



WAY Investment Services



WAY Inheritor Loan Plan

Adviser guide – Technical and tax Questions and Answers



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Adviser Guide

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Please note

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

The Inheritor Loan Plan is a trust-based investment. WAY Investment Services (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 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 Inheritor Loan Plan

Technical Questions and Answers

Introduction

What is the Inheritor Loan Plan?

The Plan is a collectives-based inheritance tax (IHT) mitigation arrangement that allows an investor to achieve a gradual reduction in their estate for IHT whilst having access to their original capital. The settlor therefore makes a gift of any future investment growth.

It involves the investor (the settlor) setting up a family trust (the Inheritor Loan Trust) and then entering a Loan Agreement to make a loan, which is interest free and repayable on demand, to the trustees, who invest this in a portfolio of unit trusts and OEICs. The settlor retains access to the original loan capital, which he/she can ask the trustees to repay in part/full at any time whilst any investment growth is held in trust for the benefit of the beneficiaries. The outstanding loan (less any repayments) remains in the settlor's estate for IHT.

Since the IHT benefits of the Plan are obtained progressively as investment growth accrues inside the trust and the settlor takes loan repayments and spends these to remove the loan from the estate, the Inheritor Loan Plan represents long term IHT planning.

There are two versions of the 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 own account with each investment fund company individually.

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

Although Plato registers the units/shares as the legal owner, the control over the holdings continues in the hands of the trustees* and the beneficial ownership stays 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.

Who may the Inheritor Loan Plan be suitable for?

The Plan may be appropriate for an individual who is in good health and wishes to reduce their IHT liability but does not want to make a lifetime gift as access to the capital is still required. The individual is, however, prepared to give up right any future investment growth on the capital concerned.

Who is the Plan not suitable for?

The Plan is not considered appropriate if the investor is in poor health, can afford to make a substantial gift without needing access to the capital, or wishes to have unrestricted access to the total investment (i.e. including any growth).

What is the minimum investment allowed?

The minimum lump sum investment (loan) is £100,000. There is no upper limit.

Can the loan amount be paid electronically?

Yes. The 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.

The 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.

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

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 by deed (supplied by WAY) to the list of beneficiaries, who can potentially benefit from the trust capital (ie the Appointed Class).

The settlor can also arrange to leave the right to any outstanding loan balance on their death under their will to their surviving spouse/civil partner (see 'Can the settlor bequeath or waive the right to the outstanding loan on death?' under 'The Loan Agreement' section).

Investments – General

Can the trustees invest in accumulation units?

No. 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/shares would result in any distributable income being capitalised immediately.

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.

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. They are also responsible for repaying the loan to the settlor. Diversification will probably be an important factor for minimising risk and achieving long term goals. Furthermore, the existence of loan repayments 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 Trust
WAY Flexible Global Growth Portfolio Trust

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?

h 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

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.
- Only income units/shares are permissible.

Charges

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

‘Traditional’ and Managed Plans

The charges will be automatically debited to the trustees from their cash account. Full details of the charges can be found in the appropriate fee schedule.

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

No. The cost of advice given to the settlor before taking out the Plan is the responsibility of the settlor, who must pay their financial adviser directly and separately from the loan. On going adviser charges for advice given to the trustees will be facilitated by Plato.

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 Inheritor Loan Trust

What type of trust is used?

The Plan uses an 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, subject to the trustees' liability to repay the settlor's loan at any time.

How is the Trust established?

When the Trust deed and Loan Agreement have been completed, the settlor will fully constitute the Trust by making the loan to the trustees.

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

No. Apart from being entitled to repayment of the loan (as a creditor), 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 trustee make payments to the beneficiaries before the loan is repaid?

Although possible, the trustees must remember that they are responsible for repaying the loan from the trust fund and must not take any action that could endanger their ability to do so. As a result, capital distributions (or loans) to beneficiaries are not likely to be considered unless the value of the trust fund after making the proposed payments will still exceed the amount of the outstanding loan.

Does the Trust limit the trustees' liability to repay the loan to the settlor?

Yes. The trustees' liability is restricted to the value of the trust fund if it has fallen below the amount of the outstanding loan at the time of repayment. As the trust fund is comprised of collective investments, there is a possibility that at any point in time this scenario could occur in falling markets. The existence of this provision can therefore protect the trustees from becoming personally liable to repay any shortfall. However, if any of this deficit results from inappropriate distributions of capital to beneficiaries (or any other unwise action by the trustees), this may be regarded as a breach of trust, thus potentially rendering the trustees responsible for making good the loss from their own resources.

The trustees must always take into account their responsibilities and obligations to the settlor and the beneficiaries.

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.

How long can the Trust last?

A maximum of 125 years from the date of creation or until such earlier time as the trustees decide.

Which law governs the Trust?

The law of England applies.

The Loan

Can existing investments be lent?

No. The loan must be in the form of cash. If the loan capital is currently held in the form of assets other than cash, they must be sold/encashed prior to commencement of the Plan.

Why is the loan interest free?

By not charging interest, the potential for accumulating capital growth outside of the settlor's estate is increased.

Why is the loan repayable on demand?

It is vital that the interest free loan is not regarded as a gift in any way. By expressing it as a repayable on demand loan, no transfer of value occurs and the amount of the outstanding loan is always an asset of the settlor's estate for IHT.

How will the loan be repaid?

The settlor can require the trustees to repay the loan in part or in full at any time. Normally, the settlor will request repayments from time to time as he/she needs the capital. If the settlor requires regular repayments from outset, the Loan Agreement provides for it to be repaid in annual instalments.

What potential downsides are there to choosing regular loan repayments?

Regular repayments will often be used to supplement the settlor's income. However, it must be borne in mind that once the loan has been fully repaid, this 'income' source will run out. The level of repayment should therefore be realistic to avoid this happening too soon. If the settlor requires a part payment of the loan while taking regular instalments, the 'income' period will again be shortened unless the rate of withdrawal is reduced accordingly.

Regular repayments will also reduce the scope for capital growth. For this reason, annual repayments are usually preferable to those made on a monthly basis.

Are there any disadvantages in not taking repayments at outset?

Frequently, the settlor will want to postpone taking an 'income' until a later date (eg on retirement) or may just want the comfort of knowing the money is always available if circumstances change (eg nursing home fees). Either situation offers a greater potential for capital growth outside the estate than if regular loan repayments had been taken. The downside is that the amount of the unpaid loan, albeit frozen in value, is still in the settlor's estate for IHT.

Do the loan repayments need to be spent?

Yes. It is crucial they are spent (or gifted) so that the value of the settlor's estate falls in line with the reducing loan.

Can the loan be repaid by in specie transfers to the settlor?

Yes. If this was desired by the settlor, the Loan Agreement permits this to happen. This will still be a disposal for CGT by the trustees in the same way as if they had instead sold the units/shares to fund a cash repayment.

What happens if the settlor demands early total repayment of the loan?

The trustees will be forced to cash in all/most of their investment portfolio to raise the necessary funds. This may also give rise to a CGT liability. However, since the unit trusts and OEICs held by the trustees are medium/long term investments, if they are sold early, their total value may be less than the outstanding loan.

What happens if the trust fund is insufficient to pay back the outstanding loan?

The trustees' liability to repay the loan is limited to the value of the trust fund if lower at the time of repayment (please refer to 'The Inheritor Loan Trust' section).

Can loan repayments be taken and then gifted by the settlor to the children or grandchildren?

Yes. If the settlor does not require the loan repayments, he/she can gift them to somebody else. The gift will be a potentially exempt transfer (PET) for IHT purposes unless covered totally by the settlor's annual £3,000 exemption.

Can the settlor gift the right to the outstanding loan to another person during lifetime?

Yes. This must take the form of a deed prepared by the settlor's solicitor. The donee will then have the right to receive future loan repayments. This is not a disposal for CGT but the gift will be a PET for IHT. The settlor should seek legal advice on this matter.

Can the settlor give up the right to repayment of the loan during lifetime?

Yes. The settlor can waive repayment of the outstanding loan in favour of the trust beneficiaries by executing an appropriate deed drafted by his/her solicitor. This gift will be a chargeable lifetime transfer for IHT and may have IHT implications for the Trust. No CGT consequences arise.

Alternatively, the settlor could amend their will to waive this right on death (see next question).

If the settlor has more than one loan trust and is proposing to waive all outstanding loans, it is strongly recommended that he/she first seeks professional advice on the potential interaction of the 'same day additions rules' contained in S62A IHTA 1984 (discussed below).

Can the settlor bequeath or waive the right to the outstanding loan on death?

Yes. This will require the settlor obtaining legal advice and making an amendment to their will.

- If the settlor wishes repayments to continue to be paid to someone else such as the settlor's spouse/civil partner, the settlor can specifically bequeath the right to the outstanding loan under his/her will. Since this is a transfer on death, it will be a chargeable transfer for IHT unless it is made to the surviving spouse/partner when the spouse exemption would apply.
- On the other hand, the settlor could waive the right to any outstanding loan in favour of the trust under his/her will. This would be a chargeable transfer for IHT and may have implications for the Trust in terms of future periodic and exit charges.

Where waiving the right is under consideration, it is also important to check the will to ensure that there are no similar provisions to top up other trusts created by the settlor during his/her lifetime otherwise the 'same day additions' rules could come into play (S62A IHTA 1984). The settlor must rely on the advice of their financial advisers in this matter.

S62A IHTA 1984

The 'same day additions' rules were introduced by Finance Act 2015 and basically mean that where property is added to two or more existing relevant property trusts on the same day (eg on death of the settlor), these will now be taken into account when calculating the IHT periodic and exit charges of each trust if the addition is more than £5,000. Professional advice is necessary if this anti-avoidance legislation could apply.

What happens if the loan is fully repaid before the settlor dies?

The loan and any capital growth on the trust investments are now outside the settlor's estate. However, the settlor is not entitled to receive any more payments from the trust. The trustees must monitor loan repayments closely to prevent excess payments being made, a situation that, apart from being a breach of trust, could also trigger the gift with reservation rules. The full value of the trust fund is now held on behalf of the beneficiaries.

What happens if the settlor dies and some of the loan is outstanding?

Please refer to 'Death of the settlor' section.

Can the settlor make further loans?

Yes. This would require the settlor entering into a new loan agreement with the trustees. However, in view of the added administrative complexity that this can introduce, it may be preferable to set up a new Inheritor Loan Trust.

Appointing trustees

Who should be appointed as trustees?

Some important points:

- The default trustees for the WAY Inheritor Loan 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 may often be suitable people, as may be the settlor's solicitor or accountant. It is not recommended to the settlor to appoint somebody who lives outside the UK as a trustee.
- 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.

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?

Their prime role is to administer the trust fund for the benefit of the beneficiaries and in accordance with the terms of the Trust and applicable trust law. 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.

The trustees are also responsible for repaying the settlor's loan on demand.

What other responsibilities do the trustees have?

These will include:

- Making loan repayments on request by the settlor (or his/her personal representatives) and ensuring no overpayment occurs.
- Reviewing the performance of the trust investments each year with the investment adviser.
- 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.
- Dealing with the tax affairs of the Trust and meeting any Trust registration and tax obligations to HM Revenue & Customs.

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.

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. Regular loan repayments to the settlor must now cease, but the Trust can continue.

What is the position if the settlor dies before the loan is fully repaid?

Any outstanding loan amount at the time of the settlor's death forms part of the estate and is potentially liable to IHT. The balance of the trust fund is outside the estate and held for the benefit of the beneficiaries.

Normally, the settlor's personal representatives will call in the loan balance so they can pay the debts and distribute the estate according to the will or laws of intestacy. The trustees will then be forced to sell investments to pay the sum due to the estate. Any growth can be distributed to the beneficiaries or continue to be held in the trust for their future benefit.

To prevent the loan being called in unnecessarily on death, the settlor will frequently amend their will so that regular loan repayments can now be paid to the surviving spouse or any outstanding balance is written off to enhance the amount eventually passing to the beneficiaries of the Trust (please refer to 'Can the settlor bequeath or waive the right to the outstanding loan on death?' in 'The Loan' section).

If the right to the outstanding loan is left to the surviving spouse, it will be exempt from IHT. If appropriate, the survivor can also now be added be included as a potential beneficiary under the Trust (see next question).

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 without the trust forming part of his/her estate for IHT purposes. 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.

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.

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). Remember that paying out capital to a beneficiary may have IHT consequences.

The WAY Inheritor Loan 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?

HMRC require the trustees to register a trust if it may receive income and/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 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 2017/18 tax year, this would be 5 October 2018) 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. As the settlor is only entitled to loan repayments and is not a beneficiary of the Trust, the Inheritor Loan Plan is not caught by the gift with reservation provisions. Furthermore, HMRC has confirmed that POAT does not apply.

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

Yes. Loan Trust arrangements such as the Inheritor Loan Plan are included on HMRC's list of schemes currently exempt from disclosure under the 'grandfathering' provisions.

Inheritance tax (IHT)

a) Establishing the Trust

What is the IHT effect of setting up the Trust?

There are no immediate IHT implications as no gift is made and the full amount of the outstanding loan remains in the settlor's estate. No reduction in the estate will occur unless and until the settlor takes and spends (or gifts) loan repayments.

For very large loans, where there is a possibility that IHT periodic charges could become relevant, consideration should be given to creating a series of smaller loan trusts on different days, with each having their own nil rate band, to minimise the prospect of potential periodic and exit charges. If there is a likelihood that the settlor may later decide to waive the right to repayment of the outstanding loans, the future implications of the recent 'same day additions' rules (S62A IHTA 1984) should be borne in mind (please refer to 'Can the settlor give up the right to repayment of the loan during lifetime?' in 'The Loan' section)

b) Repayments of the loan

Does a loan repayment made to the settlor cause an IHT liability?

No. This is not a taxable event for IHT (see 'Exit charges'). However, it is important the settlor spends the repayment 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. The value of the trust fund is not treated as part of any beneficiary's estate for IHT unless the trustees have given them an absolute interest (ie made an absolute appointment in their favour).

d) Ten year anniversary charge

When may the trust fund be subject to IHT?

Being an interest in possession trust, the trust fund itself may be subject to IHT charges 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. The trustees will pay any IHT due from the trust fund.

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. This is unlikely in most instances:

- The value of the trust fund on the ten-yearly anniversary (reduced by the amount of any outstanding loan), plus
- The settlor's seven year cumulative total of chargeable transfers immediately 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 loan repayments made to the settlor taken into account?

No. The settlor is entitled to these capital payments as a creditor and not as a beneficiary of the trust.

e) Exit charges

When can an IHT exit charge occur?

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

Will loan repayments to the settlor attract an exit charge?

No. Loan repayments are not capital distributions from the trust. They are payments made under the terms of the loan agreement.

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?

Exit charges should be nil during this period as no gift was made and no IHT was payable when setting up the trust.

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 the previous periodic charge was nil, the exit charge will also be nil.

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 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.

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

Selling investments (e.g. to raise cash to fund loan repayments), transferring investments out of the trust 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 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. The rules can be complicated and both parties should seek individual 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 (or transfers) 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.

If the settlor receives an in-specie loan repayment, can CGT holdover relief be claimed?

No. Even though this involves a transfer of assets by the trustees 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?

The trust is treated as settlor-interested whilst any of the settlor's loan is outstanding. 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 death of the settlor (or on earlier full repayment of the loan), each individual beneficiary will become responsible for tax on his/her share of the income received from the trustees.

No tax is payable on the loan repayments received by the settlor as these are capital.

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 (alive and any of the loan remains outstanding)**
If the loan has not been fully repaid, all trust income will be taxable on the settlor at his/her marginal rate. However, the trustees will still be liable to the basic tax rates above but the settlor will receive a tax credit for the 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 (where the settlor is alive and any of the loan remains outstanding)**
During this period, no tax is payable by beneficiaries on trust income received by them. Consequently, they cannot recover or offset any of the tax paid by the trustees.
 - **Beneficiary (after death of settlor or on earlier full repayment of the loan)**
At this point, 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 (and retain) a tax repayment.
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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.



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