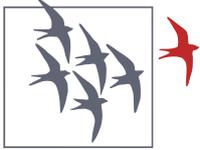


*WAY Investment Services*



# WAY Flexible Inheritor Plan

*Adviser guide - Technical and Tax Questions and Answers*



*WAY Investment Services*

# WAY Flexible Inheritor Plan

## *Adviser Guide*

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#### **Please note**

This guide must be read in conjunction with the Flexible Inheritor Plan brochure and the appropriate literature dealing with the investments to be held within the Trust.

The Flexible Inheritor Plan is a trust-based investment. WAY Investment Services (WAY) only accepts applications for the Plan introduced by financial advisers, who are regulated by the FCA (Financial Conduct Authority). WAY cannot give financial advice. Investors must therefore rely on the recommendations of their financial adviser on whether such an arrangement is appropriate for their individual circumstances.

Throughout this guide, it is assumed that the settlor, trustees and beneficiaries are all domiciled and resident in the UK for tax purposes. It further assumes that the underlying investments of the Trust consist solely of UK authorised unit trusts and OEICs.

The information contained in this guide is based on WAY's understanding of current law and HM Revenue & Customs (HMRC) practice, which can change at any time.

Any investments held within the trusts that WAY provides are regulated by the Financial Conduct Authority however our range of trusts and associated services are not.

# The WAY Flexible Inheritor Plan

## Technical Questions and Answers

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### Introduction

#### What is the Flexible Inheritor Plan?

The Plan is a collectives-based lump sum inheritance tax (IHT) mitigation arrangement. It allows the investor (the settlor) to make an effective gift (a chargeable lifetime transfer) into a family trust (the Flexible Inheritor Trust) for the benefit of their beneficiaries whilst retaining potential access to capital payments (reversions) for his/her own personal use each year, without infringing the gift with reservation and POAT provisions.

There are two versions of the investment advisory Plan - 'traditional' and 'managed portfolio' (please refer to 'Investment Options'). Both Plans are set up and administered on our Plato Nominee & Investment Administration Service.

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#### What is the Plato Nominee & Investment Administration Service?

Plato is a nominee service which means that the units or shares in the selected investment funds are registered and held by Plato nominees on behalf of the trustees. The nominee consolidates all holdings into a single account so that the account holder does not have to open their own account with each investment fund company individually.

Plato also provides an online service that allows valuations of the Inheritor Plan assets to be viewed daily by the settlor, trustees and/or their financial adviser.

Although Plato registers the units/shares as the legal owner, the control over the holdings remains in the hands of the trustees\*, and the beneficial ownership remains with the beneficiary(ies) subject to the terms of the trust and the trustees' discretion.

*\*or the settlor/beneficiaries as from time to time is appropriate.*

Plato is a trading name of Platform One Limited, a company registered in England No 06993268, whose registered address is: Peartree Business Centre, Cobham Road, Wimborne BH21 7PT.

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#### Who may the Flexible Inheritor Plan be suitable for?

The Plan may be appropriate for an individual who is in good health and wishes to reduce their potential IHT liability during their lifetime but requires a flexible solution that can deal with changes in their own personal circumstances and those of their family in the future.

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#### Who is the Plan not suitable for?

The Plan is not considered appropriate if the investor is in poor health, would need an immediate 'income' from their gifted capital, requires an instant reduction in their IHT liability or wishes to have unrestricted access to the original sum invested.

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#### What are the minimum and maximum investments allowed?

The minimum lump sum investment is £50,000. There is no maximum, although the balance of any gift above the settlor's available NRB (and, if applicable, Annual Gift Exemptions) would be subject to an entry tax charge.

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#### Can the investment sum be paid electronically?

Yes. Payment can be made by cheque or electronic transfer (BACs, Faster Payments or CHAPS). However, before this can happen, WAY must be in receipt of properly completed Plan set up documentation, including identity verification forms for the settlor and all trustees. WAY will then provide instructions to the adviser so the electronic transfer can proceed.

### Settlor

#### Who can be a settlor?

The investor must be aged 18 or over, of legally sound mind and domiciled/resident in the UK for tax purposes. There is no upper age limit.

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#### Can a husband and wife or registered civil partners set up a joint Plan?

No. The Plan can only be created by an individual settlor.

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#### Can each spouse or civil partner set up their own Plan?

Yes. Married couples and registered civil partners can each establish their own Plan without it being a gift with reservation because the settlor's spouse/civil partner is excluded as a beneficiary under the Trust during the settlor's lifetime.

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#### Can the settlor's spouse/civil partner be added to a deceased settlor's Plan?

Yes. When the settlor dies, the trustees have discretion to add the widow(er)/surviving civil partner to the list of beneficiaries, who can potentially benefit from the trust capital (ie the Appointed Class).

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## Investments – General

### Why is a cash gift not allowed?

By necessity, the gift to the Trust must be represented by units/shares in collectives as it is not possible for the settlor to 'carve out' annual reversions in a cash sum (see 'Reversions'). Accordingly, the settlor must own the investments before setting up the Trust. Only income units or shares may be purchased.

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### Why can only income units be held?

Since this is an interest in possession trust, income belongs to specified beneficiaries and must be kept separate from trust capital. Accumulation units would result in any distributable income being capitalised immediately.

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### When will the investments be transferred into the Trust?

This will occur as soon as the settlor's cancellation rights have expired. In the meantime, the holdings will remain an asset of the settlor's estate.

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### What are the advantages of investing in collectives?

In many instances, a potentially higher net investment return can be obtained if realised gains are taxable under capital gains tax (CGT), rather than income tax. Collectives allow the trustees to use their annual CGT exemption. They can also permit valuable CGT hold-over relief to be claimed when trust investments are transferred to a beneficiary, who can then make use of their full annual CGT exemption to offset against the gain when they are eventually sold.

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### Are there any key considerations when formulating an investment strategy?

The Plan was originally designed with capital growth as the main objective, primarily for reasons of tax efficiency and the potential for enhancing investment returns for the beneficiaries. The adviser has an important role in balancing the wishes of the settlor and the interests of the beneficiaries. For example, the investment strategy and risk that the settlor may take with their own money may not coincide with that generally expected of trustees. Trustees are duty bound to always act in the best interests of the beneficiaries and will often be more cautious and long term in their approach towards investment. Diversification will also probably be an important factor for minimising risk and achieving long term goals. Furthermore, the existence of reversionary interests means that the Trust is settlor-interested for income tax purposes (please refer to the Tax Q&A section in this guide), and the settlor will be subject to tax on all trust income. This factor may also suggest that a bias towards capital growth is more preferable.

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## Investment options

### *'Traditional' Plan*

#### Do investment restrictions apply when setting up the 'traditional' Plan?

Yes. The settlor must use the investment sum to purchase one or more of the following WAY-branded unit trusts and OEICs:

#### **Unit trusts**

WAY Global Balanced Portfolio Fund  
WAY Flexible Global Growth Portfolio Fund

#### **OEICs**

WAY Global Cautious Portfolio Fund  
WAY MA Cautious Portfolio Fund  
WAY Global Growth Portfolio Fund

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#### What are the main benefits of the WAY-branded funds?

The funds available are risk-graded funds of funds and multi-asset funds that have been designed specifically for holding within the Trust. They are run by the external fund managers and are generally managed with the objective of capital growth, which is likely to result in there being no net investment income generated. Being geared towards growth, use of the annual CGT exemption can be maximised.

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### *'Managed portfolio' Plan*

#### Do investment restrictions apply when setting up the 'managed portfolio' Plan?

Yes.

- The investment choice offers access to a wide range of unit trusts and OEICs that are either currently available or acceptable for investment using the Plato Nominee & Investment Administration Service or any other investment platform.
  - Only income units/shares are permissible.
-

## Charges

### **How will WAY's charges for setting up the Plan and providing ongoing support be paid for?**

See separate fee schedule for the **WAY Gifts from Income Inheritor Plan**.  
All charges will be deducted from the cash account.

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### **Can payment of the initial adviser charge be facilitated on instruction from the settlor?**

Yes. This can be deducted from the total amount received from the settlor and paid direct to the adviser.

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### **Who is responsible for paying any ongoing adviser charges?**

The trustees are accountable for any advice or support given to them in respect of the Trust. Such fees will be subject to their prior agreement and will be paid out of the trust fund. The trustees must not pay for any advice provided to the settlor.

The trustees will pay these from their cash account.

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### **How will the fees charged by professional trustees or a trust company be paid for?**

These will be paid from the trustees' cash account.

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## The Flexible Inheritor Trust

### **What type of trust is used?**

The Plan uses a flexible reversionary interest in possession trust which gives the trustees significant discretionary powers that allow its assets to easily pass down the family generations. The trust fund is held for the beneficiaries but reversionary interests carved out by the settlor at outset enable him/her to have potential access to capital payments on survival to stated due dates.

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### **How are the settlor's reversionary interests created?**

Under the Trust, the settlor retains the right to a series of annual capital reversions if alive on the due dates. When completing the trust deed, the settlor will specify the initial size of each reversion ('a Relevant Share') and the trust anniversary date when it becomes payable ('the Relevant Date') in Part Two of the First Schedule. These reversions are held absolutely (ie in a bare trust) for the settlor and will cease on his/her death ('the Relevant Event'). However, they are not automatically passed to the settlor as they can be defeated or deferred by the trustees, an important ingredient of the Plan. This aspect is covered further in 'Reversions'.

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### **Does the settlor have any other access to the trust fund?**

No. Apart from the reversions, the settlor is specifically excluded from benefiting under the Trust.

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### **Do any beneficiaries have to be named in the trust deed?**

Yes. The settlor must name the 'interest in possession' beneficiaries individually at outset and also specify their respective shares of the trust income. Since this is a family trust, the settlor will usually name their children or, if a generation is to be skipped, their grandchildren as the beneficiaries. The settlor's choice of income beneficiary will, in turn, also determine who will automatically feature amongst the beneficiaries who can benefit from the trust capital at the discretion of the trustees.

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### **What rights do the 'interest in possession' beneficiaries have?**

These beneficiaries (and their successors) are legally entitled to any trust income arising to the trustees in the shares stipulated. However, in arriving at any amount payable to the beneficiaries, the trustees may first deduct any trust management expenses. In the unlikely event that part of the trust fund remains undistributed at the end of the 125 year trust period, this would pass to the interest in possession beneficiaries living at that time.

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### **Can the 'interest in possession' beneficiaries be changed by the trustees?**

No. The trustees cannot alter the beneficiaries (or their successors) or vary their share of the trust income.

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### **What happens if an 'interest in possession' beneficiary dies?**

The deceased's right to income will pass to his/her living children in equal shares or further down the bloodline, per stirpes. If there are no descendants alive, the deceased's share will accrue proportionately to the surviving 'interest in possession' beneficiaries.

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### **Who will be entitled to the trust capital?**

The trustees have the power to appoint capital to a wide range of potential beneficiaries (known as the Appointed Class). The trustees have full control over who will benefit from the trust capital, how much and when.

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### **Who is included within the Appointed Class?**

The list of beneficiaries, who can potentially benefit from the trust capital, includes the 'interest in possession' beneficiaries and their descendants (ie children, grandchildren, great grandchildren, etc) together with their respective spouses/civil partners, plus any person the settlor specifically included when creating the Trust. Once the Trust has been set up, the trustees can add further beneficiaries to the Appointed Class by completing a deed (available from WAY).

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### **Can the trustees distribute capital to the beneficiaries whilst the settlor is alive?**

Yes. The trustees have discretion to make payments of capital or loans to anybody in the Appointed Class at any time. Whenever the trustees wish to distribute capital, they should consider which is the most tax efficient route so that the benefits for the beneficiary can be maximised (eg by the use of CGT holdover relief).

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### **Will capital distributions or loans made to beneficiaries impact on future reversions?**

Yes. Any appointment of capital will permanently reduce the amount of capital that can potentially pass back to the settlor by way of reversions (ie the reversions are defeasible). In the case of a loan, the total amount available via reversions will be affected whilst the loan remains outstanding.

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### **How should the settlor inform the trustees of their wishes?**

Although not legally binding on the trustees, the settlor should regularly keep the trustees informed of how he/she would like them to use their discretionary powers by writing them a letter of wishes and then updating this as and when required.

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### **Which law governs the Trust?**

English law applies.

## **Appointing trustees**

### **Who shall I appoint as trustees?**

Some important points

- The default trustees for the WAY Flexible Inheritor Plan are WAY Tax and Trustee Advisory Services Limited, which firm is staffed by senior tax and trustee professionals who act in a conscientious and impartial manner for the settlor and his/her beneficiaries.
  - Alternatively, the settlor must appoint a minimum of two individual trustees or a trust company. If a trustee is also a beneficiary, one of the trustees must be independent and cannot benefit from the Trust.
  - Trustees must be adults, have the legal capacity to act and should be resident in the UK. They should be responsible individuals. In normal circumstances, members of the settlor's family or his/her close friends will often be suitable people, as may be the settlor's solicitor or accountant. If the settlor wants to appoint somebody who lives outside the UK as a trustee, he/she is recommended to obtain professional advice before doing so.
  - Neither the settlor nor his/her Spouse/registered civil partner can act as a trustee.
  - If the settlor wishes to appoint a trust company or other professional trustee, he/she should bear in mind that any fees they charge will be payable out of the trust fund.
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### **Where can I find details relating to WAY Tax and Trustee Advisory Services Ltd?**

In the first instance, please contact your WAY Regional Sales Manager.

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### **Can a beneficiary under the Trust also be a trustee?**

Yes. However, in this scenario, the Trust includes a provision that an independent trustee (ie someone who cannot benefit directly or indirectly from the Trust) must be appointed as well.

### **What if one of the trustees dies or wishes to retire?**

In either situation, a replacement trustee must be appointed. The settlor has the power to appoint new and additional trustees whilst alive and of legally sound mind. Thereafter the power vests in the trustees. The appropriate deeds can be obtained from WAY.

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### **Can a trustee be removed?**

The Trust does not contain a specific power to dismiss a trustee. Unless the trustee agrees to retire, legal advice will be essential. A court has the power to remove a trustee in certain circumstances.

## **Responsibilities of the trustees**

### **What is the main duty of the trustees?**

Once the Trust is established, the trustees take over the legal ownership of the investments from the settlor. Their prime role is to administer the trust fund in the best interest of the beneficiaries and in accordance with the terms of the Trust. They must be seen to always exercise their duties seriously, impartially and reach decisions unanimously. Where appropriate, they must obtain professional advice. They should keep full records of their decisions and actions.

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### **What other responsibilities do the trustees have?**

These will include:

- Considering, from time to time, whether to exercise their discretionary powers to appoint or lend trust capital to beneficiaries, including minimising any tax implications wherever possible.
- Deciding whether to postpone a forthcoming reversion in part or in full to a future anniversary date and completing/returning the necessary paperwork relating to WAY before the due date.
- Reviewing the performance of the trust investments each year with their investment adviser.
- Dealing with the tax affairs of the Trust and meeting any Trust registration and tax obligations to HMRC.

The receipt of trust income will entail additional duties to those above, including:

- Operating a cash account on the Plato system and ensuring it is always adequate to pay trust management expenses.
- Being able to readily identify the capital and income elements of the cash account balance.
- Dealing with and distributing trust income to the entitled beneficiaries.
- Producing annual trust accounts.
- Filing annual tax returns, paying any tax and preparing tax certificates for the settlor.

## **Setting up the Trust**

### **How is the Trust established?**

There are two stages. Once the settlor's remittance has cleared, any initial adviser charge will be paid and the balance will be invested in the chosen funds on behalf of the settlor. After the cancellation rights have expired, the holdings will then be transferred to the trustees to formally constitute the Trust.

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### **What happens if the settlor dies within the cancellation period?**

The investments will form part of the deceased's estate and pass according to their will or under the laws of intestacy.

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### **How are the investments gifted to the Trust?**

The appropriate instruction to transfer investments from the settlor's account to the trustees' account is built into the Plan Application pack.

## Reversions

### What are reversions?

Under the Trust, the settlor retains a right to receive annual capital reversions on pre-selected dates during lifetime. These reversions can be defeated by the trustees and are known as defeasible reversions. Each reversion is expressed as a specified percentage of the investments originally gifted into the Trust.

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### Does this mean that a reversion, if made, will also comprise of units/shares?

Yes. It will consist of a proportionate number of the units/shares held by the trustees at the time of the reversion. A reversion will also include part of the trustees' cash account balance that relates to capital.

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### How are the annual reversions structured?

When making the gift to the Trust, the settlor will decide the size and due dates of the reversions and schedule these within the trust deed. Typically, a Plan will be set up on the basis that 10% of the trust fund reverts to the settlor each year for the first ten years. Alternatively, reversions could be arranged to become payable when the settlor may possibly need access to the capital concerned.

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### What does 'defeasible' mean?

Under the Trust, the trustees have discretionary powers to defeat or defer a reversion. This is different to, say, a discounted gift trust, where the reversions are 'fixed' and will be paid to the settlor, regardless of whether they are wanted or not.

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### Does this mean that the settlor will not automatically receive a forthcoming reversion?

Correct. In performing their fiduciary role, the trustees have a duty to consider whether and to what extent they wish to exercise their powers to appoint capital in favour of the beneficiaries or to postpone the reversion to a future anniversary date. A reversion will only take place if, after due consideration, they decide not to exercise their powers. The settlor should inform the trustees if he/she does not require the payment.

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### What is the relevance of the trustees' power to defer a reversion?

This discretionary power is core to the flexibility of the Plan and allows the trustees to deal with each reversion individually, according to the needs of the Trust at the time. It can also prevent the settlor from receiving an unwanted payment. The flexibility is further enhanced by the trustees' ability to make capital payments or loans to beneficiaries when appropriate.

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### What happens when a reversion is due?

In good time beforehand, WAY will send a 'reversion pack', containing relevant paperwork, to the first named trustee for all trustees to act upon. A copy of the accompanying letter and a current portfolio valuation will also be sent to the settlor and their financial adviser for information. This will also allow the financial adviser to carry out an investment review on behalf of the trustees.

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### What does the 'reversion pack' contain?

It consists of a current valuation of the trust investments showing how they are allocated between the various reversions, a deed of deferral and a completion guide.

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### If the trustees wish to defer a reversion, what is the process?

If the reversion is to be deferred in part or in full, the trustees must complete/date the supplied deed of deferral before the reversion date and return it to WAY. If the deed is not received by WAY within this deadline, the reversion will be deemed to have taken place.

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### What happens if a reversion is to be paid to the settlor?

If a reversion is to occur, WAY will provide the settlor and the trustees with the relevant forms so that the investments can be transferred into the settlor's name and then either sold, once the reversion date has passed, or retained by him/her. It is very important that the settlor does actually need the reversion otherwise the proceeds or investments received will form part of the estate for IHT and reduce the IHT effectiveness of the Plan.

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### If the settlor receives a reversion, is its value fixed?

No. Its value will depend on the value of the underlying units/shares. This approach also allows the settlor to benefit from any growth achieved on the investments to date.

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**Can the trustees bring forward the date of a future reversion?**

No.

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**What if the settlor does not wish to receive an approaching reversion?**

The settlor should inform the trustees, who can then act accordingly.

**Death of the settlor**

**What happens when the settlor dies?**

WAY must be notified at the earliest opportunity since any intervening transactions cannot be reversed. Reversions to the settlor will now cease. However, the settlor's death will not affect the trust investments in any way and the Trust can continue.

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**Are the trustees obliged to wind up the Trust?**

No. The Trust is capable of lasting 125 years and so can carry on offering tax efficient benefits for the different generations of beneficiaries. In any event, distributing the trust fund is not always desirable, especially where the deceased settlor has been survived by their spouse or partner or the beneficiaries are young. Tax can also be an influencing factor.

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**Can the settlor's surviving spouse/civil partner now become a beneficiary of the Trust?**

Yes. The trustees can now use their discretion to add the survivor to the Appointed Class as a potential beneficiary. If the survivor subsequently requests funds from the Trust, the trustees could make a capital payment to him/her or, perhaps more preferably, make a loan, which, if still outstanding at the time of the survivor's death, may count as an allowable debt and reduce their estate accordingly for IHT.

# The WAY Flexible Inheritor Plan

## Tax Questions and Answers

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- The Plan can be affected by three taxes – inheritance tax, capital gains tax and income tax.
- The trustees must rely on the advice of their financial advisers on all tax matters relating to the Trust.

### Registering the Trust

#### **Do WAY notify HM Revenue & Customs (HMRC) when the Flexible Inheritor Trust is created?**

No. The trustees are responsible for the tax affairs of the Trust.

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#### **When is it necessary to inform HMRC about the Trust?**

HMRC require the trustees to register a trust if it may receive income or make chargeable capital gains.

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#### **How is the Trust registered?**

The trustees will need to register the Trust via the online Trustee Registration Service. The first step is to obtain an "organisation" Government Gateway account for each Trust to be registered.

<https://www.gov.uk/trusts-taxes/trustees-tax-responsibilities>

Once this has been obtained, the trustees will be able to sign in and formally register the Trust. HMRC will then send the first named trustee a Unique Taxpayer's Reference (UTR) for the Trust through the post.

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#### **What will normally happen next?**

The trustees will get a Unique Taxpayer Reference (UTR) and then receive a Trust and Estate Tax Return (Form SA900) or a notice to file one shortly after the end of the current tax year. They must complete the return within the stated deadlines even if no tax is due. Failure to do so will result in HMRC imposing fines upon the trustees.

For the 'traditional' Plan, if there is no tax liability, HMRC will often agree that subsequent tax returns will only be required every five years provided, in the meantime, no income arises to the trustees and any chargeable capital gains are within the trustees' annual CGT exemption. If, during the intervening period, income is received or there are excess gains, the trustees must submit a return under normal self assessment rules.

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#### **What if the trustees decide not to register the Trust on commencement?**

If the trustees subsequently make chargeable capital gains (or receive income), they are legally obliged to notify HMRC by 5 October following the end of the tax year concerned (ie for the 2015/16 tax year, this would be 5 October 2016) even if no tax will be payable.

### General

#### **Is the Plan caught by the gift with reservation rules or pre-owned assets tax (POAT)?**

No. HMRC has confirmed to WAY that these provisions do not apply to the Flexible Inheritor Plan. The retention of a reversionary interest by the settlor is a well established concept in estate planning. The settlor's reversionary interests are carved-out (ie pre-determined) at outset and cannot be brought forward. The gift is made subject to these rights, which are held on bare trust for the settlor absolutely. The settlor is specifically excluded from benefitting under the Flexible Inheritor Trust.

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#### **Is the Plan exempt from the Disclosure of Tax Avoidance Schemes (DOTAS) regime?**

Yes. Reversionary interest schemes such as the Flexible Inheritor Plan have been included on HMRC's list of schemes currently exempt from disclosure under the 'grandfathering' provisions.

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## Inheritance tax (IHT)

### a) Establishing the Trust

#### What is the IHT effect of setting up the Trust?

After deducting any unused annual £3,000 allowance, the gift will be a chargeable lifetime transfer for IHT and fall out of account once the settlor has survived seven years. Future investment growth is outside the settlor's estate immediately.

#### Is there any IHT to pay when the gift is made?

No. The value of the gift must be within the settlor's available nil rate band. The nil rate band, which is frozen until 2020/21, is currently £325,000.

#### When would an immediate IHT liability be payable?

This would only arise if the value of the gift and the total value of any other chargeable lifetime transfers made by the settlor in the previous seven years exceeds the current nil rate band. If this happened, the excess would suffer lifetime IHT at 20%.

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### b) Death of the settlor

#### What happens if the settlor dies within seven years of setting up the Trust?

If the gift was within the settlor's unused nil rate band when made, there should be no IHT liability on the gift itself. However, the original value of the gift will reduce the nil rate band available for calculating the IHT on the balance of the settlor's estate. Should the settlor's death cause IHT to be due on the gift, perhaps as a result of a failed PET, this would be payable by the trustees but the liability will be reduced by taper relief if the settlor has survived the date of the gift by three years or more.

#### What is the position if the settlor survives the gift by seven years?

The gift will no longer form part of the settlor's estate for IHT.

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### c) Reversions

#### Does deferring a reversion give rise to a transfer of value for IHT?

No. Since the trustees can defeat the reversions, the value of the settlor's retained rights is nil. HMRC has confirmed to WAY that postponement of a reversion by the trustees does not result in a further chargeable lifetime transfer by the settlor.

#### Does a reversion made to the settlor cause an IHT liability?

No. The payment of a reversion to the settlor is not a taxable event for IHT (see 'Exit charges'). However, it is important the settlor spends the capital received otherwise it will form part of their estate for IHT.

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### d) Death of a beneficiary

#### Does the death of a beneficiary have any IHT implications?

No. None of the beneficiaries are treated as owning the trust capital for IHT purposes.

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### e) Ten year anniversary charge

#### When may the trust fund be subject to IHT?

Being relevant property, the trust fund is potentially liable to an IHT charge on every ten-year anniversary of the Trust (the periodic charge) and whenever capital is distributed to beneficiaries (the exit charge). These IHT chargeable events may be reportable to HMRC via Form 100c (exit charge) and 100d (periodic charge) even though no tax is payable.

#### How is the periodic charge calculated?

In broad terms, a periodic charge will only occur if the total of the following exceeds the then current nil rate band:

- The value of the trust fund on the ten-yearly anniversary, plus
- The cumulative total of any chargeable transfers (including any failed PETs) made by the settlor in the seven years before creating the Trust and
- Any capital payments made by the trustees to the beneficiaries in the last ten years

Any excess will be charged to IHT at 6%. No periodic charge will be due if the total is below the nil rate band.

#### Are reversions made to the settlor taken into account?

No. The reversions are held on bare trust for the settlor and are not relevant property.

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## f) Exit charges

### **When can an IHT exit charge occur?**

An IHT liability can potentially arise whenever the trustees appoint capital to beneficiaries.

### **Will reversions passing to the settlor attract an exit charge?**

No. They are held on bare trust for the settlor absolutely and are exempt.

### **Will an exit charge arise on a loan made by the trustees to a beneficiary?**

No. A loan is not an appointment of capital.

### **Will an exit charge arise in the first ten years?**

No. Provided the gift to the Trust was within the settlor's available nil rate band, exit charges will be nil during this period.

### **How is an exit charge calculated?**

Exit charges are based on the rate of tax charged at the last ten-yearly anniversary and the length of time (as measured by complete three month periods) that has expired since the last periodic charge. If there is an exit charge, it will be applied to the value of the capital leaving the Trust.

### **What happens if no IHT was payable at the last ten-yearly anniversary?**

If no IHT periodic charge arose at the previous ten-year anniversary, no exit charge will be due.

### **What is the IHT effect of setting up the Trust?**

After deducting any unused annual £3,000 allowance, the gift will be a chargeable lifetime transfer for IHT and fall out of account once the settlor has survived seven years. Future investment growth is outside the settlor's estate immediately.

## Capital gains tax (CGT)

### **How is the Trust treated for CGT?**

The trustees will pay CGT on all realised capital gains that exceed their annual exemption.

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### **What is the trustees' annual CGT exemption?**

The trustees are eligible for an annual exemption which is one-half of that available to an individual. If the settlor has created more than one trust since 6 June 1978 (excluding pensions and bare trusts but including life policy trusts), this exemption will be shared equally between those trusts still in existence. However, it will never be less than one-fifth of the maximum trustee exemption.

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### **Is deferral of a reversion a disposal for CGT purposes?**

No.

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### **If the settlor receives a reversion, is this a disposal for CGT by the trustees?**

Yes.

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### **What other events may give rise to a CGT liability for the trustees?**

Selling investments and appointing/lending capital to beneficiaries.

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### **What are the options for trustees wishing to advance capital to a beneficiary?**

The trustees can transfer investments to the beneficiary or sell them within the Trust and pay out cash. Please note that distributing capital to a beneficiary can also result in an IHT exit charge.

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### **When may CGT holdover relief apply?**

Holdover relief is usually available to defer CGT where the trustees transfer assets to a UK resident beneficiary. This can be advantageous, for example, where the trustees have already used their annual CGT exemption or the gain arising far exceeds it but the gain can be safely realised by the beneficiary within his/her own full annual exemption. The relief must be claimed jointly by the trustees and the beneficiary. Both parties are recommended to seek advice before transferring any assets out of the Trust.

### **What is CGT holdover relief?**

This means that the beneficiary will effectively inherit the trustees' base costs for future CGT purposes, thereby allowing the trustees to escape paying tax when advancing the asset. When the beneficiary subsequently sells the asset, the realised gain can be offset against their annual CGT exemption. If the gain is likely to attract CGT, the beneficiary could stagger the disposal over different tax years to minimise or even eliminate the tax.

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### **Can the settlor claim CGT holdover relief in respect of a reversion?**

No. Despite the fact that a reversion involves a transfer of assets by the trustees to the settlor and is also a disposal for CGT, holdover relief cannot be claimed as the trust is settlor-interested for CGT. The CGT base cost of the units transferred to the settlor are their value as at the date of transfer.

## **Income tax**

### **What is the income tax status of the Trust?**

Since the settlor can potentially benefit through reversions, the Trust is treated as settlor-interested for income tax whilst he or she is alive. This means that any trust income is taxable on the settlor even though the income (net of expenses) will be paid to the beneficiaries. After the death of the settlor, each individual beneficiary will be responsible for tax on his or her share of the income received from the trustees.

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### **What rate of tax is payable on any income received?**

#### **Trustees**

The trustees are liable for income tax at the appropriate basic rates on any dividend or interest they receive. They are not entitled to any personal tax allowances for this purpose.

#### **Settlor (during lifetime)**

The settlor is taxable on the total trust income and will be assessable at their marginal rate. The settlor will receive a tax credit for the basic rate tax accounted for by the trustees and can also use his/her dividend allowance and personal savings allowance to offset. However, should the settlor qualify for a tax refund, please refer to 'What happens if the settlor receives a repayment of the tax paid by the trustees?'

#### **Beneficiary (whilst the settlor is alive)**

No tax is payable by beneficiaries on trust income received by them during the settlor's lifetime. Consequently, they cannot recover or offset any of the tax paid by the trustees.

#### **Beneficiary (after death of settlor only)**

When the settlor dies, the Trust will no longer be settlor-interested. Beneficiaries in receipt of trust income will then become taxable on this at their marginal rate and can use their personal allowances accordingly. Credit is given for the basic rate tax paid by the trustees. Where applicable, a beneficiary may claim a tax repayment.

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### **What happens if the settlor receives a repayment of income tax paid by the trustees?**

This must be paid back to the trust (S7 Finance [No 3] Act 2010) and cannot be retained by the settlor.

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### **How do the trustees advise the settlor or beneficiaries of any trust income?**

The trustees will supply HMRC form R185 to the settlor or beneficiaries as appropriate. The form contains the details of the income received and tax paid by the trustees that needs to be included in the individual's tax return.

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### **Can trust management expenses reduce any tax payable?**

No. Trust expenses are not an allowable deduction for income tax. However, they will be used by the trustees to determine how much income, if any, is payable to the entitled beneficiaries.

**The contents of this guide are not exhaustive and it is not practical to cover all aspects of the Plan in depth. If you require any further technical or tax information, please contact our trust and IHT experts on 01202 890 895.**

### **Please note**

Information contained in this brochure is based on WAY's understanding of taxation, legislation and HM Revenue & Customs practice as at February 2020, which may change in the future. Every care has been taken to ensure the material is correct. WAY does not offer investment and tax advice and can accept no liability for any actions based on the contents of this publication. The investor must obtain professional legal, tax and other appropriate advice on his/her own individual circumstances before entering into a Plan.



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