

LOAN TRUST

OUTSTANDING LOAN

This guide covers the common areas that arise when dealing with the outstanding loan on a loan trust.

HOW IS THE AMOUNT OF OUTSTANDING LOAN DETERMINED?

The settlor will provide a loan agreement to the trustees confirming the amount of the loan. The trustees will then use the loan to invest into a new policy or possibly top-up an existing policy.

The trustees can take withdrawals at various stages from the trust. These withdrawals could be loan repayments to the settlor, trustee costs/fees, as well as distributions to the beneficiaries.

The value of the outstanding loan would equal:

Total Loan Agreements to Trustees - Total Loan Repayments to Settlor - Total Loans Waived by Settlor

NB: The total loan amount on the agreement to the trustees could be different to the premium received. This situation could occur where the settlor is looking to both make an additional loan to the trustees (that would be repaid) as well as a gift in favour of the beneficiaries.

HOW IS THE OUTSTANDING LOAN TREATED FOR UK INHERITANCE TAX?

Although any growth of the trust fund is immediately outside of the settlor's estate, the outstanding loan remains part of the settlor's estate for UK inheritance tax (IHT).

During the settlor's lifetime they may decide that they no longer require access to the outstanding loan and would like to know what options are available to remove the IHT liability from their estate, or the settlor may want to know what will happen to the outstanding loan following their death.

SETTLOR ALIVE

During the settlor's lifetime they are able to:

- Demand repayment of the loan in full. This could give rise to a chargeable event for a UK tax resident. Once the funds are outside of the trust the settlor would be able gift the funds as they see fit. Gifting of the funds, unless exempt, would be a potentially exempt transfer (PET).
- Waive the rights of some or all of the loan in favour of the trust. This would either be a chargeable lifetime transfer (CLT) where the discretionary version of the trust has been used, or a PET where the bare version of the trust has been used.

Once the loan has been waived in full, the loan trust effectively becomes a gift trust. The trustees no longer have an obligation to repay the loan and are able to distribute the trust fund to the beneficiaries as per the terms of the trust.

RL360 has a draft deed that can be used to waive all or part of the outstanding loan.

- Gift the rights to the outstanding loan to another individual. The gift would be made by deed and would be treated as a PET unless the gift was exempt. The individual who receives the rights to the loan could then request repayment on demand from the trustees. The outstanding loan could remain as part of that individual's estate for IHT.

NB: where the gifting or waiving of the loan is a CLT or PET the usual seven year rule would apply. An IHT charge could apply where the gifting or waiving of the loan is a CLT.

SETTLOR DECEASED

The outstanding loan remains an asset of the estate. If cash is required to repay any liabilities or pay IHT, the personal representatives will need to request the trustees repay the outstanding loan.

If the personal representatives do not require any cash to settle debts they would need to review any specific provisions left within the will.

Therefore, it is important that the will of the settlor is kept up to date to address the outstanding loan.

- The settlor could leave instructions within their will for the outstanding loan to be left to another individual. The trustees could continue to make loan repayments to that individual without the need to surrender the investment.
- The settlor could leave instructions within their will to waive the rights to the loan in favour of the trust. The trustees would not be required to make any further loan repayments and could distribute the trust fund to the beneficiaries.
- If no provision has been made within the will the personal representatives would generally need to contact the trustees and call in the outstanding loan. This could give rise to a chargeable event. The funds would then be passed to the beneficiaries entitled to the residual estate.

Although the personal representatives could have a duty to call in the outstanding loan, this must be carried out by contacting the trustees directly.

RL360 would only accept an instruction from the trustees to make a withdrawal from or surrender the policy held within the loan trust, even if another individual has been given the rights to the outstanding loan under a will.

It is therefore important that the settlor makes plans for any outstanding loan at the time the trust is created and ensures that this information is kept up to date.

IMPORTANT NOTES

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

Taxation of an offshore policy is subject to the client's residency.

Please note that every care has been taken to ensure that the information provided is current and in accordance with our understanding of current law and HM Revenue and Customs' (HMRC) practice.

You should note however, that we cannot take on 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.