Trust School Lesson 4 - Insurance Company Trusts in IHT Planning

This content is based on our understanding of current taxation, legislation and HM Revenue & Customs practice all of which are liable to change without notice. The impact of any taxation (and any tax reliefs) depends on individual circumstances.

Where content includes case studies or examples these are for illustration purposes and are not recommending a specific course of action.

Past performance is not a reliable indicator of future performance. The value of an investment can go down as well as up and your client may get back less than they've paid in.

Learning Objectives

By the end of this session, you will be able to:

- Describe how gift trusts, discounted gift trusts, and reversionary interest trusts work
- Explain the IHT treatment of insurance based trust planning
- Assess suitability based on control, access and client objectives

Insurance company trusts

Gift Trust

Discounted Gift Trust

Reversionary Interest Trust

Loan Trust

Primary considerations

Access

Control

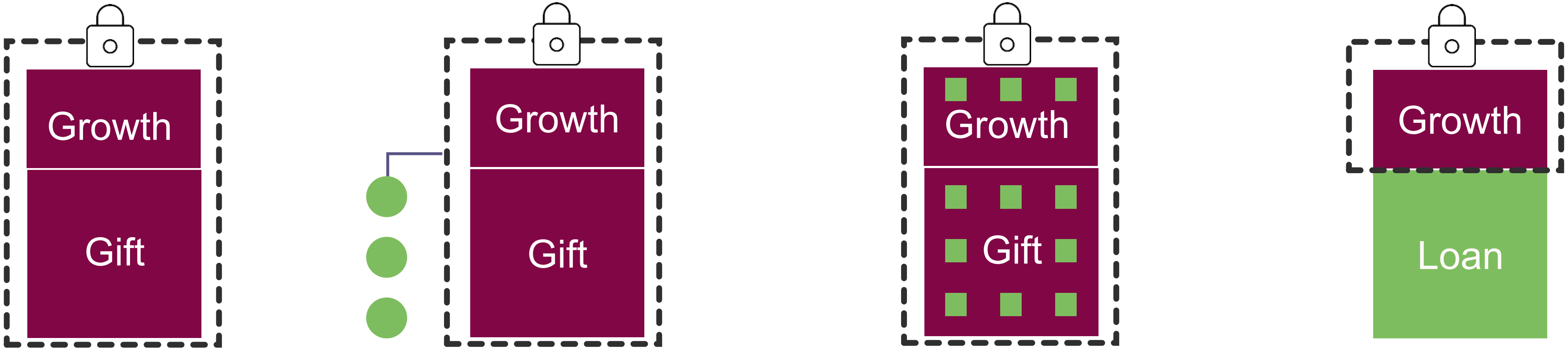
Settlor access

Gift Trust	Discounted Gift Trust
None	Fixed withdrawals decided at outset

Reversionary Interest Trust	Loan Trust
Access to reversions on specified dates	Access to loan as and when desired

Settlor access

Gift Trust	Discounted Gift Trust	Reversionary Interest Trust	Loan Trust



None	Regular payments	Pre- planned	Flexible

Control

Absolute

A gift into an absolute trust is a potentially exempt transfer (PET)

Discretionary

A gift into a discretionary trust is a chargeable lifetime transfer (CLT)

Control

Gift Trust

Discretionary

Absolute

Discounted Gift Trust

Discretionary

Absolute

Absolute beneficiary can't demand trust fund during settlor's lifetime

Reversionary Interest Trust

Discretionary

Loan Trust

Discretionary

Absolute

Trustees need to be able to repay loan on demand

Giving up access

Discounted Gift Trust

- Settlors get a deed of release from a solicitor
- PET or CLT
- Difficult to value gift

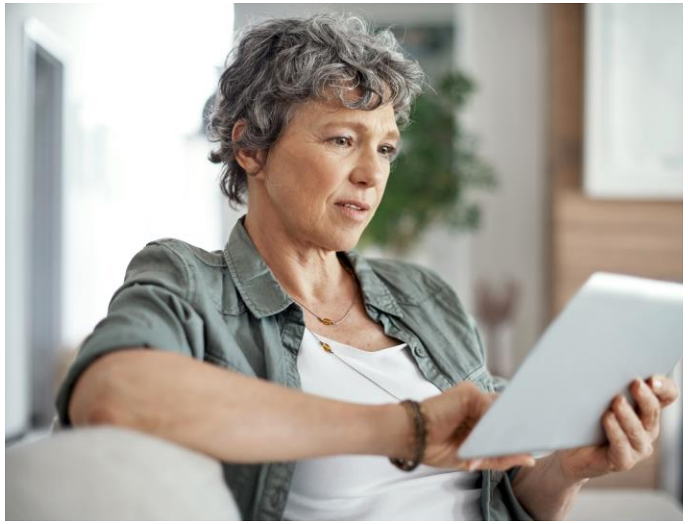
Reversionary Interest Trust

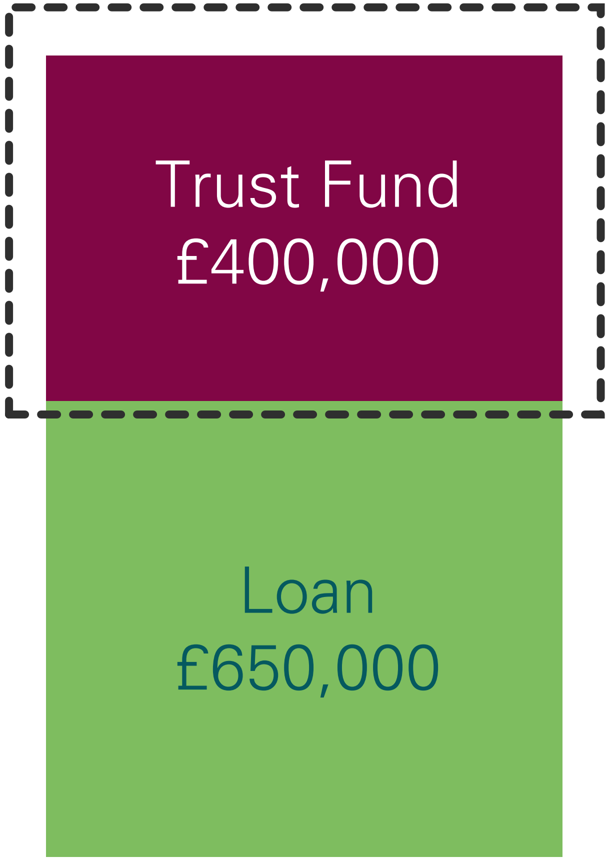
- Trustees defeat/defer reversions
- No gift

Loan Trust

- Waive part of the outstanding loan (PET or CLT)
- Take a loan repayment and make a gift (PET)
- Gift of amount waived/gifted

Waiving the loan during lifetime

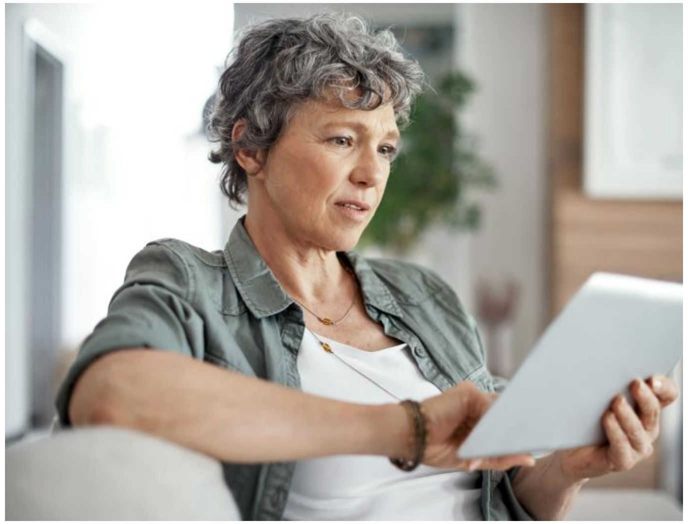




Edith has a loan trust with an outstanding loan of £650,000

She decides to waive £325,000 of the loan

Waiving the loan during lifetime



Trust Fund
£725,000

Loan
£325,000

Loan reduces by £325,000

Waived amount is a gift
“7 year clock”

Trust fund increases
by £325,000

Waiving the loan must be done by deed!

Secondary considerations

IHT impact	Interaction with RNRB	Beneficiary access
Periodic charges	Administration on death	Order of gifting

IHT impact

IHT Impact

Gift Trust

7 year clock
Transfer of value = Full Gift

Discounted Gift Trust

7 year clock
Transfer of value = Discounted Gift

Entry charge where cumulative chargeable lifetime transfers exceed nil rate band over 7 year period

The discount

- Tom is gifting £100,000 and needs £4,000 p.a.
- Underwriters assess life expectancy to be 10 yrs
- Retained Rights – 10 x £4,000 = £40,000
- Discount - £40,000 / £100,000 = 40%
- Transfer of Value (gift) = £60,000

Its not all about the discount!

IHT Impact

Gift Trust

7 year clock
Transfer of value = Full Gift

Discounted Gift Trust

7 year clock
Transfer of value = Discounted Gift

Reversionary Interest Trust

7 year clock
Transfer of value - Full Gift

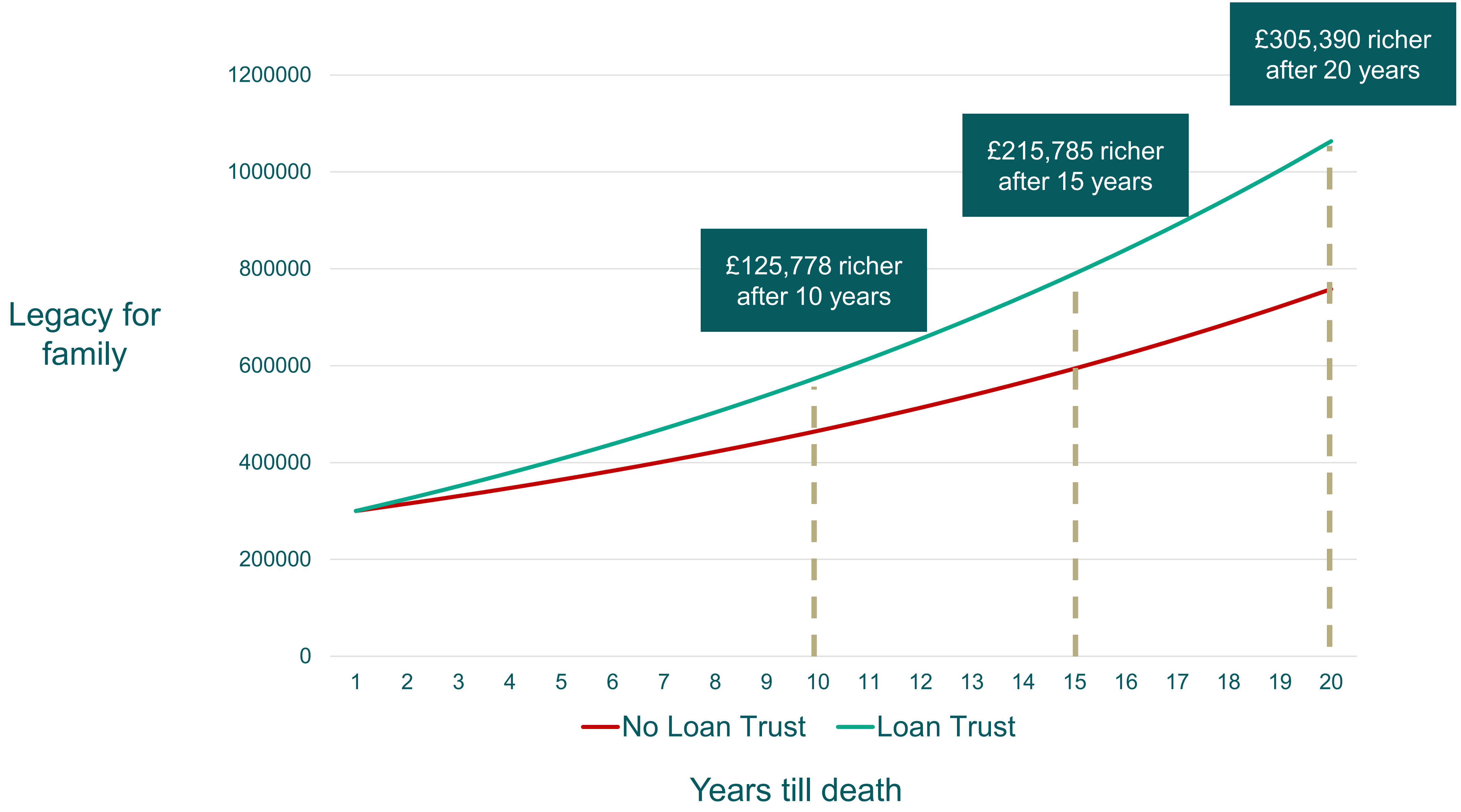
Loan Trust

Full l… s
…estate

Loan trusts never have an entry charge!

Entry charge where cumulative chargeable lifetime transfers exceed nil rate band over 7 year period

Loan Trust - £500,000 (growth 5% p.a.)



Tax efficient ISAs?

Interaction with the RNRB

Interaction with the RNRB

Gift Trust

Full gift out immediately!

Discounted Gift Trust

Full gift out immediately!

Reversionary Interest Trust

Full gift out immediately!

Loan Trust

No reduction in estate for the taper

(unless loan waived/spent)

RNRB taper

Single RNRB being lost	Estate of £2,350,000 = No RNRB	Gift of £350,000 = Full RNRB	Potential saving of £175,000 x 40% = £70,000 Immediately!
Double RNRB being lost	Estate of £2,700,000 = No RNRB	Gift of £700,000 = Full RNRB	Potential saving of £350,000 x 40% = £140,000 Immediately!

20% tax relief on failed gifts (60% relief if successful!)

Beneficiary access

Beneficiary access

Gift Trust

From day 1

Discounted Gift Trust

Emergency distributions during settlor's lifetime

Reversionary Interest Trust

From day 1

Loan Trust

From day 2
(if sufficient growth!)

The "quirky" chargeable event bits

Parental settlements	Discounted gift trusts	Reversionary interest trusts	Loan trusts
Gains exceeding £100 in a tax year assessed on settlor where the beneficiary is their minor child	Segment assignment or encashment reduces settlor's withdrawals Partial reduces TDA	Providers may not allow a partial withdrawal during settlor's lifetime	Normal chargeable event rules apply

P.S. Absolute DGT - Where settlor's withdrawals cause a chargeable event the settlor is liable

Periodic charges

Periodic charges

1	Notional lifetime transfer (A)	A
2	Less NRB available (B)	B
3	Difference (C)	C = A – B
4	Notional IHT (D)	D = C x 20%
5	Effective rate (E)	E = D/A
6	Actual rate (F)	F = E x 3/10

Notional lifetime transfer

Gift Trust

Trust fund

Discounted Gift Trust

Discounted Trust fund

Reversionary Interest Trust

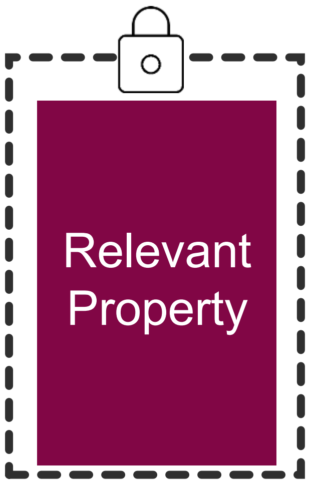
Trust fund

Loan Trust

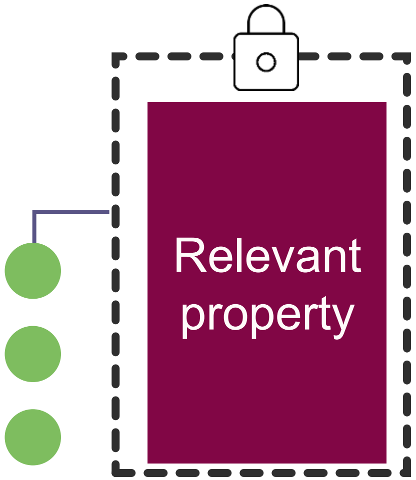
Trust fund less outstanding loan

Periodic charges

Gift Trust

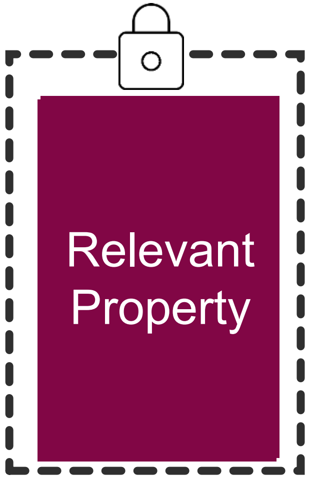


Discounted Gift Trust



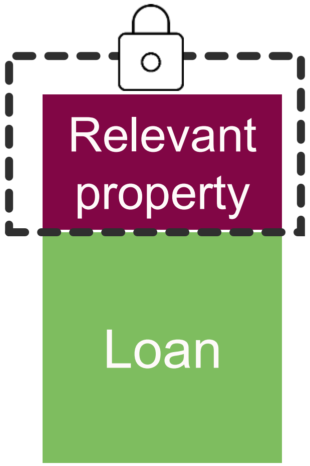
Apply updated discount!

Reversionary Interest Trust



Include reversions!

Loan Trust



Deduct loan!

Periodic charges

1	Notional lifetime transfer (A)	A
2	Less NRB available (B)	B
3	Difference (C)	C = A – B
4	Notional IHT (D)	D = C x 20%
5	Effective rate (E)	E = D/A
6	Actual rate (F)	F = E x 3/10

Nil rate band available

Gift Trust

Capital payments to beneficiaries reduce NRB

Discounted Gift Trust

Capital payments to beneficiaries reduce NRB

Settlor's withdrawals don't!

Reversionary Interest Trust

Capital payments to beneficiaries reduce NRB

Mixed views on reversions…

Loan Trust

Capital payments to beneficiaries reduce NRB

Loan repayments don't!

Administration on death

Administration on death

Gift Trust

Trust continues for the benefit of the beneficiaries as normal

Discounted Gift Trust

Settlor's withdrawals cease
(on 2nd death for joint settlor trust)

Trust continues for the benefit of the beneficiaries as normal

Reversionary Interest Trust

Reversions cease

Trust continues for the benefit of the beneficiaries as normal

Loan Trust

Outstanding loan forms part of the settlor's estate for IHT

(for joint settlor trusts passes to surviving settlor)

Gifts within 7 years of death use up NRB

Loan trusts - Options on death

Repay the loan to the estate

- Encash investments and repay cash to estate
- Chargeable gain implications
- Distributed in accordance with the Will

Estate beneficiaries take over the loan

- Settlor's personal representatives instruct trustees to hold outstanding loan for estate beneficiaries
- Estate beneficiaries can request repayment of loan at any time
- Chargeable gain implications

Waive the loan on death

- Tick box on trust deed at outset or include codicil in the settlor's Will
- Loan forms part of estate for IHT
- Trustees hold for benefit of trust beneficiaries
- Simpler chargeable event management?
- Useful for quick access

Order of gifting

Order of gifting

Absolute Loan trusts – doesn’t matter where they are created

FIRST	SECOND	LAST
Discretionary Loan Trusts	CLTs Discretionary Gift Trust, DGT, FRIT	PETS Outright gifts Absolute Gift Trusts, DGTs

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Any questions?

Thank you