Trust Range

Guide to Trusts

For financial advisers only

You can count on us

RL 360

Introduction

This booklet is intended as a practical guide for advisers who are considering the use of an offshore bond in conjunction with a trust to assist the planning and arrangement of their client's investment affairs. In particular, it will be of use to those wishing to enhance the benefits offered through the range of products designed to meet the needs of both UK domiciled and non-UK domiciled clients.

Significant and controversial changes to the Inheritance Tax treatment of trusts were contained within Schedule 20 of the Finance Act 2006. Subsequently, since 22 March 2006, trusts may be broadly divided between those trusts which come under the mainstream Inheritance Tax regime for 'Relevant Property' trusts and those which do not. 'Relevant Property' trusts are taxed as 'Discretionary Trusts'. The changes were made to ensure that the Inheritance Tax treatment of trusts were streamlined so that all trusts are treated in the same way, with some limited exceptions.

As a consequence of these changes, we offer the choice of establishing a trust on either a 'Bare Trust' basis or a 'Discretionary Trust' (flexible) basis, in order to accommodate the needs of a wider range of investors.

This guide will help advisers to understand not only the implications of choosing a particular trust but also to understand the reasons behind why an individual may need to create the trust on either a bare or flexible trust basis.

All our trusts are 'Pre-owned Assets Tax' (POAT) friendly. They are all governed and construed according to the law of the Isle of Man. Therefore, the Courts of the Isle of Man shall have exclusive jurisdiction to hear all disputes concerning these Trusts.

Our trusts are offered free of charge to our clients and ongoing support is provided by our Technical Team who will assist and provide support in respect of any trust and tax related queries.

The taxation information set out in this guide is based on our understanding of the general application of Her Majesty's Revenue and Customs (HMRC) practice as at June 2017. The contents of this booklet and any trust wording provided by us should not be used as the basis of advice given to individual clients without independent legal advice being sought. We cannot be held responsible for any actions taken or refrained from being taken by individuals as a result of the information provided in this guide.

What is a trust?

Put simply, a trust is a legal arrangement where property/assets are held by someone, '**the trustees**', on behalf of someone else, '**the beneficiaries**', subject to the terms of the trust.

Who are the parties to a trust?

Settlor

The Settlor is the provider of the funds for the trust. A Settlor can also be a beneficiary of his or her own trust although this would represent a 'gift with Reservation' and therefore would generally make the trust ineffective from an Inheritance Tax perspective. Although some of our trusts allow for joint Settlors, this option should only be chosen where both parties are the providers of the funds, or joint policy owners in the case of an existing policy.

Trustees

Trustees must be at least 18 years of age, of sound mind and not bankrupt. Beyond that, as the name implies, trustees should principally be people whom the Settlor feels can be trusted. With the exception of the Discounted Gift Trust, our trusts do not automatically appoint the Settlor as a trustee. However, the Settlor can appoint him or herself as a trustee and additional trustees could include family friends, family members, professional advisers or a trust corporation. Beneficiaries may also act as trustees although care should be exercised to avoid any potential conflicts of interest.

When accepting the role of trustee, it is important that the trustees fully appreciate the terms contained within the trust deed and the legal principles which govern the trust. The Isle of Man Trustee Act 2001 updated the statutory powers and duties of trustees contained in the Isle of Man Trustee Act 1961. Although the full provisions and implications of this Act are outside the scope of this guide, under this Act trustees have a statutory duty of care when carrying out their duties as well as a duty to act in the best interests of the beneficiaries.

Beneficiaries

These are the beneficial owners of property held within the trust. If a client establishes a Discretionary (Flexible) Trust, the trust will appoint both classes of discretionary and named beneficiaries. Alternatively, if a client establishes a Bare Trust, there will be no discretionary beneficiaries and instead the Settlor will appoint one or more absolute beneficiaries. The differences between these three types of beneficiary are explained next.

Discretionary

'Discretionary beneficiaries' is the name given to beneficiaries of a Discretionary (Flexible) trust. They may only benefit from the trust funds at the trustees' discretion and could also be excluded from benefiting at a future date. The death of a discretionary beneficiary does not have any Inheritance Tax implications for the trust.

Named (where applicable)

A named beneficiary has an entitlement to income but not capital. In the event that the trustees do not make an appointment of capital during the lifetime of the trust, the trust fund would default to those individuals who are named

in the trust deed as named beneficiaries in the percentage shares stipulated in the trust deed.

Absolute

An 'Absolute' beneficiary is the name given to beneficiaries of a Bare Trust. An absolute beneficiary will have an outright entitlement to capital from the trust and is able to demand payment of their share of the trust fund once they reach the age of majority.

If an absolute beneficiary dies, the portion of the trust fund belonging to him or her forms part of their estate for Inheritance Tax purposes.

Therefore, after the beneficiary's death, his or her share must be passed to his or her estate to be distributed in accordance with the terms of the will or via the laws of intestacy in their particular jurisdiction. If a client establishes a Bare Trust it is not possible to change the absolute beneficiaries.

Why use a trust in conjunction with an offshore bond?

There are various reasons why an individual might wish to place their bond into a trust or invest through a trust into a bond. The most common reasons are listed below:

To avoid Manx Probate

Any policies issued in the Isle of Man are classed as Manx assets and Manx Probate will be required on the death of a policyholder before either proceeds can be paid out or the policy is re-registered into the name of the new owner. Grant of Probate/Letters of Administration refers to the situation where, on a person's death, the court must confirm that the executors are entitled to deal with the deceased's estate before any assets can be distributed. If a bond is placed into trust, legal ownership lies with the trustees and Manx Probate will not be required on the Settlor's death. Therefore, this can help to provide privacy, as unlike trusts, Grant of Probate/ Letters of administration records are available to the public.

As long as there is a surviving trustee, proceeds of the bond can therefore be paid to the beneficiaries without delay.

To control family assets

Trusts have an advantage over an outright gift as the donor can exercise a degree of control and can still have access to capital in some limited cases. Many investors wish to set aside assets for the future benefit of members of their family whilst restricting beneficiaries' access until it is thought appropriate that those assets should be distributed. If the bond is written in a flexible trust, the trustees can be instructed to hold the bond until the beneficiaries reach a certain age or for future children or grandchildren.

Inheritance Tax planning for UK domiciled individuals

For individuals who are domiciled or deemed domiciled in the UK, Inheritance Tax applies to their worldwide property and would therefore include offshore investments. By arranging for the offshore bond to be held under trust, all or part of the proceeds from the bond may be removed from the Settlor's estate for Inheritance Tax purposes depending upon the type of trust chosen.

As you will see later in this guide, we offer a range of trusts which can be used to mitigate UK Inheritance Tax.

Inheritance Tax planning for non-UK domiciled individuals

An individual who has been a long term resident of the UK for Income Tax purposes but is not UK domiciled or deemed UK domiciled may wish to consider the establishment of an Excluded Property Trust in which to hold their offshore bond. This is because non-UK domiciled individuals who are likely to remain in the UK in the medium to long term can avoid future liability to Inheritance Tax on non-UK assets if those assets are placed in trust whilst the individual is still non-UK domiciled.

The trust assets will remain excluded property for as long as they remain in trust and are situated outside the UK (e.g. an offshore bond).

If an individual wishes to establish an Excluded Property Trust then please refer to our Excluded Property Trust Guide.

Introduction to Inheritance Tax

Where an individual is UK domiciled or deemed UK domiciled for Inheritance Tax (IHT) purposes, their worldwide assets are potentially subject to IHT at a rate of 40% (2017/2018). Generally speaking, IHT is the tax payable on an individual's estate when they die if the value of their estate exceeds the Inheritance Tax threshold which is known as the nil rate band (currently £325,000). Inheritance Tax can also be charged during an individual's lifetime.

Lifetime gifts can generally be classed into three main categories – exempt, potentially exempt or a Chargeable Transfer.

An exempt gift is free from Inheritance Tax. An example of an exempt gift would be a gift made from one UK domiciled spouse to another UK domiciled spouse.

A Potentially Exempt Transfer is where a lifetime gift is made outright to another individual or where the gift is being made to a Bare Trust (also known as an 'Absolute Trust') or a trust created for a disabled person (as defined under section 89(4) IHTA 1984). If a donor survives the potentially exempt transfer by seven years, it will be outside of their estate for IHT purposes.

A Chargeable Transfer is where an individual establishes a Discretionary (Flexible) Trust for the benefit of a wide range of beneficiaries. A Chargeable Transfer is not immediately chargeable to IHT providing there is an available Nil Rate Band against which it can be offset. Any amount of the Chargeable Transfer which exceeds the available nil rate band is chargeable immediately.

On the death of an individual, the seven year period prior to death is reviewed to see what gifts have been made. If during that period a Chargeable Transfer has been made, it is then necessary to review the seven years prior to the Chargeable Transfer in order to ascertain whether or not there was an available nil rate band available at the time of the Chargeable Transfer. This is why, potentially, there is a 14 year period under review when an individual dies.

Potentially Exempt Transfers and Chargeable Transfers take their chronological position for cumulative purposes at the time the gift was made at its value at that time.

Taper Relief provides that if a donor survives for at least three years after making a potentially exempt or Chargeable Transfer, only a reduced percentage of the full death rates will be used as follows:

Complete years between gift and death	Percentage of full charge at death rates
3-4	80%
4-5	60%
5-6	40%
6-7	20%

Although the taper relief reduces the amount of tax payable, it does not reduce the value of the gift.

It is important to remember that all transfers between UK domiciled spouses are completely exempt, unless the donor is domiciled in the UK but the donee is not, in which case the exemption is limited to £325,000. This is in addition to the £325,000 IHT NRB available to the estate of the UK domiciled spouse, so up-to £650,000 could be left to the Non UK domiciled spouse.

Despite the changes announced in the Finance Act 2006, many lifetime gifts made from small to medium sized estates will generally still fall within the nil rate band. In many cases therefore, lifetime Inheritance Tax planning using trusts can still be carried out without an immediate Inheritance Tax charge arising. Provided the donor survives for seven years and undertakes no further IHT planning during this period which would impact on the availability of his or her nil rate band, the full nil rate band will be available again.

One potential strategy which could be utilised, is for individuals to make lifetime gifts up to the value of the nil rate band every seven years. Any gifts made in between those years could be to utilise exemptions such as the annual exemption for gifts or the normal expenditure out of income exemption. It is of course also possible to establish a Bare Trust where no nil rate band is available at that time.

The Inheritance Tax treatment of Bare Trusts

The creation of the trust constitutes a Potentially Exempt Transfer.

If the Settlor survives seven years from the date of the Potentially Exempt Transfer, then the gift becomes exempt from Inheritance Tax.

If the Settlor dies within this period, the value of the initial gift would become potentially chargeable to Inheritance Tax unless there was an available nil rate band with which to offset against the value of the gift.

Any growth on the value of the gift is immediately outside of the Settlor's estate for Inheritance Tax purposes.

The value of the trust fund will form part of the named beneficiary's estate for IHT purposes.

The Inheritance Tax treatment of Discretionary (Flexible) Trusts

The creation of the trust is a Chargeable Lifetime Transfer (CLT).

It is possible to utilise the current year's annual exemption of £3,000 (2017/2018) and the previous year's annual exemption where they are still available in order to reduce the value of the gift.

If the amount of the gift is within the Settlor's available nil rate band, there is no immediate charge to IHT.

A CLT is immediately subject to Inheritance Tax at 20% (2017/2018) if the value of the gift exceeds the individual's available nil rate band at the time. The 20% applies to the excess of the value of the gift over and above the available nil rate band.

Where the nil rate band was exceeded on the creation of the trust, there would be further IHT to pay on the Chargeable Transfer if the Settlor died within the seven year period.

If a Settlor survives for seven years, the Chargeable Transfer drops out of their cumulation period.

As a result, the value of the gift will then be outside the Settlor's estate for IHT purposes. All investment growth (if applicable) is immediately outside the Settlor's estate.

The trust will be assessed for IHT on every tenth anniversary and every ten years thereafter at a maximum charge of 6% on the excess of the value of the trust fund over and above the nil rate band.

Distributions from the trust may trigger an IHT charge.

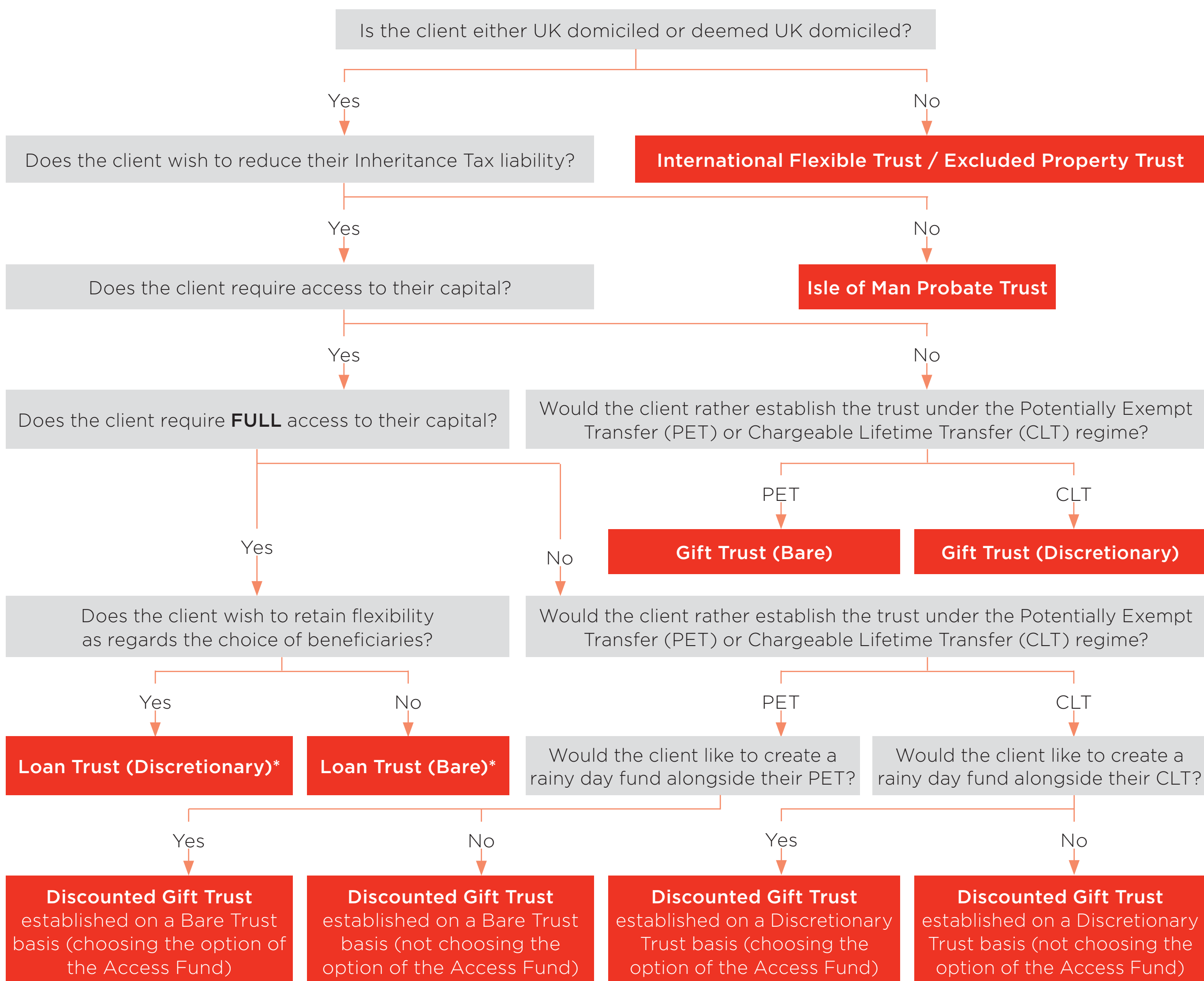
There will be reporting requirements to HMRC.

Chargeable Transfer reporting to Her Majesty's Revenue and Customs

It is sometimes necessary for a Chargeable Transfer to be reported to HMRC. The relevant statutory instruments are the Inheritance Tax (Delivery of Accounts) (Excepted Transfers and Excepted Terminations) Regulations 2008 and the Inheritance Tax (Delivery of Accounts) (Excepted Settlements) Regulations 2008.

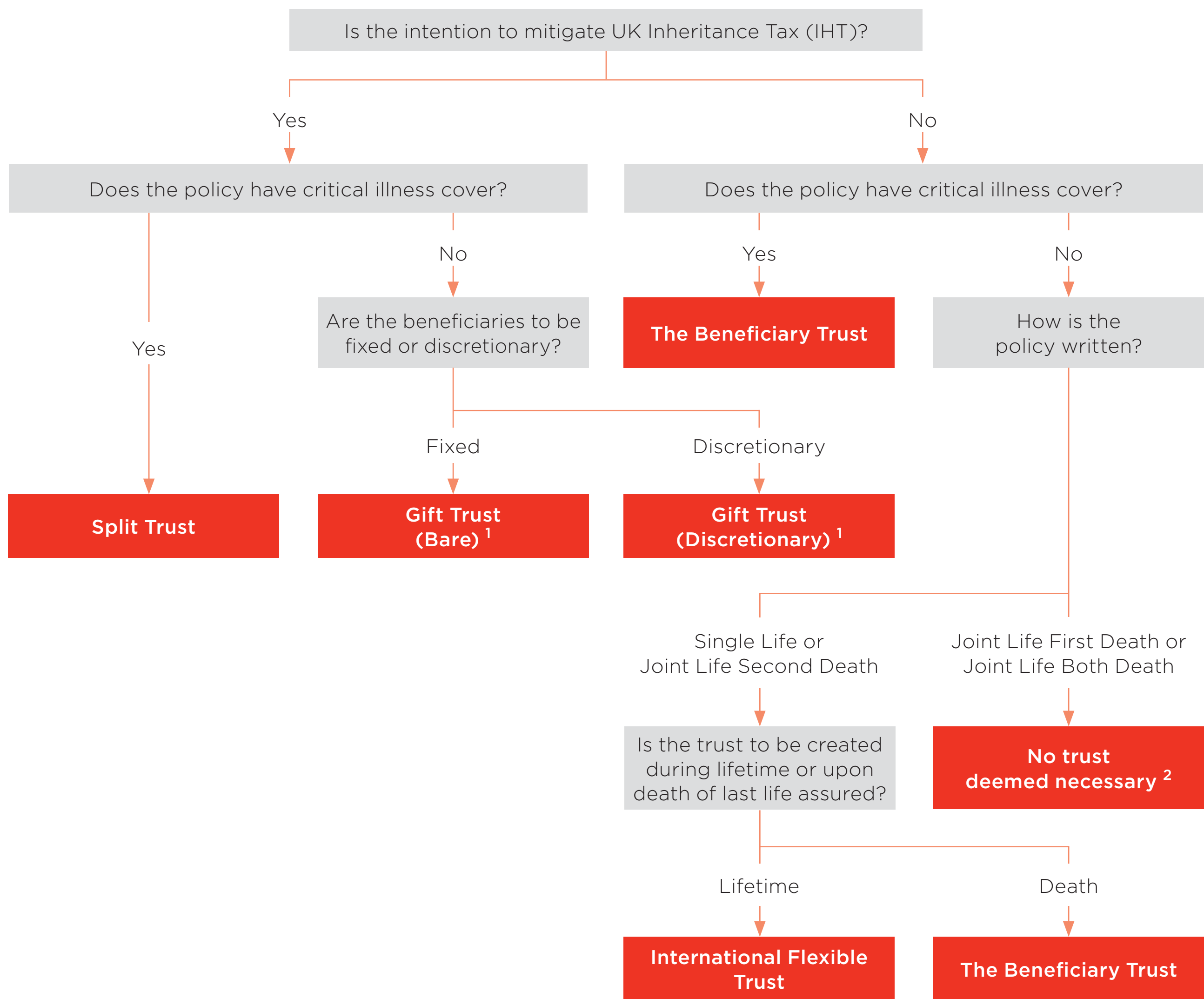
It is also necessary to submit an account to HMRC every ten years and also where monies leave the trust fund. The rules can be found in full on the HMRC website.

Which trusts are available for single premium products?



*** Please note that the Loan Trust cannot be used for existing policies.**

Which trusts are available for regular premium products?



1. The Settlor is excluded from benefit.
2. If Joint Life Both Death is chosen, assuming there is a surviving bondholder, the bond could be placed under a trust after the death of the first bondholder.

The Isle of Man Probate Trust

This is a simple Bare Trust which allows the Settlor access to their investment during their lifetime. The sole purpose of the trust is to avoid Manx Probate.

General features of the trust

- The trust can have up to two Settlors.
- The trust can be used for existing bonds.
- The trust can accept increments to the Trust fund.
- Since the Settlor is the sole beneficiary, the establishment of the trust is a ‘Gift with Reservation’ and therefore the value of the trust fund will remain within the Settlor’s estate for IHT purposes.
- The trust will avoid Manx Probate and providing that there is a surviving trustee, proceeds of the bond can therefore be paid to the beneficiaries without delay.

Key points to note

- The creation of the trust is neither a Potentially Exempt Transfer or a Chargeable Transfer.
- The Beneficial Owner is the sole beneficiary.
- If the offshore bond policy is written on a sole life assured basis, it allows the policy proceeds to be paid to the Beneficial Owner’s estate without the need for Manx Probate. Alternatively, if the policy was written on more than one life assured, or as a capital redemption policy, the ownership can be transferred into the name of a chosen beneficiary (named in the Beneficial Owner’s will or via the laws of intestacy) without the need for Manx Probate on the death of the Beneficial Owner.
- The trust will come to an end upon the death of the Beneficial Owner.
- The trust should not be used as an excluded property trust for non-UK domiciled individuals.

The Isle of Man Probate Trust would be suitable for individuals who:

- want to retain access to their investment
- wish to avoid Manx Probate and ensure policy proceeds can be paid without further cost and delay
- do not wish to create a Chargeable Transfer or a Potentially Exempt Transfer.

The Gift Trust

The Gift Trust represents the simplest form of Inheritance Tax planning in that the Settlor passes property by way of a gift to the trustees for the benefit of chosen beneficiaries. Some individuals will have an aversion to making substantial gifts directly to their children. For example, they may want the children to inherit the money at a later age when they are more financially mature or they may want to gift away money without it affecting the spouse’s access to the funds. This trust will allow an individual to make a gift without relinquishing full control over the monies.

General features of the trust

- The trust can be established with single or joint Settlors.
- The Settlor is not automatically included as a trustee.
- The Settlor is not a beneficiary.
- The trust can be used for existing or new RL360° bonds.
- The trust can accept increments to the Trust fund.
- The trust will avoid Probate assuming there is a surviving trustee alive at the time of the death of the last life assured on the policy.

The Gift Trust is suitable for individuals who:

- are UK domiciled or deemed UK domiciled for Inheritance Tax purposes
- can afford to gift away capital with no requirement for future access.

Establishing the trust as a Bare Trust would be suitable for individuals who:

- wish to create a potentially exempt transfer for IHT purposes
- wish to avoid reporting requirements to HMRC
- have specific beneficiaries in mind.

Establishing the trust as a Discretionary (Flexible) Trust would be suitable for individuals who:

- wish to create a chargeable lifetime transfer for IHT purposes
- wish to retain flexibility regarding their future choice of beneficiary.

Example

James is a UK resident property owner and wishes to invest £500,000 in an offshore policy. He has no intention of using this capital in the future and requires no income from the investment. He ultimately wishes the investment to pass to his two sons or their respective estates should they have pre-deceased him at the time of his death. James has two options. He can either:

1. place the policy into a Gift Trust established as a Bare Trust and nominate his two sons as the beneficiaries

or

2. decide against the use of a trust and leave the policy to his sons in his will instead.

What would be the difference in Inheritance Tax, should James die just over 5 years later? For this example we assume that the bond has grown in value at 5% per year, so is now valued at £638,141, with the remainder of his estate (including the property), being £600,000.

Option 1

Inheritance Tax arising on the Potentially Exempt Transfer on the creation of the Gift Trust:

Amount of initial investment into trust	£500,000
Less current year's IHT annual exemption	£3,000
Less last year's IHT annual exemption	£3,000
Less Inheritance Tax nil rate band of £325,000[1]	£325,000
Chargeable to IHT	£169,000

Taper relief of 60% available as James died between years 5 and 6. So 40% of the death rate of 40% = 16%.

16% of £169,000	£27,040
Tax on remainder of estate at death:	
Value of estate	£600,000
Less inheritance tax nil rate band (already used)	£0
Less Residence Nil Rate Band (RNRB)[2]	£175,000
Chargeable to Inheritance Tax	£425,000
Tax at 40%	£170,000
Total tax due on estate & trust £170,000 + £27,040 =	**£197,040**

Option 2

Inheritance Tax on estate at death where the policy was not written under trust.

Bond	£638,141
Balance of estate	£600,000
	£1,238,141
Less IHT NRB[1] of £325,000 & RNRB of £175,000[2]	£500,000
Chargeable to Inheritance Tax	£738,141
Tax at 40%	£295,256
Total tax due on estate - no trust used	£295,256

Placing the policy under the trust would save the estate a total of **£98,216** in Inheritance Tax.

[1] As of tax year 2017/2018. The IHT nil rate band has been frozen at £325,000 until the 2020-21 tax year.

[2] The Residence Nil Rate Band (RNRB) will increase to £175,000 from the 2020-21 tax year and then will increase in line with the Consumer Prices Index (CPI).

The Loan Trust

The Loan Trust enables the Settlor to make a gift of the growth of their initial investment and still retain control over it.

General features of the trust

- The trust **cannot** be used for existing policies.
- The trust allows for single or joint Settlor. However, as you cannot loan money to yourself, there needs to be an additional trustee that is not a Settlor.
- The Settlor is not a beneficiary but is entitled to repayment of their loan.
- The creation of the trust is neither a potentially exempt transfer or a chargeable lifetime transfer.
- Any growth on the value of the initial investment is immediately outside of the Settlor's estate for Inheritance Tax purposes.
- Any outstanding loan on the Settlor's death will form part of their estate for Inheritance Tax purposes.
- Assuming the level of loan repayments does not exceed the cumulative 5% per policy year, there is no immediate liability to Income Tax.
- If the Settlor has taken loan repayments then, to the extent that they have spent the money on disposable items, their taxable estate will be further reduced. Spending or gifting the loan repayments is therefore absolutely critical to the success of the planning to avoid them increasing the value of the Settlor's estate.
- The Settlor can make an express bequest of the outstanding loan balance in their will or in a codicil. If the bequest is in favour of the Settlor's UK domiciled spouse it will fall within the spouse exemption for Inheritance Tax and will enable the spouse to continue to receive loan repayments.
- Although deferring income is possible and will enhance the growth potential of the bond, the full amount of the loan will remain as an asset of the Settlor's estate.
- The trustees are responsible for repaying the loan to the Settlor. It is likely therefore that suitable trustees would include the Settlor's spouse/partner and or other family members rather than professional trustees. In practical terms it will often make sense to appoint the same person who has been named as executor(s) of the Settlor's will.

- Although there is nothing to stop the trustees making a distribution to a beneficiary during the lifetime of the Settlor, the trustees should never lose sight of the fact they are responsible for repayment of the loan and the trust fund provides their only means of doing this.
- Since the Settlor's entitlement is only in respect of the loan, it is important that the trustees monitor the position closely and ensure all repayments are recorded to avoid any breach of trust occurring through excess payment.
- The trust will avoid Probate assuming there is a remaining trustee alive at the time of the death of the last life assured on the policy.

Discretionary (Flexible) Trust – key points to note

- Although the trust will normally include the Settlor's spouse as a discretionary beneficiary, care should be taken if any payments are made to them during the life of the Settlor. If the payment can be seen in any way to benefit the Settlor, it could be deemed to be a Gift with Reservation.
- For the purposes of the ten yearly calculations in respect of potential Inheritance Tax charges, the value of the trust fund will be reduced by the amount of any outstanding loan.

The Loan Trust would be suitable for individuals who:

- are UK or deemed UK domiciled for Inheritance Tax purposes
- can afford to gift away future growth on their capital
- require full access to initial capital
- require flexibility as regards to frequency and amount of capital repayments
- do not wish to create either a Potentially Exempt Transfer or a Chargeable Lifetime Transfer.

Creating the trust as Bare Trust would be suitable for individuals who:

- have specific beneficiaries in mind
- wish to avoid ten yearly charges or charges when distributions are made from the trust
- wish to avoid future reporting requirements to HMRC.

Establishing the trust as a Discretionary (Flexible) Trust would be suitable for individuals who:

- Require flexibility as regards future beneficiaries.

Example

Gerald, who does not own any property, wishes to invest £100,000 in an offshore bond. He calculates that he will require income of £5,000 per annum from the investment and wishes only his current grandchildren to benefit from the investment on his death.

Gerald has two options, he can either:

1. establish a Loan Trust on a Bare Trust basis and name his grandchildren as the beneficiaries. He lends the trust £100,000 which is invested in an offshore bond. The trustees withdraw £5,000 per annum and pass this to Gerald as repayment of his loan

or

2. decide against the use of a trust and withdraw £5,000 from the bond each year. The investment is left to his grandchildren in his will.

What would be the difference in Inheritance Tax should Gerald die 10 years later? For this example we assume that the value of the bond is £100,000 with the remainder of his estate being £508,000.

Option 1

Tax position when the policy is written under a Loan Trust

Loan remaining in Gerald's estate	£50,000
Balance of estate	£508,000
Total estate or IHT purposes	£558,000
Less nil rate band*	£325,000
Chargeable to Inheritance Tax	£233,000
Tax due at 40%	**£93,200**

Option 2

Tax position when the bond is not written under trust

Value of bond at Gerald's death	£100,000
Balance of estate	£508,000
Total estate for Inheritance Tax purposes	£608,000
Less nil rate band*	£325,000
Chargeable to Inheritance Tax	£283,000
Tax due at 40%	**£113,200**

If Gerald had written his policy under a trust he would have saved IHT of £20,000 because the growth in the policy of £50,000 would have been outside of his estate for IHT purposes.

* Frozen at £325,000 until the 2020-21 tax year

The Discounted Gift Trust (DGT)

Our DGT is a trust where the individual gifts one of our offshore bonds into a trust for the ultimate benefit of the trust's nominated beneficiaries.

The trust allows for both a Gifted and an Access Fund to be created. The Settlor carves out a right to capital sums which are payable to the Settlor for as long as the Settlor survives or the trust fund is exhausted, if that should happen earlier.

Once the trust has been created it is not possible to amend the amounts of these capital sums payable to the Settlor.

The creation of the Access Fund is optional and is essentially a 'rainy day' fund which provides the Settlor with access to capital should unforeseen circumstances arise. If in the future, the Settlor decides they no longer require access to this fund, it can be gifted to the trust to be held for the benefit of their nominated beneficiaries.

The value of the amount gifted initially into the Gifted Fund is reduced for Inheritance Tax purposes should the Settlor die within seven years of creating the trust. This is because in the case of a gift made subject to retained rights, the amount of the transfer equals the gift less the value of those retained rights.

As this arrangement is trust based as opposed to product based, this provides flexibility if the trustees should decide to change the underlying assets.

General features of the trust

- It can be established with single or joint settlors and be used for new applications and can also be used with existing bonds.
- The Settlor is automatically included as a trustee
- The trust can accept increments to the trust fund whilst the Settlor is still alive and these can be used to top-up income. Furthermore, these further gifts can also be discounted subject to a satisfactory underwriting outcome.
- The trust allows the Settlor the option of creating an Access Fund.
- The trust will avoid Probate assuming there is a remaining trustee alive at the time of the death of the last life assured on the policy.

The DGT would be suitable for individuals who:

- are UK domiciled or deemed UK domiciled for Inheritance Tax purposes
- are looking to reduce the value of their estate for Inheritance Tax purposes and are prepared to make a gift so long as their standard of living can be maintained
- can afford to gift away any potential growth on their existing capital
- are in good health
- require an immediate reduction in Inheritance Tax
- require access to pre-determined capital payments from the trust
- are not confident about gifting away all of their disposable capital and would like the ability to retain access to some of it should unforeseen circumstances occur.

Establishing the trust as a Bare Trust would be suitable for individuals who:

- wish to create a discounted potentially exempt transfer for Inheritance Tax purposes
- wish to avoid reporting requirements to HMRC
- have specific beneficiaries in mind.

Establishing the trust as a Discretionary (Flexible) Trust would be suitable for individuals who:

- require flexibility regarding their choice of beneficiaries and would like to cater for as yet unborn family members.

Example

Mr Young is aged 65 and is a UK resident and domiciled individual. After speaking to his financial adviser, he sets up a RL360° Discounted Gift Trust using liquid assets of £250,000.

Mr Young's combined index linked pension and investment income is currently £20,000 per year and he has decided that he would like to take his maximum 5% withdrawals from the bond, as this is the amount he can withdraw each year without creating an immediate income tax liability. Based on £250,000, Mr. Young will be able to withdraw £12,500 per annum from his policy in order to supplement his existing pension and investment income.

Whilst Mr. Young is prepared to invest all of his liquid capital, he does want to retain the possibility of access to £100,000 of this money as he would like to be able to cover any unexpected future spending requirements. He therefore decides to place £150,000 in the Gifted Fund and £100,000 in the Access Fund. Proportionate withdrawals from both funds will provide him with annual payments of £12,500 for the remainder of his life or until such time as the trust fund is exhausted.

Mr Young currently has three children and one grandchild but he would like a trust which caters for the possibility of having further grandchildren in the future and decides therefore to create the trust on a flexible basis. Because the amount being invested in the bond is below his available nil rate band there will be no immediate inheritance tax charge.

Following underwriting, Mr. Young is found to be in good health and we calculate the discounted value of the transfer to the Gifted Fund as being £52,979. Therefore , if Mr. Young should die within the next seven years, this reduces the gift for inheritance tax by £97,021, resulting in a saving of £38,808 in inheritance tax.

In addition, if Mr. Young survives seven years, then the full value of the trust fund will be outside his estate for inheritance tax.

The Split Trust

The Split Trust allows a UK domiciled LifePlan policyholder to undertake flexible Inheritance Tax (IHT) planning where Critical Illness Cover and Life Cover are selected. Upon the diagnosis of a Critical Illness, and subject to surviving the diagnosis by 30 days, the trustees will advance the Critical Illness Cover to the life assured for them to use as they see fit. The Life Cover element of LifePlan will remain in trust and will not be taken into account for IHT valuation purposes on their death.

General features of the trust

- Can only be used with RL360° LifePlan
- Must only be used where the plan is owned by one person where both Critical Illness Cover and Life Cover are selected
- The Settlor is automatically included as a trustee
- Critical Illness Cover is advanced to life assured (subject to surviving the diagnosis by 30 days)
- Life Cover remains in trust for the beneficiaries
- Life Cover element will not be taken into account for IHT purposes

The Split Trust would be suitable for individuals who:

- require the policy to be placed in trust but require access to a lump sum if diagnosed with a Critical Illness
- are UK domiciled or deemed UK domiciled for Inheritance Tax purposes
- want their Life Cover to fall outside their estate for Inheritance Tax purposes
- wish to avoid Probate and ensure policy proceeds can be paid without further cost or delay. (Probate will be avoided as long as there is a remaining trustee alive at the time of the death of the last life assured on the policy).

Example

John is a UK national who is currently living and working in Africa. He is concerned that should something unfortunate happen to him, both he and his family may struggle financially. John arranges to see a local financial adviser. After evaluating the overall position, John's adviser suggests that he should apply for a RL360° LifePlan with additional Critical Illness Cover.

Whilst John has no plans to return to UK just yet, he will eventually and, as such, his adviser suggests that the policy is written in a suitable trust. The correct trust will avoid the death benefit being assessable to IHT upon John's death.

The trust being suggested by the adviser is the RL360° Split Trust which allows John to be given access to the Critical Illness benefit under the policy providing he survives the diagnosis of a Critical Illness by 30 days.

This will of course be an asset of John's IHT assessable estate however, by surviving 30 days it is likely that John's prognosis will be such that he will be able to use and spend the amount of cover to improve his standard of living should his health be impaired.

If John does not survive the diagnosis of the Critical Illness by 30 days, then rather than unnecessarily increasing his potential liability to IHT, the amount of cover will remain in trust and fall outside of his IHT assessable estate as per the Life Cover.

John applies for LifePlan and decides that £500,000 Life Cover with £150,000 Critical Illness Benefits is more than sufficient for his and his dependants' needs. Once the policy is issued, it is placed in the Split Trust.

Two years later, John suffers a heart attack. He survives the diagnosis by 30 days and his general prognosis looks good. John's Trustees (of which he is one) pay the £150,000 Critical Illness cover to him to spend as he sees fit. John decides to take early retirement and move back to the UK permanently.

Ten years later, John unfortunately dies, however as the Whole of Life Cover continued to be held in the Split Trust, it does not form part of the estate for IHT valuation purposes and his trustees are free to distribute the benefit in accordance with John's wishes, without having to wait for John's executors to file an IHT return and obtain UK and Isle of Man probate.

International Flexible Trust

This is a simple trust which allows a Settlor to nominate a person(s) who in the event of the policyholder's death should be paid the proceeds of the death claim without the need for obtaining Isle of Man Probate.

General features of the trust

- The trust can have up to two Settlors.
- The trust can be used for existing bonds.
- The trust can accept top-ups.

Key points to note

- The trust should only be used by individuals who are non-UK domiciled for IHT purposes. This is because, for individuals who are UK domiciled, the creation of the trust would be a chargeable transfer as well as a Gift with Reservation.
- The Settlor is a beneficiary of the trust.
- For a non-UK domiciled Settlor, who may move to the UK at a later date, the trust can be used as an Excluded Property Trust. However, we do also have an Excluded Property Trust which is specifically designed for Non-UK domiciled individuals moving to or already resident in the UK.
- For non-UK domiciled persons already resident in the UK, this is only effective where the person is not yet deemed UK domiciled for UK IHT purposes, i.e. worldwide assets are then subject to UK IHT. (See our *Excluded Property Trust Guide* for further details).

The International Flexible Trust might be suitable for non-UK domiciled individuals who:

- wish to retain access to their investments.
- wish to ensure that their policy passes to a nominated beneficiary upon death.

Excluded Property Trust

A flexible/discretionary trust which enables Non-UK domiciled individuals to protect their Non-UK assets (e.g. a single premium offshore bond with ourselves) from UK inheritance tax (IHT).

General Features of the Trust

- The trust can have up-to two Settlors
- The trust can be used for new applications and for existing bonds.
- As long as the individual is still deemed non-UK domiciled for inheritance tax purposes, then the trust can accept top-ups.

Key Points to Note

- Just like the International Flexible Trust, the trust should only be used by individuals who are non-UK domiciled for IHT purposes. This is because, for individuals who are UK domiciled, the creation of the trust would be a chargeable transfer as well as a Gift with Reservation.
- The Settlor is a beneficiary of the trust.
- Please see our Excluded Property Trust Guide for further details.

The Excluded Property Trust might be suitable for non-UK domiciled individuals who:

- wish to retain access to their investments.
- wish to protect their investment from UK inheritance tax.
- wish to ensure that their policy passes to a nominated beneficiary upon death.

The Beneficiary Trust

This trust has been designed for policyholders who are non-UK domiciled and who want the policy's benefits to go to one or more beneficiaries in the event of death. Whilst there is nothing to prevent UK domiciled policyholders from also using the trust, it is important to understand that there would be no IHT planning advantages in doing so.

The Beneficiary Trust comes into being on the death of the 'Relevant Person'. The 'Relevant Person' is the person on whose death the benefits of the policy become payable. Where there are joint policy owners, the policy will not pass into trust until both owners are deceased. It is important to note however that where the policy is written on a joint life first death basis, the trust will not work because, on the death of the first life assured, the policy would simply pay out to the surviving policyholder.

The trust will be of particular interest to those individuals who want the bond to remain in their own name during their lifetime but would like the policy to pass into trust after their death. This will mean that, assuming at least one of the nominated trustees is still alive on the death of the last surviving policyholder, the costs and delays associated with obtaining Probate would be avoided.

How does it work?

When the sole or last surviving policyholder dies and this simultaneously brings the bond to an end by virtue of them also being the sole or last remaining life assured, then the proceeds of the policy may be paid to the trustees. Alternatively, assuming the beneficiaries are 18 or over and our requirements have been met in terms of obtaining satisfactory client and address verification requirements we could make payment directly to the beneficiaries.

If the beneficiaries are under the age of 18, because the trust has powers of reinvestment, the proceeds of the policy could be reinvested under the terms of the trust until such time as the beneficiaries reach the age of 18.

Where the sole or last surviving policyholder dies and there is still a life assured in existence, the policy automatically passes into trust and is held by the trustees until such time as the trustees wish to distribute the trust fund either by surrendering or assigning the bond out of the trust to a beneficiary.

The trust can be revoked at any time leading up to the death of the last policyholder by the policyholder simply writing to us and informing us that they no longer wish to use the trust or by completing a new Beneficiary Trust which would simply replace the previous version. This would be relevant where the policyholder(s) has a change of heart over his or her intended beneficiaries of the trust.

Important notes

For financial advisers only. Not to be distributed to, nor relied on by, retail clients.

Please note that every care has been taken to ensure that the information provided is correct and in accordance with our current understanding of the law and Her Majesty's Revenue and Customs (HMRC) practice as at June 2017. You should note however, that we cannot take upon ourselves the role of an individual taxation adviser and independent confirmation should be obtained before acting or refraining from acting upon the information given. The law and HMRC practice are subject to change. Legislation varies from country to country and the policyholder's country of residence may impact on any of the above.

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