after day one:
£500,000

Provided the trust continues to hold BR qualifying shares, or if Mira passes away after 7 years, there will be no further charge for IHT. If the trust isn't holding BR-qualifying shares at the 10-year point, it may be subject to period and exit charges.

That's a saving of £100,000

Case Study

Inheritance tax planning for clients in conjunction with the residence nil-rate band

Case Study

- Cassandra is 81 and divorced. She has already begun planning for inheritance tax (IHT), but her financial adviser recently told her that the size of her estate means it does not qualify for the residence nil-rate band (RNRB).
- However, the nil-rate band (NRB) of £325,000 is available. She is therefore keen to carry out further estate planning to lessen the IHT due on her estate.
- Cassandra's estate is valued at £2.35m, including her home which is valued at £500,000. As the RNRB is tapered for estates worth over £2m, it cannot be claimed. She plans to leave her entire estate to her children.
- Cassandra has a whole-of-life policy worth £100,000 which has been written into trust.

Case Study

- She invested £350,000 into Business Relief (BR)-qualifying shares more than three years ago, and also made some monetary gifts to her children over seven years ago.

- The £175,000 of relief that is available through the RNRB is tapered by £1 for every £2 that her estate is worth over £2m, meaning that she doesn't qualify.

- Even though her BR-qualifying shares are exempt from IHT, they still form part of the calculation of the size of her estate.

- As a result, the potential IHT liability on Cassandra's estate when she dies will be £670,000.

Case Study – a potential solution

Inheritance tax planning for clients in conjunction with the residence nil-rate band

- Cassandra's financial adviser recommends that Cassandra settles the £350,000 of BR qualifying shares into a discretionary trust.
- Cassandra is no longer considered the legal owner of the BR-qualifying shares as they now belong to the trust.
- As the shares have already qualified for BR, they will not use up any of Cassandra's available NRB or create a Chargeable Lifetime Transfer (CLT).
- Provided the trust continues to hold the BR-qualifying shares, they will still be exempt from IHT should Cassandra pass away within seven years.
- Cassandra's personal estate is therefore valued at £2m, meaning her estate is eligible to claim the full RNRB value of £175,000, which can be used against her main residence as she plans to leave it to her children.
- If Cassandra goes ahead with her adviser's recommendation, the IHT liability on her estate should be reduced from £670,000 to £600,000.

Cassandra's estate value

£2.35m (includes £350k of BR-qualifying investments)

Keep BR-qualifying shares portfolio
£350,000

Settle BR-qualifying shares into discretionary trust
£350,000

No CLT is paid s shares are BR-qualifying and does not use up the NRB

Cassandra dies after 5 years

Available IHT allowances
(1 x NRB £325,000)

IHT liability on entire estate
£670,000

Available IHT allowances
(1 x NRB £325,000 + 1 x RNRB £175,000)

IHT liability on entire estate
£600,000

That's a saving of £70,000

Questions

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In reference to the Inheritance tax planning for clients in conjunction with the residence nil-rate band case study

This illustration does not take into account investment growth or charges. It is based on the tax rules as at January 2023 which could be subject to change. It is assumed that the NRB has already been used. Tax rules and reliefs are subject to change and the availability of business relief depends on the company in which the investment is arranged establishing and maintaining its tax status. The availability of tax reliefs for investors will also depend on their personal circumstances.

In reference to the Inheritance tax planning for clients settling assets into a discretionary trust case study

This is a hypothetical estate planning scenario. For simplicity, this illustration does not take into account investment growth or charges apart from the CLT for either investment. It is based on the tax rules as at January 2023 which could be subject to change. It is assumed that the NRB and the RNRB have already been used. Tax rules and reliefs are subject to change and the availability of business relief depends on the company in which the investment is arranged establishing and maintaining its tax status. The availability of tax reliefs for investors will also depend on their personal circumstances.

Business Relief schemes are high risk investments and there may be no market for the shares should you wish to dispose of them. You may lose your capital. Certain investments carry a higher degree of risk than others and are, therefore, unsuitable for some investors.

Don't invest unless you're prepared to lose all the money you invest. These are a high risk investments and you are unlikely to be protected if something goes wrong.

The tax treatment depends on the individual circumstances of each client and may be subject to change in future.

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This Information represents our understanding of current law and HM Revenue & Customs practice as of May 2023. Tax assumptions and reliefs depend upon an investor’s particular circumstances and may change if those circumstances or the law change.

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