# THINKING ABOUT TRUSTS FOR GENERATION PLANNING

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ABOUT THE AUTHOR

David Matthews is the Head of UK Sales in Utmost Wealth Solutions and has worked in the life assurance industry for over 20 years. In this article, he explores some key points around trusts and how they can be employed as part of a holistic financial planning strategy.

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Oliver Wendell Holmes, an American physician, poet, and polymath was a wise man indeed. He told us 'Put not your trust in money, but put your money in trust.'

It is widely proposed that the concept of 'trust' originates from medieval England when knights went to war and left their property at the disposal of other persons. It was necessary to comply with the will of the knight, the initial owner, whilst at the same time enabling the empowered person to manage this property effectively. It has also been proposed that the concept of trust is even older and was present in Roman and Greek law. (Source: Lexcorp.com)

Today, the benefits of creating a trust are widely recognised. Modern trusts are used for a variety reasons including asset protection, probate avoidance, estate planning and Inheritance Tax (IHT) mitigation. So let's take a look at how to demystify trusts and how they can be employed as part of a holistic financial planning strategy.

Generally, there are three main parties to a trust as noted below:

**Settlor:** The original owner

**Beneficiary:** The equitable owner

**Trustee:** The absolute owner

The following paragraphs cover general concepts regarding the application of trusts. Specific attention needs to be given to any interaction of considerations such as allowances and previous gifts, for example.

Since the amendments to trust taxation in 2006, which brought the majority of lifetime trusts into the 'Relevant Property' regime, there are broadly two main types of trusts to take into account when considering making gifts, namely the absolute / bare trust and the discretionary trust.

Transfers to absolute / bare trusts are treated as Potentially Exempt Transfers (PETs). The gifted amount will be removed completely from the settlor's estate for IHT purposes on survival for seven years. The settlor is excluded from benefit but there is no flexibility in future, as the beneficiaries named at the outset are the only people who can benefit. Beneficiaries' individual shares of the trust property will be stipulated in the trust deed. On reaching the age of majority (18), beneficiaries can also legally demand their right to their portion of the trust fund.

Transfers to discretionary trusts are treated as chargeable life transfers (CLTs). The gifted amount will also be removed from the settlor's estate after the seven year gifting period, assuming the settlor is excluded from benefitting. This said, due to the extra flexibility, which is covered later, there are also a number of other potential charges that may apply. Transfers to discretionary trusts are not chargeable to the lifetime rate of IHT (20%) at the time of transfer, as long as they do not exceed the IHT Nil Rate Band (NRB). Transfers in excess of the NRB will be charged at the time at 20% on the excess over the NRB.

There is also the potential for periodic and exit charges at the 10 year point or at the time of withdrawal. At the 10 year periodic charge point and subsequent 10 year anniversaries, there will be a charge due of 6% on the value exceeding the then NRB. Discretionary trusts are often preferred in generation planning due to the extra flexibility they allow in being able to benefit a very broad class of beneficiaries, including potential unborn generations.

There are a wide variety of trust based schemes which can be used to mitigate IHT. Many such schemes will be used in conjunction with an offshore portfolio bond, which, as a non-income producing asset, complements trusts perfectly due to the simplified administration. Some of the most popular arrangements to mitigate IHT are: Discretionary Will Trusts, Loan Trusts, Discounted Gift Trusts, Lifetime Gifts to Trustees and Deeds of Variation.

There isn't space in this particular article to cover all five but let's look at the basic benefits and mechanics of one of the most popular, the Loan Trust.

## LOAN TRUST KEY BENEFITS

- Retaining access to capital
- Removing future growth from the estate of the settlor
- Providing a tax efficient income stream throughout life

## LOAN TRUST MECHANICS

The available funds for investment, which must be in cash, are packaged up as an interest free loan made by the settlor to individual or corporate trustees. The loan is repayable on demand at any time.

The Trustees then use the funds to purchase an offshore portfolio bond, which is held in trust for the potential beneficiaries. The outstanding loan remains in the estate of the settlor.

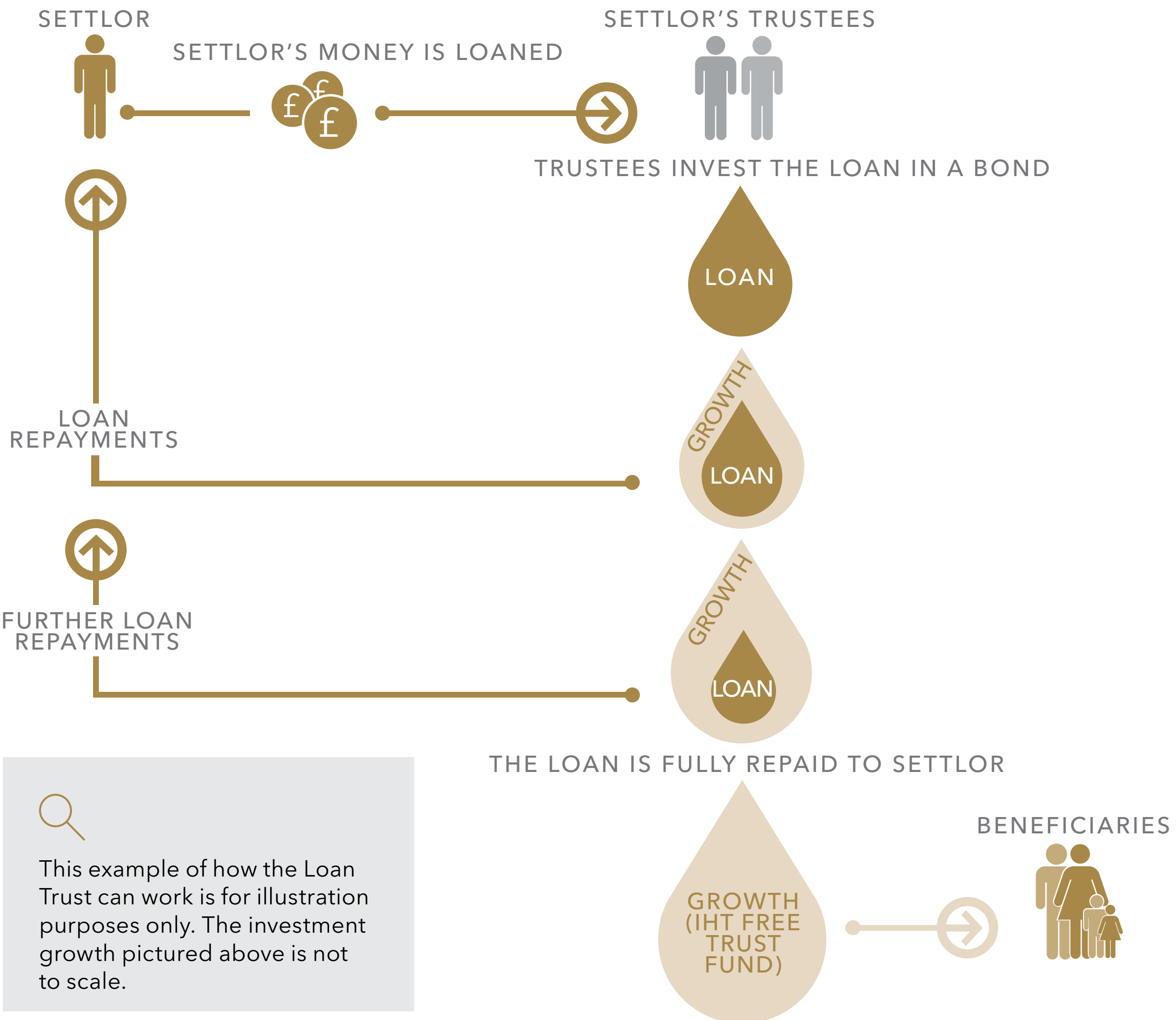
Typically, the Trustees, which should exclude the settlor and their spouse, will make use of the 5% tax deferred withdrawals from the portfolio bond in order to make part repayments of the loan. Over 20 years, for example, the whole loan will have been repaid and the settlor will be unable to have any further access to funds, as all of the original loan capital has been returned.

Any growth on the bond will be held on trust for the potential beneficiaries and will be outside the settlor's estate for IHT purposes.

As an alternative strategy, where the settlor does not need to take withdrawals, growth on the part held on trust for the beneficiaries will be maximised but the full outstanding loan would remain in the estate of the settlor. Thus, the liability to IHT would be frozen at the same level it was at the establishment of the Loan Trust.

For more information on the planning benefits of the Loan Trust please contact your Utmost Regional Sales Manager or visit our online technical hub, uTECH, where a wealth of technical briefings and sales aids can be found. The next article in the series looks at the key benefits and the mechanics of the Discounted Gift Trust.

## HOW THE LOAN TRUST WORKS




This example of how the Loan Trust can work is for illustration purposes only. The investment growth pictured above is not to scale.

This information is based on our understanding of current law and taxation practice in the Isle of Man, the UK and Ireland as at 1 December 2021. This could change in the future. Tax treatment is subject to individual circumstances and your client should always seek independent and individual tax advice. The value of the bond can go down as well as up and the trustees may get back less than they invested.

https://lexcorp.com/en/trust/history/