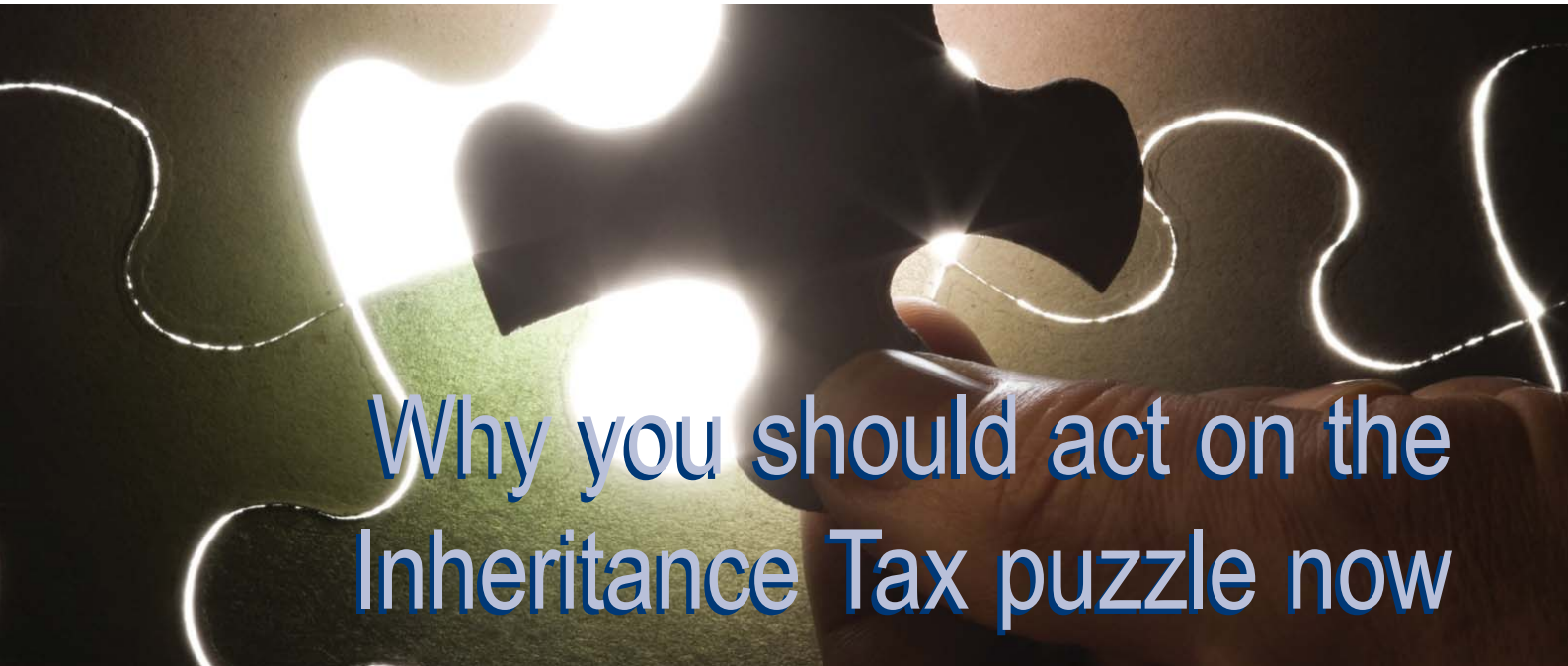


# financialsurgery

Autumn 2006 - Inheritance Tax Guide



## Why you should act on the Inheritance Tax puzzle now

This Supplement is vital reading if you

- 1 Need help understanding the recent changes in Inheritance Tax (IHT) legislation.
- 2 Have a Will that may now need revision, or have no Will in place.
- 3 Have sizeable estates and are concerned as to how IHT will impact on you or your parents.
- 4 Want to learn from real case studies how we help clients tackle IHT and make substantial savings.
- 5 Need guidance on prudent steps to follow to mitigate IHT.
- 6 Would like tips on what we call IHT dos and don'ts.

Use our IHT Calculator on page 8 to work out your likely IHT liability.



Regent

**A**re you finding all the recent Inheritance Tax (IHT) changes a bit of a puzzle? Well this guide has been produced to help you. We consider that there has never been a more important time for you to review your strategy to minimise the impact of IHT legislation. Neither are we certain that our present government will rest at the changes made. Many of the best strategies we use rely on taking advantage of gifts into trusts that are potentially exempt transfers (PETs throughout this guide). We think there is a possibility a future government could look to limit the size of gifts allowable as PETs, or alternatively change the period of years applicable. Presently PETs fall outside of your estate once 7 years has elapsed. Imagine if the period was changed to 10 or 15 years and the amount limited to a lot less than the current Nil Rate Band (NRB)!

We hold strongly to the view it is best to plan now within the new legislation given to us. Future legislation could block off more of the tax saving routes available today, by a Government hungry to create more tax revenue. It would be a pity if for want of early prudent action, sound IHT mitigation schemes available presently (see case studies in this Guide) become closed to you in the future.

To obtain personal advice from us we need to arrange a meeting with you. As the first step towards this either call us or complete and return the brief questionnaire.

We do stress that to get the best from your tax shelter planning you need independent financial advice. Regent IFA Services Ltd is authorised and regulated by the Financial Services Authority to give such advice. Our independence means all recommendations made will be suitable for client needs and can be arranged on either a fee or a commission basis to suit your preference.

We give you the following thought:

*"No man in this country is under the smallest obligation, moral or other, so as to arrange his legal relations of his business or to his property as to enable the Inland Revenue to put the largest shovel into his stores."*

From Lord Clyde in 1929 when hearing a tax case brought by the Commission for the Inland Revenue, this is a tenet that guides our client casework to this very day. This is embodied in the content of this Inheritance Tax Guide.

Important Inheritance Tax information for clients of Regent

# Trusts and Inheritance Tax

## – All Change?

**I**n the 2006 Budget, and subsequent Finance Act passed into law this July, the Chancellor sprung the biggest shock most commentators can recall in terms of attacking trusts as a means of Inheritance Tax (IHT) planning. Whilst the Nil Rate Band has been uplifted to £285,000 (and we know it will become £300,000 in the year 2006/7) the implications are very significant. That said it is important to understand, as we show in our case studies throughout this topical guide, that there remains much we can do to help clients mitigate IHT.

Basically, existing trusts – those created on or before 21 March 2006, whether they were established during the Settlor's lifetime or following his or her death by a Will are broadly unaffected. However, any new trusts – those created on or after 22 March 2006 will be affected by the new legislation.

A large number of our existing clients have in the past made life time gifts, used annual exemptions and small gifts allowances and have transferred significant amounts of capital and assets into a wide variety of trusts. Many would be familiar with the seven-year rule and the term potentially exempt transfer.

In recent years, possibly due to the rapid growth of property values, we have seen many more of our client base taking pro-active steps to mitigate Inheritance Tax.

We have helped clients set up life policies in trust, also used Gift and Loan Trusts, Retained Interest Trusts, Discretionary Trusts and Immediate Discount Trusts.

We also use alternative schemes that qualify for Business Property Relief and so are well placed to provide a client with the widest possible choices. We work closely with the legal profession and believe in providing a holistic approach.

It may be helpful to comment briefly on simple strategies and perhaps answer a few queries that you might have.

## Will Trusts

A number of married people (and those in a Civil Partnership), include a provision in their Will leaving assets of up to the Nil Rate Band (NRB) to a discretionary trust on their death with the balance of their estate to their spouse/partner. Such planning is a very effective way of utilising the NRB on the first death as well as enabling the surviving spouse/partner to have

access to the assets held in trust, if and when required.

Such trusts will, by definition, be post 21 March 2006 trusts, as they do not come into operation until death! However, they will not be directly affected by the change in legislation because they would in any event have been taxed as discretionary trusts under the old rules. So no change there.

But, it is important that the Will does not leave the balance of the estate to a trust that is also caught under the new rules, as otherwise an IHT charge may arise on the first death. To avoid this, people should review their Wills with their legal adviser to ensure that the residue of the estate, which is comprised of amounts over and above the NRB, and any other provisions, is not caught. This will involve either leaving the residue outright to the spouse/partner or to a trust under which the spouse/partner has a fixed life interest with others entitled absolutely after the second death, at age 18.

## The New Rules

So what are the changes and what do they mean?

### Immediate charge

Broadly, the Government is now saying that any gifts to trusts that take the Settlor over his NRB will suffer immediate IHT at 20% on the excess. So, for example, given that the NRB is currently £285,000, a gift of £300,000 would give rise to IHT of £15,000 (£3,000 @ 20%).

### Periodic charge

The trustees of a trust will now be subject to IHT tax every 10 years based on the then value of the trust. The rules are complex, but basically you have to imagine that the trustees made a lifetime gift equal to the value of the trust fund and tax it at 30% of the lifetime rates of IHT, i.e. 6% (30% of 20%).

## Case Study 1 - IHT Mitigation

**The financial problem** – A couple in their late 50s were willing to look at giving away only the growth in value on some of their capital, in favour of the growth monies passing to their children when the survivor of the two of them dies. In the meantime they wanted to be able to have an income from their capital and wanted to be able to have access to the whole of the principal sum if needed. **Our advice involved setting up a trust where the couple made a loan of some of their capital into the trust. They as the settlors set up the trust, appointing the trustees (themselves and two of their children) and naming beneficiaries as their children. During their lifetime they retained full access to their capital and when required in the future this could be repaid to them in annual instalments to provide income.**

Here the trust provisions ensure all subsequent growth on the amount placed in trust does not form part of their estate for IHT purposes. All growth on the capital invested is always therefore exempt from IHT. As an example, let us assume the sum of £100,000 placed in this trust then doubled in value over 15 years. When the survivor of our couple dies, then £100,000 will be exempt from IHT.

**Example:** Terry sets up a trust in January 2007 for £200,000. In January 2017 the trust is worth £500,000. The NRB is then £400,000. IHT on the trust is therefore £100,000 charged at 6%. This produces an IHT charge of £6,000, which equates to 1.2% of the whole value of the trust.

#### Exit charge

If cash (or other assets) is distributed to a beneficiary of the trust, that amount distributed can be subject to an exit charge.

The tax rate that will apply depends on when the distribution is made.

If a distribution is made between 10-year anniversaries, the IHT rate will be that suffered at the last 10-year anniversary. But you get a credit reflecting the period of time since the last 10-year charge.

**Example:** In January 2022 (15 years after it started), £100,000 is paid out of Terry's trust. This is subject to IHT at 1.2% (the rate paid at the last 10 year anniversary) and so the IHT is £1,200. But this can be further reduced by 50% (5/10) because it was 5 years since the trust last paid tax. Consequently, the actual IHT charge would be £600 (£1,200 x 50%).

If a distribution is made in the first 10 years, the IHT rate is that which applied when the trust was established.

**Example:** In January 2016 (9 years after it started) the trustees distributed all of Terry's trust fund – then worth £400,000 – to his daughter. No IHT arises because the rate suffered when the trust was established was zero – the total gift being within Terry's NRB.

So, these are the new rules, but what trusts do they apply to?

## Which Trusts are affected?

As we have already said, these new rules will apply to all trusts created after 21 March 2006.

However, they will also apply to trusts created before 22 March 2006, but only in cases where there is a further payment to the trust and/or the beneficiaries are changed after 5 April 2008.

Life assurance policies that were put in trust before 22 March 2006 benefit from a further concession.

## Case Study 2 - IHT Mitigation

**The financial problem** – A couple in their early 60s realised there would be a large inheritance tax liability on the death of the survivor of them. They had already made full use of Will planning but were not willing to make large gifts of capital to their children. They wanted to remain in control of their capital and the income it generated. They also were looking for a relatively simple and straight forward solution to IHT funding and mitigation. **Our advice allowed this couple to gift just a quarter of 1% of their total assets each year into trust for the children. This worked out at just £1,800 a year payable monthly at £150. This would generate sufficient monies in trust to meet IHT from the date of the first monthly payment into trust. This would be payable upon death of the survivor of the two of them – a sum of £250,000.** The great benefit was that each year the couple retain 99.75% of their assets and the income they generate for themselves.

HMRC (Inland Revenue as was) has confirmed that provided premiums or benefits under regular premium policies are not increased, except within the terms of the original policy provisions after 21 March 2006, the policies will not be affected. So the continuation of the current level of regular premiums under such policies will not mean that these are subject to the new rules. Incidentally, this means the concession also applies to premiums that are due to be increased automatically by indexation!

## What does all this mean if I hold an existing life policy in Trust?

Provided that:

- ▲ in the case of a single premium bond, you may be able to pay further amounts to the trust provided the original terms of the policy allow it, but this has still to be confirmed
- ▲ in the case of a regular premium policy, you do not change the policy other than what is permitted under the policy provisions
- ▲ you do not change the named beneficiaries after 5 April 2008

your policy/trust will be taxed in exactly the same way as before. This means that there will be no IHT payable when benefits are paid to named beneficiaries. Because of the 5 April 2008 “cut off”, it is advisable to review the existing Trust to consider whether there should be a change of beneficiaries before that date.

Other than that, the IHT treatment of all existing policies in trust, for example Discounted Gift Trusts, Loan Trusts and other similar arrangement is unaffected.

If you have taken out an investment bond with a view to leaving it to a trust under your Will to utilise your NRB on death, you would be advised to consult your legal adviser to check that your Will is still tax efficient and doesn't need changing.

It is worth stating that trusts can be just as effective as before, it is just that now you can only put up to £285,000 in them (that is £285,000 each, for husband, wife and civil partners). Also, you have to keep an eye on their value to avoid later IHT charges (although advanced planning action can frequently reduce the problem – for more on this see our second article in this Guide).

## Frequently asked questions

**Q1** Does the new legislation affect me?

**A1** It may well do, if any of the following apply:

- You have made a Will that sets up ongoing trusts; or
- You have set up a trust for family and/or friends (but not charities);

You should read on.

**Q2** What kind of provision is not affected at all?

**A2** In a couple of words, absolute gifts. A simple gift of money in a Will to a child, where the child gets the capital as well as any income on or before his or her 18th birthday, is unaffected. A gift in trust to a surviving spouse/partner, where nothing can interfere with that interest (except with his or her consent, or where the spouse becomes entitled to capital as well as income) is taxed as before.

**Q3** But surely, a gift of a life interest to a spouse/partner is still tax-free?

**A3** No, not necessarily. If the trust is subject to what are commonly called “overriding powers”, it is no longer regarded as belonging to the spouse/partner and is instead treated as property in a discretionary trust. Strangely, the spouse relief is also denied where, on the death of the spouse, the further interests do not pass absolutely at age 18. The other side of the coin is that on the death of the spouse/civil partner, there will be no IHT charge on the fund. Instead there will be a charge every ten years – at up to 6% - and a charge when property is released to a beneficiary. The total tax bill could, in theory, be lower.

**Q4** Discretionary trusts sound expensive to me. Are there extra forms to fill in?

**A4** Yes and no. The IHT regime for discretionary trusts is less well known, even among legal advisers, than the “normal” IHT regime. All trusts involve the completion of annual tax returns, but it is fair to assume that the returns for discretionary trusts will be slightly more complicated – and therefore more expensive – than those for interest in possession trusts. On top of that, the release of money from a discretionary trust triggers completion of form IHT100 for the HMRC. That form must also be completed every ten years.

**Q5** My Will provides a gift of the NRB to my children, with the Residue passing to my husband. There is provision for him to satisfy the gift to the children by an IOU. Must I now remake that Will?

**A5** Probably not, but it will depend on the precise terms. What does the Will provide if your husband fails to survive you? Does the Residue pass to your children? If so, at what age do they get capital? If they get it at 18, and if the gift to your husband is a simple, absolute gift, your Will is probably unaffected.

On the other hand, if there are any “overriding powers” – see Answer 3 – you should revise your Will. Also, if the age at which your children get capital is greater than 18, as the legislation stands, you must reconsider your Will because the spouse/partner exemption for IHT may not be available.

**Q6** Why can't I just leave things as they are? Can't I let my family vary the Will by deed after I'm gone?

**A6** A deed of variation can be very useful, but everyone who is affected has to agree – and children under 18 cannot agree because they are too young to sign. Also, the tax rules are quite strict: a deed of variation does not work for tax purposes if all it does is to remove “overriding powers”.

The deed must actually change the inheritance, i.e. who gets what.

**Q7** But aren't there some transitional rules to help?

**A7** Yes, up to a point. If the trusts can be varied before April 2008, it may be possible to avoid the complex IHT regime for discretionary trusts. However, in some cases there may simply not be power in the trust deed. That may not be a problem if all the beneficiaries are adults (and capable of making a decision); but in some cases it will be necessary to

apply to the Court for approval. Although the case will not normally be contested, it will still cost a good (or bad!) deal in fees.

**Q8** I've heard about “vulnerable” beneficiaries and there seem to be special rules. Is that right?

**A8** Yes. A child under 18 who has lost a parent is treated better under the new rules. There is some provision for a person receiving Attendance Allowance or Disability Living Allowance. However, a young person – such as a student away from home for the first time – is not considered to be vulnerable. There is no proper provision under the new rules for the young person who is inexperienced in money matters.

The only way to protect them from themselves and others now involves significant extra trouble and cost, even if in the end there is no extra tax to pay.

**Q9** When we were younger there was a family “accumulation and maintenance” trust. It was all quite simple and enabled our children to go on school trips etc. that they might otherwise have missed out on. Can we still do that for our grandchildren?

**A9** You can, but it will be taxed like a discretionary trust was in the past. If you have made no previous gifts and you each settle less than the NRB, currently £285,000, and if you make sure that all the money is paid out within 10 years, IHT will not be a problem. If any money is still in the trust after 10 years, you must comply with the IHT regime.

**Q10** So if I've already set up an accumulation and maintenance trust, am I OK?

**A10** Yes and no. If any beneficiary of your trust is already entitled to income – which may be because he or she is over 18 – that person is not prejudiced. Any beneficiary who is not yet entitled to income, and who will not be sure to get capital at 18, comes under the new rules.

**Q11** You mean an older grandchild may be better off, in tax terms, than a younger one?

**A11** Yes. I'm afraid so. It seems unfair but there is nothing in the legislation to help this situation. In a small trust the problem is not acute, but costs and fees will be an issue.

**Q12** Can anything be done to stop all this?

**A12** Maybe. You could write to your MP. It is likely that between one and two million families are affected, and these are ordinary hardworking folk who pay income tax each year. Future legislation could be more precise – targeted, if you like, at those who have significant wealth whilst leaving alone those whose estates consist of, say, a house, a pension fund and some savings. But that is a political issue and this note is intended to be a preliminary guide to what the effect of the new legislation will be, if not changed in the future.

**We ask readers to note that these comments are intended only as general guidance. All references to “partner” mean a “Civil Partner” only. For personal advice please call us or complete and return the brief IHT mitigation questionnaire.**

# Inheritance Tax Dos and Don'ts

**A**fter much debate some consensus has emerged on how best to deal with the Chancellor's new legislation on trusts. Here is a set of rules with regard to dealing with pre 22 March 2006 trusts and new trusts – both bare and non-bare trusts - set up on or after that date. Again these are produced here for general guidance only and no action should be taken on what is to follow without first seeking individual help and guidance from one of our advisers.

## Rule 1

**As a general rule, don't put any new money into a pre 22 March 2006 trust**

This is a very general rule as there are special rules as regards life assurance policies held under a pre 22 March 2006 trust.

Where life assurance policies are held in a pre 22 March 2006 trust, further money paid into the trust through the original terms of the policy, or increases as a result of the exercise of an option or a compulsion written into the policy provisions, will leave the trust still treated as one established prior to 22 March 2006.

New money paid into any other type of pre 22 March 2006 trust could result in the new rules applying to the existing trust.

## Rule 2

**Think very carefully about changing the interest in possession beneficiary in a pre 22 March 2006 trust after 5 April 2008**

Changing the interest in possession beneficiary in a pre 22 March 2006 trust after 5 April 2008 will generally bring the trust under the new rules – unless the change is to make the trust a bare one. However, a modification to the original provisions means that if the change is merely triggered by the death of the interest in possession beneficiary, the new rules are not invoked.

If the new rules come into play through a change in the interest in possession beneficiaries then:

- ▲ That is treated as a chargeable transfer at that time from the previous interest in possession beneficiaries.
- ▲ The chargeable transfer will be treated as a gift with reservation (this will be the case, even if the change is made before 6 April 2008).
- ▲ Periodic and exit charges will be levied in the future.

The start date of the trust as regards the periodic charges will be the start date of the trust – not the date of any change.

### Example

A flexible trust was established on 1 Jan 2000. The value of the trust assets is £500,000. Anne and Brian are the 2 x 50% interest in possession beneficiaries. The trustees promote Catriona from a possible to an interest in possession beneficiary in place of Anne and Brian after 5 April 2008. At that time, both Anne and Brian will be deemed to have made a chargeable transfer of, say, £250,000, which will be regarded as a gift with reservation, and there will be potential periodic charges on 1 January 2010, 2020 etc.

*If the change in interest in possession beneficiary comes about as a result of the death of an interest in possession beneficiary, the deceased's estate will include his/her share of the trust assets when calculating any IHT liability. The trust itself will continue under the old rules.*

### Example

*David is the interest in possession beneficiary in a pre 22 March 2006 trust. He dies and Eleanor now has the interest in possession. At the time of death, the trust assets are valued at £300,000. £300,000 will be included in David's estate in calculating his IHT liability on death but the trust will remain under the old rules. The trust assets will now be regarded as being in Eleanor's estate.*

*If the change in interest in possession occurs as a result of an absolute appointment of trust assets to one or more beneficiaries, then a PET may be deemed to occur if the absolute appointment does not reflect the exact interest of each beneficiary.*

## Case Study 3 - IHT Mitigation

**The financial problem** – Yet another couple, this time in their early 70's, had significant means but felt unable to give away to their children a significant capital sum unless they could retain a lifetime right to the income it generated. They needed the income to be sure of maintaining their standard of living and to provide for future care needs if necessary. **Here our advice meant setting up for this couple yet another type of trust. With this type of trust they again make a gift of capital to trustees. As before the trustees then invest the money for the beneficiaries. During their lifetime they retain a right to income that will be paid annually with the level of income fixed at 5% at inception. The gift of capital is a potentially exempt transfer (PET). If they survive for 7 years after making the gift, the transfer will fall out of their estate for IHT purposes. The value of the PET will be less than the amount gifted into the trust. This is because the PET is calculated as the amount they gifted into the trust less the value of what they retained (their right to annual payments for their lifetime).** The actual value after allowing for the above is governed by their age, sex and the income taken as annual payments to them. The discount on the gift made is likely to be around 22% so from that, on say a total sum of £100,000, only £78,000 counts as a PET that will fall out of the estate once 7 years has elapsed. In effect, £22,000 is removed from counting for IHT from their estate from the date the gift is made to the trustees and invested for the beneficiaries. So here they gift all the money away and have no right of access to the capital. They do however have a right to income for their lifetimes. As an example, let us assume they placed £100,000 in this trust and it increased in value over 20 years to £150,000, when the last of our couple dies, then £150,000 will be exempt from IHT. In the meantime they might have enjoyed up to £5,000 a year tax deferred income.

## Case Study 4 - IHT Mitigation

**The financial problem** – A widow aged 80 has a sizeable estate and IHT in excess of £100,000 would be payable upon her death. She was not confident of living for another 7 years. Gifting capital was not likely to be a solution as the sums will be likely to count as being part of the estate if she died within 7 years. **For this widow we adopted a solution we have been using for clients since 2003. We placed some of her capital in an AIM share portfolio in March of 2003. £100,000 was invested with IHT mitigation in mind. Once these particular shares have been held in her name for 2 years they become exempt from IHT. At the time of writing this the value of her portfolio after all charges has increased to a good deal more than £200,000.** Currently, our client is very happy with the way matters are progressing. That said, both she and her two sons accepted that the shares could fall as well as rise in value and are higher risk investments. All were involved from the conception of our ideas to mitigate tax and all agreed to the strategy to be adopted.

### Example

*£500,000 is held in a pre 22 March 2006 trust where the two interest in possession beneficiaries are Frances and Gerald. The trustees bring the trust to an end but use the flexibility in the trust to distribute £100,000 to each of Frances, Gerald, Harry, Iain and Mary. Frances and Gerald will each be deemed to have made a PET of £150,000 – although they may have exemptions available to reduce that figure to £147,000 or even £144,000.*

## Rule 3

### Never do related non-bare trusts

As a general rule, each trust is looked at separately as regards periodic charges. However, related property is also taken into account. Related property is the property in a related trust just after it was established. A related trust is one established by the same settlor on the same day. Inclusion of both the relevant property in the trust you are dealing with and related property can increase the probability of a periodic charge arising. Don't risk it as a general rule. No two trusts should therefore be established on the same day by the same settlor.

## Rule 4

### Consider small non-bare trusts

Consider the scenario of where a chargeable transfer of £250,000 is made into a post 22 March 2006 trust. The transferor has not made previous chargeable transfers in the last 7 years so there will be no immediate lifetime charge to IHT.

However, the chances of the trust funds growing to more than the trust's Nil Rate Band (NRB) at the ten, twenty etc. anniversaries must be fairly high – if you have received good investment advice and funds selected show good performance.

Consider an alternative scenario where a chargeable transfer of £50,000 is made into a trust.

The chances of this investment growing to more than the trust's nil rate band at the ten, twenty etc. anniversaries must be less than if £250,000 had gone into the trust. The question is, therefore, would you be better to do 5 trusts (unrelated!!) of £50,000 each or just 1 trust for £250,000? Here we need to bear in mind that a trust's NRB is reduced by any chargeable transfers made in the 7 years prior to setting up a trust, so each subsequent trust will have a reduced NRB but, overall, the position will be improved.

### Example

*Trust A established with £250,000. No previous chargeable transfers were made in the 7 years prior to setting up the trust.*

*At the ten year anniversary, the trust will have a nil rate band of, say, £400,000 and a periodic charge will be levied at a rate of 6% x (value of trust assets less the nil rate band).*

*Instead of 1 trust of £250,000, the settlor establishes 5 (unrelated) trusts of £50,000 each.*

*Trust B at the ten-year anniversary will have the full NRB (£400,000) available.*

*Trust C at the ten-year anniversary will have an NRB of (£400,000 less £50,000 = £350,000) available.*

*Trust D at the ten-year anniversary will have an NRB of (£400,000 less £100,000 = £300,000) available.*

*Trust E at the ten-year anniversary will have an NRB of (£400,000 less £150,000 = £250,000) available.*

*Trust F at the ten-year anniversary will have an NRB of (£400,000 less £200,000 = £200,000) available.*

*Although the NRB of each subsequent trust is reduced by chargeable transfers made in the previous 7 years, overall the 5 trusts have much greater NRBs available and, therefore, it is much less likely that a periodic charge will occur.*

The downside here is that setting up several (unrelated) trusts can be more of a pain from an administration point of view. We would work to seek to ensure allocation percentages on a series of investment bond vehicles, that in general may not be as good for the individually smaller sums on investment, are not materially unattractive compared to that on offer for one single large transaction.

## Rule 5

### Order matters

If you are looking to set up more than one (unrelated) trust, you need to always consider the order you do them in.

This is probably best illustrated by an example. In this example, let's assume that the full NRB at the ten-year anniversary is £400,000.

### Example

*An individual sets up a Discounted Gift Trust (DGT) with a chargeable transfer of £250,000. (This may involve an investment of substantially more than £250,000 as the chargeable transfer is the discounted figure.) There were no previous chargeable transfers made in the previous 7 years so there would have been no lifetime IHT payable.*

*At the ten-year anniversary, this trust will have the full NRB of, say, £400,000 available.*

*A couple of weeks later (so the trusts are not related), this same individual sets up a Loan Trust with a loan of £300,000. A loan is not a chargeable transfer so no lifetime IHT will be payable – and no IHT100 or IHT100a to complete for the HMRC!*

*At the ten-year anniversary, the NRB available in this trust is only £150,000 – the normal NRB is reduced by the chargeable transfer of £250,000 made in the 7 years prior to setting up this trust.*

*Suppose the person had done these trusts the other way round.*

An individual sets up a Loan Trust with a loan of £300,000. There were no previous chargeable transfers made in the previous 7 years. At the ten year anniversary, the NRB available in this trust is the full nil rate band of £400,000.

A couple of weeks later (so the trusts are not related), this same individual sets up a Discounted Gift Trust (DGT) with a chargeable transfer of £250,000. At the ten-year anniversary, this trust will have the full NRB of £400,000 available, as there were no previous chargeable transfers made in the previous 7 years.

This way round, both trusts have a full NRB. The other way round, the Loan Trust has a restricted Nil Rate Band.

So you see, order matters!

## Rule 6

### A bad time to die

There is probably never a good time to die – although it will come to us all eventually. There are, however, bad times for an individual to die if he/she has a life assurance policy under trust. A bad time to die is immediately before a ten-year anniversary of a non-bare trust holding a protection policy. Chances are that the value of the trust fund at the anniversary will be substantial and could result in the possibility of a periodic charge. Remember, however, that an actual charge may not arise as the value of the property in the trust may be less than the trust's NRB.

## Rule 7

### Spousal By-Pass is not dead – just not as nice as before

As a general rule, the value of a protection policy is minimal if the client is still alive and in reasonable health – although here we have to be careful, as there is a market for policies where the life assured is in ill health.

If a policy held under a trust pays out, it does so to the trustees who are the legal owners of the trust property. They are the ones who then decide (within the overall terms of the trust) who will receive the money and when. If held under a discretionary or flexible trust, it may be that this decision can be made at any time during the perpetuity period of the trust, which

can be up to 80 years from outset – although in most cases the money would be paid out long before the end of that period. If the payout is made before the next ten-year anniversary of the trust, the rate of exit charge will generally be determined by the rate of periodic charge at the previous 10-year anniversary. This rate will generally be 0% in the case of most protection policies. The temptation is to pay the proceeds out to beneficiaries with a 0% exit charge.

Remember, however, that any payout serves to increase the estate of the recipient. This has issues where that recipient already has an IHT problem – such as an adult 'child' or the surviving spouse. If not careful this could mean ultimately 40% IHT could be suffered when the adult 'child' or surviving spouse dies. The alternative to a payout is a loan – where the terms of the trust allow one. This loan does not increase the recipient's estate but is repayable, although at the same time it does obviously give him/her access to funds. The downside, however, is that assets remain in the trust and could incur a periodic charge at the next ten-year anniversary and a later exit charge. Remember, however, that the worst that can happen is a periodic charge of 6% (and a later exit charge) although, in practice, the rate would probably be less than this because of the trust's NRB.

#### Example

Term assurance with sum assured £500,000 is held in a discretionary trust which includes the spouse and children as possible beneficiaries, has an 80 year perpetuity period and the trustees have the power to make loans to beneficiaries.

The life assured dies after 13 years and the trustees receive a payout of £500,000. The periodic charge at the ten-year anniversary was 0% as the trust assets were deemed to be of negligible value at that time.

#### Scenario 1

Trustees pay £500,000 out to surviving spouse, increasing her estate by £500,000 and potentially increasing the IHT liability on her death by £200,000 (40% of £500,000). However, the exit charge will be 0% on the payment out of the trust.

#### Scenario 2

Trustees lend surviving spouse, say, £200,000, backed up by a properly documented loan agreement. This does not increase the surviving spouse's estate but gives her access to funds. Further funds could be borrowed if necessary in the future.

There is no exit charge on this payment as it is not a capital distribution – it is a loan. The downside is that the trust assets are still £500,000 (£300,000 cash which could be invested and an IOU from the spouse of £200,000). A periodic charge will occur at the next ten-year anniversary of 6% x (value of trust assets less the trust's nil rate band). In practice, this will probably be much less than 6%. And of course a later exit charge.

Overall, scenario 2 will probably mean a better tax position, although the needs of the recipient will always be paramount, so the most tax efficient scenario might not be the one chosen. However, it should always be considered.

## Rule 8

### Consider bare trusts but be careful

Gifts to bare trusts are still potentially exempt transfers (PETs). The new rules as regards trusts do not affect these types of arrangements. It is perhaps very tempting, therefore, to set up these types of arrangements rather than more complicated trusts.

However, the two major problems with bare trusts are:

▲ The beneficiaries of these trusts must be specified at the outset. For example, a trust for the benefit in equal shares of my grandchildren whenever born is not a bare trust, as the exact beneficiaries are not known.

If a grandparent sets up a bare trust for known grandchildren now, morally the same provision would have to be made for any future grandchildren.

▲ Once a beneficiary attains the age of majority (16 in Scotland and 18 elsewhere), he/she can demand his/her share of the trust assets. This is very dangerous, as none of us can tell if beneficiaries will be competent to look after substantial amounts of capital at such an early age.

**These then are some general suggestions as regards trusts. There are indeed no hard and fast rules. But in our view one thing the new legislation has done is to make taking advice from an independent financial adviser crucial with regard to tax planning. We always consider trusts for protection policies and continue to minimise our client's potential tax bills using trusts and other avenues to IHT mitigation as our case studies show.**



# Protect your nest egg from Inheritance Tax

To get the best from your tax shelter planning you need independent financial advice. Regent IFA Services Ltd is authorised and regulated by the Financial Services Authority to give such advice. Our independence means all recommendations made will be suitable for client needs and can be arranged on either a fee or a commission basis to suit your preference.

Remember what we quoted from Lord Clyde on the opening page of our Guide:

*“No man in this country is under the smallest obligation, moral or other, so as to arrange his legal relations of his business or to his property as to enable the Inland Revenue to put the largest shovel into his stores.”*

**With our help many clients have legitimately sidestepped the impact of Inheritance Tax. Why not join them? As the first step towards obtaining personal advice call us, or complete and return the brief questionnaire.**

## Quick IHT calculator

Are you at risk from Inheritance Tax? Here is a quick aid to working it out for yourself.

Value of your home		£
Value of other property (holiday homes, other property)	+	£
Contents of your home	+	£
Bank/building society deposits	+	£
Other investments (bonds, ISAs, unit trusts, shares)	+	£
<b>Total Assets</b>	<b>=</b>	£
Reduce by Nil Rate Band *	-	£ 285,000
<b>Estimated Net Estate Size</b>	<b>=</b>	£
<b>IHT at 40% gives a total tax bill of</b>	<b>=</b>	£

\*If you are a couple and in your Wills you each leave a Nil Rate Band to your beneficiaries, then reduce total assets by £570,000 (two times £285,000). The NRB in the year 2006/2007 will be £300,000.

**If the likely IHT is significant, do revisit each of the case studies in our Guide. You will see with our help many clients mitigate likely IHT bills. We can help you too upon request.**

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The comments and case studies in this Supplement do not constitute individual financial advice to readers. Readers should ask for personal advice before acting on any of the comments or case studies shown. We are happy to provide such advice.

## Acknowledgement

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# Inheritance Tax Enquiry Form



Do not  
give 40% to  
the Taxman!

With our help IHT  
can be mitigated

**I have received your Inheritance Tax Guide and I would like advice on  
how to mitigate inheritance tax for me and my family**

Name (Dr, Mr, Mrs, Ms)

Address

Postcode

Date of Birth

Telephone number (Daytime)

Telephone number (Evening)

Approximate value of estate  
(Use IHT Calculator for this)

£

**Please return by post to:**

IHT Mitigation Centre, Regent IFA Services,  
FREEPOST, One College Hill, London, EC4B 4HQ  
(No postage stamp is needed if you use our freepost address).

**Or by faxing this form to:** 0845 8800 228 (local call rate applies)

**Or telephone any of our numbers listed on page 8 of our Guide**

# Important facts about Inheritance Tax and recent changes in legislation

The number of properties valued above the inheritance tax threshold will triple to 4.2 million by 2020.

*(Source: Halifax)*

**More and more families are moving into the IHT net.**

*(Sunday Times  
27th August 2006)*

**61% of those with estates exceeding the new IHT threshold have not looked into ways of reducing the tax charge.**

Sharply rising house prices have tripled the number of homes which are now worth more than the IHT threshold. IHT is no longer an exclusive tax of the rich.

*(Alliance & Leicester August 2006)*

**Rise in IHT threshold (to £285,000) still not nearly enough to compensate for the soaring property prices of recent years.**

When Labour came to power in 1997, the inheritance tax threshold stood at £200,000. Today, it is £285,000, an increase of 42.5%. But over the same period, house prices have risen on average by 140%. Millions more households are now caught in the IHT net.

*(The Mail on Sunday 10th September 2006)*

**Accountants Grant Thornton estimates as many as 15% of estates will pay IHT by the end of the decade.**

**Do not be one of the 61% as above. Ask us to help you consider your options to mitigate and avoid IHT. Your first step to this is to call us, or post or fax the enquiry form as overleaf back to us**

**Please call us on 0845 8800 227 or fax us on 0845 8800 228**