A Brief Guide to………
IHT Planning – Gift & Loan Plans

Whitings Chartered Accountants LLP

Loan trusts are investment bond based Inheritance Tax (IHT) planning arrangements. This fact-sheet explains how a loan trust works and the IHT treatment for the settlor. All content relates to a UK domiciled and resident settlor and an onshore life assurance investment bond.

Loan trusts were first introduced as IHT planning arrangements in the 1980s. They are 'slow burners' as they offer the potential to reduce exposure to IHT over the medium to long term.

A loan trust can be suitable for someone who wishes to minimise a potential IHT liability but wants to retain access to their capital. Such a person is unwilling or unable, to make an outright gift (that would count as either a potentially exempt or chargeable lifetime transfer) which is likely to be more IHT efficient.

Loan trust providers offer all the necessary documentation for setting up a loan trust. The first stage is to create the trust itself. The settlor then makes an interest-free cash loan to the trustees. The settlor also stipulates the terms on which they want the loan repaying (this is often at a rate of 5% a year). The arrangement should be on a single settlor basis, not either joint settlors or two separate 'reciprocal' plans for a couple, to avoid IHT gift with reservation of benefit concerns.

Advisers will also be familiar with 'gift and loan' trust plans where a, usually IHT efficient, starter gift is made to the trust. The amount of the gift is normally covered by the £3,000 annual IHT exemption and therefore falls immediately outside of the settlor’s estate. In all other aspects such plans are identical to loan trusts.

The trustees will invest the loan amount in an investment bond. There are many advantages of holding a bond as an asset of a discretionary trust, including:

- A bond is a non-income producing asset. If an income producing asset was held, by trustees of a discretionary trust, there would be the added problems of what physically to do with that income, complex taxation rules (including possible anti-avoidance complications) and the need for tax returns.
- The ability to take tax efficient withdrawals.
- The general product features of a bond. These include a wide range of investment fund options, straightforward switching between funds (with no tax implications) and the ability to segment a policy into a number of "cluster" policies.
- Bonds can be written on a joint-life second death basis, and this can provide great flexibility when dealing with the bond after the settlor’s death. If the bond has at least one life assured who has survived the settlor, it is possible to time the final encashment of the bond and so that the greatest tax efficiency is achieved.

The trustees fund the loan repayments using regular withdrawals from the bond. For maximum IHT efficiency, it is important that the settlor spends or gifts the repayments they receive so that these amounts do not accumulate and form part of their estate.

The settlor may, at any time, instruct the trustees to stop, increase or decrease the loan repayments and can also demand full repayment of the outstanding loan balance. Once the loan capital has been repaid in full, after 20 years at 5% a year, the settlor has no further right to any remaining trust capital. The trustees can distribute any residual amounts, the 'growth' element, to trust beneficiaries according to the trust terms and conditions. Most loan trusts, since 2006, are written under on a discretionary basis and include a wide range of potential beneficiaries.

If the value of a bond has fallen below the amount needed to meet a repayment, the trustees may be personally liable to fund any shortfall. Some trust wordings avoid this possibility by limiting the trustees' liability to the value of the bond. The settlor could also waive the amount of shortfall although this would be treated as a gift to the trust for IHT purposes.

If a settlor dies before the loan is repaid, the value of the outstanding balance is included as an asset of their estate. Any surplus value falls outside of the estate. The settlor can gift the right to any outstanding loan to someone else, in their will, and the loan trust could therefore continue on that basis. If the bond is written on a joint life second death basis, on the lives of the settlor and a young and healthy trust beneficiary, the bond could also continue after the settlor's death.

Whilst a number of IHT planning schemes have been forced into closure, by a combination of tax or anti-avoidance legislation, case law and HM Revenue & Customs practice, the slow burning loan trust has stood the test of time. HM Revenue & Customs know all about loan trusts and they therefore fall outside of the Disclosure of Tax Avoidance Scheme (DOTAS) requirements.

Important notes

Anyone thinking of using a Gift & Loan Plan, or doing anything under the provisions of a trust, must seek and rely on the advice of a suitable tax and trust practitioner. You should take appropriate professional advice before going ahead with any planning of this nature.

This is very important for a number of reasons.

- This trust will not be suitable in all cases. Other forms of tax and trust planning may be more suitable in individual circumstances.
- Creating a trust can have tax as well as legal consequences.
- Once a trust has been created it cannot be revoked.

The trustees have special duties to the settlor(s) and beneficiaries and the misuse of a trust power by a trustee can make him or her personally liable for resulting losses.

- Situations that may involve international or cross-border legal and taxation issues can be extremely complex.
- Tax and trust law can be open to differing interpretations.

Find out more

For further information, advice and guidance please contact one of our specialists:

Richard Franks – Senior Financial Planner
Telephone 07519 109906
E-mail richard@whitingswm.co.uk

Every care has been taken as to accuracy, but it must be appreciated that Whitings Wealth Management and their representatives cannot accept responsibility for loss, however caused, suffered by any person who has acted or refrained from acting as a result of the material published in this guide or with the use of trust instruments. This is a general illustrative guide only and individual professional advice should be obtained on specific issues and their own circumstances.
Information is believed correct at time of publication but may alter.

Whitings Chartered Accountants LLP

Bury St. Edmunds Office
Greenwood House, Greenwood Court
Skyliner Way
Bury St. Edmunds
Suffolk
IP32 7GY
Telephone: (01284) 752313
E-mail: bury@whitingsllp.co.uk

Ely Office
George Court
Bartholomew's Walk
Ely
Cambridgeshire
CB7 4JW
Telephone: (01353) 662595
E-mail: ely@whitingsllp.co.uk

King's Lynn Office
Norfolk House
Hamlin Way
Hardwick Narrows
King's Lynn
Norfolk
PE30 4NG
Telephone: (01553) 774745
E-mail: kingslynn@whitingsllp.co.uk

March Office
The Old School House
Dartford Road
March
Cambridgeshire
PE15 8AE
Telephone: (01354) 652304
E-mail: march@whitingsllp.co.uk

Mildenhall Office
Willow House, 46 St. Andrews Street
Mildenhall
Bury St. Edmunds
Suffolk
IP28 7HB
Telephone: (01638) 712267
E-mail: mildenhall@whitingsllp.co.uk

Peterborough Office
Eco Innovation Centre
Peterscourt
City Road
Peterborough
PE1 1SA
Telephone: (01733) 564082
E-mail: peterborough@whitingsllp.co.uk

Ramsey Office
108 High Street
Ramsey
Huntingdon
Cambridgeshire
PE26 1BS
Telephone: (01487) 812441
E-mail: ramsey@whitingsllp.co.uk

St Ives Office
Raleigh House
14C Compass Point Business Park
Stock Bridge Way
St Ives
Cambridgeshire
PE27 5JL
Telephone: (01480) 468931
E-mail: stives@whitingsllp.co.uk

St Neots Office
First Floor, Phoenix House, 2 Phoenix Park
Eaton Socon
St Neots
Cambridgeshire
PE19 8EP
Telephone: (01480) 470755
E-mail: stneots@whitingsllp.co.uk

Wisbech Office
12 & 13 The Crescent
Wisbech
Cambridgeshire
PE13 1EH
Telephone: (01945) 584113
E-mail: wisbech@whitingsllp.co.uk