ADVISER
GUIDE

WAY Investment Services

WAY Gifts from Income Inheritor Plan

Adviser guide - Technical and Tax Questions and Answers

For professional advisers only

WAY Investment Services

WAY Gifts from Income Inheritor Plan

Adviser Guide

Contents

Please note

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

The Gifts from Income Inheritor Plan is a trust-based investment. WAY Investment Services (WAY) 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.

Normal expenditure out of income exemption
Technical Questions and Answers

In this context, the 'donor' (the person making a gift) and the 'settlor' (the person creating the Trust and making gifts to it) are the same individual.

What is the relevant legislation for this exemption?

Section 21 of the Inheritance Tax Act 1984.

Can the exemption apply to a transfer made on death?

No, it is a lifetime exemption.

Are gifts made under this exemption excluded from the gift with reservation rules?

No.

Is the exemption given automatically by HM Revenue & Customs (HMRC)?

No. In nearly all situations, it must be claimed retrospectively on death of the settlor by his/her personal representatives. Consequently, it will not usually be possible to say at the time a gift is made whether it will definitely be regarded as exempt. Good record keeping is therefore essential. HMRC will judge each case on its merits when a claim for the exemption is made.

Please also refer to 'Are there lifetime HMRC reporting requirements for this exemption?' (p5).

What are the three statutory conditions for the exemption to apply?

To be exempt, the gift must satisfy all the following criteria:

- It must be made as part of the donor's normal expenditure;
- Taking one year with another, it must be made out of the donor's income;
- After making the gift, the donor must be left with sufficient income to maintain their usual standard of living without resorting to capital.

Is there a monetary limit for this IHT exemption?

No, so long as the sums gifted meet all the criteria.

What is meant by 'normal'?

This means what is typical of the donor and not of the average person. 'Normal' is therefore subjective and will require consideration of the donor's individual circumstances.

What is meant by 'normal expenditure'?

This is not defined in legislation. However, in the case of Bennett v IRC (1995), it was determined that the donor must establish a settled pattern of expenditure either by reference to a series of gifts over a period of time or by having evidence of a prior commitment or resolution in place to make further gifts, and then complying with it. The WAY Gifts from Income Inheritor Trust deed contains a clear indication that the settlor intends to make future regular gifts out of surplus income to the Trust.

Is there a fixed minimum period to establish a pattern?

No. Although HMRC's stated approach is to require a pattern of gifting to be demonstrated over a three to four year period, the existence of a prior declaration to make regular gifts (as found in the trust deed) may be sufficient for gifts made over the first one or two years to qualify as 'normal' if, say, the donor dies unexpectedly.

Can there be a variation in the pattern?

Yes but the donor must be able to show that a pattern of gifting was intended and continue for a period of time, barring unforeseen circumstances.

Would a 'deathbed' gift qualify for the exemption?

This will only be possible if the donor had commenced the pattern of expenditure at a time when the terminal illness had been unforeseen.

If the commitment had been set up when the short life expectancy was known (eg on the settlor's 'deathbed'), it will be difficult to prove that any gifts were 'normal expenditure'. There must always be a realistic expectation that further gifts will be made to establish a pattern.

What is meant by 'out of income'?

Gifts must be made out of income. 'Income' is not defined in the legislation but HMRC regard it to mean net income after payment of income tax, as calculated under normal accountancy (rather than income tax) rules. HMRC also considers income to refer to current income of the tax year in which a gift is made so care must be taken if considering making gifts out of income from a previous year. The exemption is not available for income that has been capitalised. Further details can be found in 'What does 'taking one year with another' mean?'

What type of income is allowed?

Only true income will be taken into account in determining the level of income. This will include income from employment/self employment, pensions, property rental, interest and dividends. Income received from investments within ISAs can also be used for this purpose/should not be overlooked.

Do gifts from capital qualify?

No. Gifts made from a capital source are not covered by the exemption. For example, withdrawals from an investment bond, the capital element of purchased life annuity payments or payments from lifetime/immediate care plans are not treated as income for the exemption.

What kinds of gifts are acceptable under this exemption?

Gifts must be made out of surplus income. They can take the form of cash or capital assets bought out of excess income for the specific purpose of making the gift (eg the purchase of unit trusts by the settlor for gifting to the WAY Gifts from income Inheritor Trust).

Do the gifts need to be of a fixed amount?

No. However, HMRC expects them to be comparable in size (ie quantifiable). If gifts are not for a fixed sum, they will often be made in accordance with a formula eg as a specific percentage of taxed income. The source of income may, of course, be variable by its nature (eg company dividends, bonuses).

If the settlor's income falls, say, due to retirement, it is acceptable to make gifts of a lower amount to reflect this.

What does 'taking one year with another' mean?

This can permit income to be carried forward from one year to another for the purpose of gifting. In this connection, it serves two main scenarios:

1. If somebody's income fluctuates from one year to the next but overall there is enough surplus income to make 'normal' gifts and still maintain their standard of living, HMRC may allow income to be carried forward from one year to the other.
2. It may also be possible for a donor to make gifts out of accumulated or uninvested surplus income from a previous year. However, unless there is evidence to the contrary, HMRC considers that such income will become capital after two years. If the donor has stored up surplus income for a number of years in order to make gifts, the exemption may not be forthcoming.

Professional advice is recommended in both instances.

What is meant by 'maintain usual standard of living'?

This means that after making a gift under this exemption, there must be sufficient net income left to meet ordinary living expenses without having to use capital to maintain their normal standard of living, otherwise this would imply that the gift was unaffordable. Good record keeping is essential as HMRC will scrutinise this aspect very closely.

'Usual standard of living' relates to that prevailing at the time of the gift and will depend on the settlor's income, financial commitments and type of lifestyle (eg frugal or lavish?). Loss of employment, retirement and the payment of nursing home fees are all circumstances that could force a change in the standard of living.

Are there lifetime HMRC reporting requirements for this exemption?

Yes. Where regular gifts being made to a trust (such as the WAY Gifts from Income Inheritor Trust) would, if the exemption was not available, cause the settlor to exceed his/her nil rate band, this must be reported to HMRC via IHT 100 by the settlor. This is the only occasion during the settlor's lifetime that HMRC will actually confirm whether or not the regular gifts qualify for the exemption.

If, as in most instances, the total of the regular gifts plus any chargeable transfers made by the settlor in the same seven year period falls within the nil rate band, HMRC will not require a report but will not confirm availability of the exemption until after the settlor dies.

Is record keeping necessary to justify a normal expenditure gift?

Yes, it is vital for the settlor to keep a record of the gifts and other relevant information that can either be produced by the settlor during lifetime, if necessary, or by their personal representatives on his/her death as evidence that the gifts satisfy the three conditions.

What record keeping is necessary?

The settlor's personal representatives must report any lifetime gifts made during the last seven years of his/her life to HMRC by way of form IHT 403, which forms part of the main IHT Return. These will also include any gifts made under the normal expenditure exemption in the same period.

For the exemption to apply, HMRC will first need to be satisfied that the statutory conditions have been met. In this connection, HMRC will require details of the settlor's income and usual living expenses for the relevant tax years to support the claim. It is seen as good practice that this evidence is recorded in the same format as that which has to be provided to HMRC by the personal representatives. Apart from keeping a record of the gifts made, the settlor should also complete the table on page 6 of form IHT 403 for each year concerned at the time gifts are made.

If the settlor does not take steps to maintain detailed records of their income and expenditure relating to the gifts made under the exemption, the onus will be on the personal representatives to reconstruct these accurately post death, an extremely difficult, if not impossible, task.

Where can I download Form IHT403?

https://www.gov.uk/government/publications/inheritance-tax-gifts-and-other-transfers-of-value-iht403

Can part of a gift qualify for the exemption?

Yes. If a gift exceeded the available surplus income, the excess would not attract the exemption. The donor would then have to rely on another exemption (eg the annual £3,000 allowance) to cover the balance. If this is not available, the non-exempt portion will be a chargeable lifetime transfer.

The WAY Gifts from Income Inheritor Plan
Technical Questions and Answers

Introduction

What is the Gifts from Income Inheritor Plan?

The Plan is a collectives-based inheritance tax (IHT) mitigation arrangement that takes advantage of the 'normal expenditure out of income' exemption to achieve immediate IHT savings. It allows the investor (the settlor) to make annual gifts out of surplus income into a family trust (the Gifts from Income Inheritor Trust) for their beneficiaries whilst retaining potential access to capital payments (reversions) for his/her own personal use at specified dates in the future, 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 the Plato Nominee & Investment Administration Service.

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 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 as appropriate*

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

Who may the Gifts from Income Inheritor Plan be suitable for?

The Plan may be appropriate for an individual who is in good health, has genuine surplus income each year and is prepared to make annual gifts out of this to reduce their potential IHT liability but requires a flexible solution that can deal with changes in their own personal circumstances and those of their family in the future.

Who is the Plan not suitable for?

The Plan is not considered appropriate if the investor is in poor health, relies on using capital to top up income needs, or wishes to have unrestricted access to the gifted sums.

What are the minimum gifts allowed?

The minimum annual investment is £10,000. There is no maximum amount provided the intended gift can meet all 'normal expenditure' criteria for the exemption to apply. Before each trust anniversary, we will invite you to make a further gift from your surplus income to the Trust. HMRC would want to see a pattern of payments into the trust to demonstrate that there is a surplus of income.

Can gifts be paid electronically?

Yes. Payments can be made by cheque or electronic transfer (BACs, Faster Payments or CHAPS). However, before this can happen, WAY must be in receipt of all required Plan documentation, properly completed. 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.

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.

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.

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).

Investments – General

Why is a cash gift not allowed?

By necessity, the gifts to the Trust must be represented by units/shares in collectives as it is not possible for reversions to be 'carved out' in a cash sum (see 'Reversions'). Accordingly, the settlor must own the investments before gifting them to the Trust. Consequently, every time the settlor wishes to make a gift to the trust, the amount available must first be used to buy units/shares in the settlor's name. Only income units or shares may be purchased.

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.

When will the investments be transferred into the Trust?

This will occur as soon as the settlor's 14 day cancellation rights have expired. In the meantime, the holdings will remain an asset of the settlor's estate.

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), where a maximum tax rate of 20% currently applies, 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.

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.

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

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 on a nil yield mandate. Being geared towards growth, use of the annual CGT exemption can be maximised and trust administration is simplified by the absence of income..

How is a nil income yield secured for a fund?

To achieve this, the fund manager will actively manage the underlying portfolio with the objective that, during any accounting period, the total income generated is less than the total fund charges.

'Managed portfolio' Plan

Is availability of the 'managed portfolio' Plan subject to any minimal investment or fund value?

Yes. Advantage can be taken of the 'managed portfolio' service immediately if the initial investment (gift) is at least £100,000. Alternatively, this service will become available for take up as soon as the cumulative total of regular gifts reaches a minimum of £100,000 or when the trust fund attains a value of £100,000. Otherwise, below these figures, investments must be limited to WAY-branded funds only (ie a 'traditional' Plan). Further information can be obtained from your Regional Sales Manager.

Do investment restrictions also apply to the 'managed portfolio' Plan?

Yes.

- The investment choice is limited to a wide range of unit trusts and OEICs that are either currently available or are acceptable for investment using the Plato Nominee & Investment Administration Service. Proposed new additions must also be a member of the EMX Message System to qualify.
- 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.

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.

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.

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

These will be paid from the trustees' cash account.

The Gifts from Income 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 within the Trust enable him/her to have potential access to capital payments on survival to stated due dates.

How are the settlor's reversionary interests created?

Under the Trust, the settlor retains the right to two capital payments (reversions) if alive on the due dates. 50% of the trust fund value is scheduled to revert to the settlor three days before the fifth anniversary of the Trust whereas the remaining 50% will revert just before the tenth anniversary. A reversion is known as a 'Relevant Share' and the date when it becomes payable is 'the Relevant Date'.

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 payable 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'.

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.

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.

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.

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.

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.

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.

Who is included within the Appointed Class?

The list of beneficiaries, who can potentially benefit from the trust capital, include 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 includes 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).

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).

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 it remains outstanding.

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.

Which law governs the Trust?

The law of England applies.

Appointing trustees

Some important points:

- The default trustees for the WAY Gifts from Income 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.
- Individual 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 or 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.
- In the case of a 'managed portfolio' Plan, where the role of trustee is more onerous, the settlor should strongly consider appointing WAY Tax and Trustee Advisory Services Limited to perform the necessary duties and provide him/her with peace of mind.

Where can I obtain details relating to WAY Tax and Trustee Advisory Services Ltd?

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

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.

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.

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 tax obligations to HMRC.
- 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.

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

- 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.

Unless the intended trustees are sufficiently competent, WAY would always recommend that a corporate or professional trustee should be appointed by 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 into the chosen investments 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.

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.

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.

What happens when a further gift is made by the settlor to the Trust?

The above process is repeated each time.

Reversions

What are reversions?

Under the Trust, the settlor retains a right to receive two capital payments on pre-selected dates during lifetime. These payments can be defeated by the trustees and are known as defeasible reversions. Each reversion is expressed as a specified percentage of the investments comprised in the trust fund.

How are the gifted units/shares allocated to the reversions?

They are divided proportionately between each outstanding reversion (eg prior to the fifth anniversary, they will be split equally between the two separate 50% reversions).

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.

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.

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.

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.

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.

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.

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.

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 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.

If the settlor receives a reversion, can future gifts be made to the Trust?

No. The receipt of a reversion implies that the settlor cannot afford to continue making gifts under the 'normal expenditure exemption' and gifts to the Trust must cease. If, subsequently, the settlor's financial position improves and regular gifts out of surplus income can resume, a new Plan would have to be set up.

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.

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

No.

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.

As part of their IHT return to HMRC, the deceased's personal representatives will now report gifts made to the Trust in the seven years before death and also submit the necessary information for HMRC to confirm that the gifts are exempt from IHT under the 'normal expenditure' exemption.

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.

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 Gifts from Income Inheritor Plan
Tax Questions and Answers

- **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.

When is it necessary to inform HMRC about the Trust?

WAY recommend that this should be done soon after the Trust has been created. HMRC require the trustees to register a Trust if it may receive income or make chargeable capital gains.

How is the Trust registered?

The first-named trustee 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.

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.

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 2016/17 tax year, this would be 5 October 2017) 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 Gifts from Income 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 Plan.

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

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

Inheritance tax (IHT)

a) Normal expenditure out of income exemption

Relevant questions and answers relating to the satisfying the qualifying criteria and the need for the personal representatives to claim the exemption on death of the settlor are covered at the start of this Guide.

b) 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 transfer of value 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.

c) 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.

d) 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 exceed 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

The above assumes that all gifts made to the Trust are covered by the 'normal expenditure' exemption.

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.

e) 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?

Provided the initial value of the Trust is within the settlor's nil rate band and subsequent gifts made to the Trust qualify as exempt, exit charges will be nill 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.

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

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.

Is deferral of a reversion a disposal for CGT purposes?

No.

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

Yes.

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

Selling investments and appointing/lending capital to beneficiaries.

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.

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 the 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.

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/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 entitled 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.

What rate of tax is payable by the trustees 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.

What happens if the settlor receives a repayment of the 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.

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. This contains details of the income received and tax paid that needs to be included in the individual's tax return.

Can trust management expenses reduce any tax payable by the settlor?

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 890895.

Please note

Information contained in this brochure is based on WAY's understanding of taxation, legislation and HM Revenue & Customs practice as at May 2019, 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.

WAY Investment Services

WAY Investment Services Limited
Cedar House, 3 Cedar Park, Cobham Road,
Wimborne, Dorset BH21 7SB.

T: 01202 890 895 **E:** advisersupport@waygroup.co.uk
W: www.wayinvestments.co.uk

GFIPTechnicalTaxQ&A/2019-01/May 2019