



INHERITANCE TAX PLANNING – LOAN TRUST

PURPOSE

To provide an Inheritance Tax (IHT) saving by placing monies into an investment bond within the loan trust arrangement that will immediately remove any growth from the estate, while allowing the creator(s) of the trust (Settlor(s)) access to the 'original' capital investment. Note that the Settlor has no entitlement to any growth within the plan.

DESCRIPTION

The IHT 'gift with reservation' rules have made it difficult to achieve an inheritance tax saving whilst retaining an income or benefit from assets.

This may be overcome by using a specially designed IHT Loan Trust. Under this plan the Settlor(s) are able to make an interest free loan repayable on demand, the proceeds of which are placed in a suitable investment written in trust for chosen beneficiaries. As the investment grows in value the growth will fall outside the estate for the benefit of the beneficiaries.

How does a Loan trust work?

- The investor (the Settlor) sets up a trust, appointing trustees and beneficiaries.
- The Settlor makes a loan, interest free and repayable on demand, to the Trustees.
- The Trustees can invest the money in for example a single premium investment bond. During the Settlor lifetime he/she retains access to the capital through his/her entitlement to loan repayments. However, the provisions of the Loan Trust ensure that subsequent growth on the amount put in trust is excluded from the Settlor estate for Inheritance Tax purposes.

As the interest free loan is not a gift for IHT purposes there is no potential IHT charge on setting up the trust. The intention is that the trustees (typically the Settlor, a professional person and/or the beneficiaries) make withdrawals from the bond in order to repay your loan over a period of time. These regular withdrawals could be used to provide an 'income' each year.





The person setting-up the trust (the Settlor) can make withdrawals up to the value of the outstanding loan. On death or earlier surrender of the bond, an additional tax charge may be incurred should the Settlor be liable to higher rates of tax. In addition to setting up the bond on the life of the Settlor, the bond can be written on the lives of the beneficiaries. In this way the bond can continue after the death of the Settlor. Under current legislation, any gains arising whilst the Settlor is alive will be by reference to your tax situation as Settlor. If however a gain is realised in the tax year following the Settlor's death or later, any gains will be taxed with reference to the rate of tax for trusts (currently 40%). This means that trustees have an additional 20% tax to pay on any gains, as tax at 20% is deemed to have been paid within the fund.

It should be noted that there is a possibility that where the value of the fund falls and the loan is called in at a time when the fund is not adequate to meet the repayment, the trustees may be personally liable for the shortfall.

It is the Trustees responsibility to cease withdrawals from the policy once the outstanding loan has been repaid.

The loan of monies to trustees is not a transfer value for Inheritance Tax purposes, and does not create any immediate liability. Because the Settlor is excluded from benefiting under the Loan Trust, the growth on the amount invested is outside of the estate and therefore free from Inheritance Tax on his or her death.

The amount of any outstanding loan will remain as part of the Settlor's estate for Inheritance Tax, but this may of course be reduced by loan repayments made by the trustees.

The Settlor and his/her spouse should not enter into reciprocal arrangements whereby each may benefit from a trust effected by the other, as this may result in adverse Inheritance Tax treatment.

The Settlor can waive their right to the repayment of the loan by means of a deed. The amount of the loan outstanding at the time would then be a Potentially Exempt Transfer for Inheritance Tax purposes and thereby fall outside of the estate after seven years following the transfer.

EFFECTS

To provide IHT savings without depriving access to capital, and thereby allowing beneficiaries to inherit a larger proportion of an estate by taking any growth within the trust outside of the estate. Note this is not a solution to IHT, but a method of mitigating its impact.

CASE STUDY

Mr & Mrs Ellison are both age 65 and have an estate worth £750,000. The main Beneficiaries of the estate is their only son. They are concerned about their estate's liability to IHT and their own financial independence into retirement. Having taken certain other steps to mitigate the IHT liability they are keen to explore other possible solutions.





Having taken into consideration their own future needs and requirements they have estimated that they can afford to gift £100,000 from their estate immediately leaving them with other liquid resources to fund foreseen and future unforeseen expenditure. However, for their own financial security they wish to have an entitlement to all these funds in case of an emergency or indeed to fund any future long term care costs.

Therefore, they have decided to invest £100,000 into a Loan Trust with themselves and family solicitor as the Trustees, and their son as the sole Beneficiary. This will allow them to keep control over monies and have the ability to alter or add Beneficiaries in the future. As they have no need for an income and have access to other capital resources they will allow the investment within the trust to accumulate.

After five years the investment is now worth £140,000. Of this, £100,000 remains inside the estate, with the remaining £40,000 growth outside the estate resulting in an IHT saving of £16,000.

After a further five years unfortunately Mr Ellison has passed away. Therefore, Mrs Ellison who is now on a reduced pension income decides to make a capital withdrawal amounting to £50,000, leaving £50,000 of original investment in the trust, plus £70,000 growth that is outside the estate resulting in an IHT saving of £28,000. Mrs Ellison also decides to take a regular withdrawal of 5% of the original investment payable each year amounting to £5,000.

After ten years Mrs Ellison, having received the repayment of the remaining £50,000 is no longer entitled to further payments from the trust having received full repayment of the £100,000. The trust is now worth £150,000 all representing growth within the trust and is therefore fully outside the estate resulting in an IHT saving of £68,000.

Five years later Mrs Ellison passes away with the trust worth £200,000 which passes without charge to IHT or the delays associated with Probate to their son resulting in an IHT saving of £80,000.

For further information please call 0845 0551970 or go to www.henwoodcourt.com

