

PARAPLANNERS ASSEMBLY

AN IN-DEPTH VIEW OF THE RELEVANT
PROPERTY REGIME

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OCTOBER 2021

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WEALTH SOLUTIONS

AGENDA

- SESSION IS FOR APPROX 45 MINS PLUS QUESTIONS
- AIM OF SESSION IS TO GIVE AN IN DEPTH ANALYSIS OF THE TAXATION OF TRUSTS.

INTRODUCTION

THE RELEVANT PROPERTY REGIME AND 2006

ENTRY CHARGES

EXIT CHARGES IN THE FIRST TEN YEARS

PRINCIPAL CHARGES (PERIODIC CHARGES)

EXIT CHARGES AFTER 10 YEARS



INTRODUCTION

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DETERMINING FACTORS FOR WHETHER A TRUST IS SUBJECT TO INHERITANCE TAX UNDER RELEVANT PROPERTY REGIME

1. Type of settlement and when it commenced
2. Domicile of the settlor
3. Situs of property, for example:
 - a) Land – where located
 - b) Shares – where register is kept
 - c) Bond – where the product is issued
4. Enveloped UK dwellings and related finance
5. “Relevant Property” regime...

IMPORTANT

IHTA s218 – Any person, other than a barrister, who has been concerned with the making of a trust in the course of his trade or profession, and knows or has reason to believe that the settlor was domicile in the UK and that the trustees are not UK resident... to report to HMRC within three months of the creation of the trust.

TRUST AND INHERITANCE TAX

Trustees should ensure that any trust which has a UK connection (either through settlor, beneficiary, trustee or asset situs) is reviewed regularly.

Importantly, a trust with a non-UK resident settlor, non-UK resident beneficiaries and non-UK resident trustees can still be within the UK IHT legislation.

Some IHT errors do not have assessment time limits and can be recovered over 20 years later.

Trustees could be liable for the IHT charges.

HMRC are receiving significant amounts of information from other countries under CRS reporting obligations and potentially the trust register in the 5th MLD.

Potential penalties of up to 300%.

IHT is an asset-value based tax and therefore any error, with a subsequent penalty, can have significant consequences for the asset base of the trust. IHT at 40% and a penalty at 150% of the tax is 100% of the asset base!

WHEN DOES IHT NEED TO BE CONSIDERED IN RESPECT OF A TRUST?

H Working out the tax

Lifetime transfers (event forms IHT100a and IHT100b)

- Value chargeable to tax (box WSA10)
- Tax (box TX9)
- Relief on successive charges (box TX10)
- Double taxation relief (box TX11)
- Tax previously paid on this transfer, if any (box TX12)
- Tax due on this transfer (box TX13) - go to box H13

Principal and proportionate charges (event forms IHT100c and IHT100d)

- Value on which tax is chargeable (box WS87)
- Rate (box R24)
- Tax (principal charge: box TX39 plus box TX46, proportionate charge: box TX59 plus box TX67)
- Reduction against tax (principal charge only: box TX40 plus box TX47)
- Double taxation relief (principal charge: box TX42 plus box TX49, proportionate charge: box TX60 plus box TX68)
- Tax payable on this transfer (principal charge: box TX43 plus box TX50, proportionate charge: box TX61 plus box TX69)

Working out the tax that is payable on this account

Lifetime transfers, principal charge or proportionate charge

- Tax which may not be paid by instalments (lifetime: box TX18, principal: box TX41, proportionate: box TX59)
- Successive charges relief (lifetime: box TX19)
- Double taxation relief (lifetime: box TX20, principal: box TX42, proportionate: box TX60)
- Tax previously paid, if any (box TX21)
- Interest (lifetime: box TX23, principal: box TX44, proportionate: box TX62)
- Tax and interest which may not be paid by instalments (lifetime: box TX24, principal: box TX45, proportionate: box TX63)

- Tax which may be paid by instalments (lifetime: box TX29, principal: box TX48, proportionate: box TX67)
- Successive charges relief (lifetime: box TX30)
- Double taxation relief (lifetime: box TX31, principal: box TX49, proportionate: box TX68)
- Tax previously paid (lifetime: box TX32)
- Number of instalments being paid now (lifetime: box TX34, principal: box TX51, proportionate: box TX70) /
- Tax now payable (lifetime: box TX35, principal: box TX52, proportionate: box TX71)
- Interest on instalments to be added (lifetime: box TX36, principal: box TX53, proportionate: box TX72)
- Tax and interest being paid now which may be paid by instalments (lifetime: box TX37, principal: box TX54, proportionate: box TX73)
- Total tax and interest payable on this account (lifetime: box TX38, principal: box TX55, proportionate: box TX74)

- Settlement or creation
- Distributions of capital (exits)
- Principal or ten year anniversary charge
- Death of the settlor
- Additions to the trust
- Where beneficiaries are added or changed (IIP settlements created pre 2006)
- Where a life interest finishes.



THE RELEVANT PROPERTY REGIME AND 2006 CHANGES

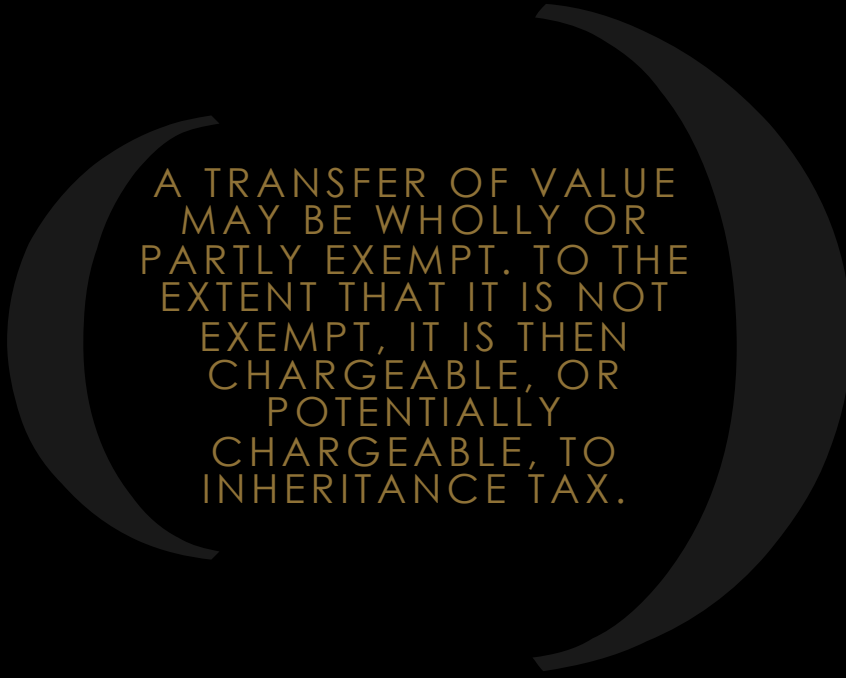
TRANSFERS OF VALUE

1. EXEMPT TRANSFERS INCLUDE:

- a) *Transfers between UK domiciled spouses and registered civil partners - s18 IHTA 1984*
- b) *Gifts within the annual exemption - s19 IHTA 1984*
- c) *"Normal expenditure out of income" (NEOI) - s21 IHTA 1984*
- d) *£250 small gifts - s20 IHTA 1984*
- e) *Gifts in consideration of marriage/civil partnership - s22 IHTA 1984*
- f) *Gifts to political parties - s24 IHTA 1984*
- g) *Gifts to charities or registered clubs - s23 IHTA 1984*
- h) *Gifts not intended to confer gratuitous benefit - s10 IHTA 1984*
- i) *Gifts for maintenance of the family - s11 IHTA 1984.*

2. POTENTIALLY EXEMPT - s3A IHTA 1984

3. CHARGEABLE - s2 IHTA 1984



A TRANSFER OF VALUE
MAY BE WHOLLY OR
PARTLY EXEMPT. TO THE
EXTENT THAT IT IS NOT
EXEMPT, IT IS THEN
CHARGEABLE, OR
POTENTIALLY
CHARGEABLE, TO
INHERITANCE TAX.

CHARGEABLE LIFETIME TRANSFERS

A chargeable transfer is a transfer of value ([IHTM04024](#)) made by an individual that is not an exempt transfer ([IHTM04026](#)).

A transfer of value is a disposition ([IHTM04023](#)) made by a person as a result of which the value of their estate has decreased. All lifetime transfers must start with a disposition.

A transfer of value may only qualify as a potentially exempt transfer ([IHTM04057](#)) to the extent that it would, apart from IHTA84/S3A, be a chargeable transfer.

FINANCE ACT 2006

- Since 22nd March 2006 most new **lifetime settlements** are chargeable lifetime transfers (CLTs) rather than PETs. The trusts will then be taxed under the relevant property regime
- This includes trusts with an interest in possession (although not gifts into bare trust which continue to be treated as PETs)
- The 2006 regime also brought some pre 22nd March 2006 settlements into the relevant property regime which previously were not
- Transitional arrangements enabled some pre 2006 trusts to retain their pre-2006 tax treatment
- We will not cover the transitional arrangements today but be aware of the **Utmost Wealth Solutions Trust Masterclass!**

MARCH 22ND 2006 – IHT CHANGES TO TRUSTS



CHARGEABLE LIFETIME TRANSFERS

- Gifts into discretionary trusts
- Gifts into interest in possession trusts from 22nd March 2006
- Gifts into accumulation and maintenance trusts from 22nd March 2006
- Other gifts or transfers which are not PETs
- Trusts subject to initial, periodic and exit charges
- Larger CLTs must be declared to HMRC on Form IHT100 and IHT 100a
- Deadline for submissions is 6 months from end of the month in which transfer made.

THE NEED TO REPORT AND EXCEPTED TRANSFERS

- Rules exist for reporting certain transfers of value. These rules are different depending on whether the asset being transferred is quoted stocks and shares or other assets
- For a current transfer of **cash and quoted stocks and shares**, if the cumulative total of all CLTs made by the transferor in the 7 years preceding the current transfer when added to the current transfer does **not exceed the NRB (currently £325,000)** this will be an excepted transfer
- An excepted transfer **does not** need to be reported using IHT100
- Note the previous CLTs do not have to be of cash or quoted stock.

THE NEED TO REPORT AND EXCEPTED TRANSFERS

- For a transfer of asset, other than **cash and quoted stocks and shares**, the rules for excepted transfers are a little more complex
- Here there are two tests to ascertain whether the transfer is an excepted transfer:
 1. Firstly, the cumulative total of all CLTs made by the transferor in the 7 years preceding the current transfer, but including the transfer, must not exceed **80% of the NRB (currently £260,000)** and;
 2. Secondly, the value of the current transfer of value* itself must not exceed **the available NRB?**
- Note an **existing** investment bond written under a discretionary trust is caught by this second test, whereas a bond going immediately into trust, such as a packaged DGT scheme, would meet the first “cash” test.

*here the transfer of value disregards the availability of BPR and APR

(2)

ENTRY CHARGES

CHARGEABLE LIFETIME TRANSFERS – TAX DUE

NO PREVIOUS CHARGEABLE TRANSFER

Charles transfers £411,000 into a discretionary trust on 30/04/2021 - he had made no previous gifts in the year or in the previous 7 years.

TAX PAID BY TRUSTEES	
Transfer	£411,000
Less: 2 x £3,000 AE	£(6,000)
Chargeable transfer	£405,000
Less nil rate band 2021/22	£(325,000)
	£80,000
Tax @ 20%	£16,000
Due date 31/10/2021	

CHARGEABLE LIFETIME TRANSFERS – TAX DUE

NO PREVIOUS CHARGEABLE TRANSFER

Charles transfers £411,000 into a discretionary trust on 30/04/2021- he had made no previous chargeable transfers. As Charles pays the tax we need to calculate the gross loss to his estate – which includes the tax paid.

TAX PAID BY CHARLES	
Transfer	£411,000
Less: 2 x £3,000 AE	£(6,000)
Chargeable transfer	£405,000
Less nil rate band 2021/22	£(325,000)
	£80,000
Tax @ 25%	£20,000
Due date 31/10/2021	
Prove tax is correct (Chargeable gift + tax) x 20% (£80,000 + £20,000) x 20% = £20,000 Or 20% / 0.8 = i.e. the tax grossed up by 20%	

CHARGEABLE LIFETIME TRANSFERS

PREVIOUS TRANSFERS

Edward transfers £411,000 into a discretionary trust on 30/04/2021 - he had made a previous chargeable transfer in 2020/21 of £100,000.

TAX PAID BY TRUSTEES		
Transfer		£411,000
Less: £3,000 AE		£(3,000)
Chargeable transfer		£408,000
Nil rate band 2021/22 x 0%	£325,000	
Less previous transfer	(£100,000)	
Available nil rate band		(£225,000)
		£183,000
Tax @ 20%		£36,600
Due date 31/10/2021		

CHARGEABLE LIFETIME TRANSFERS – TAX DUE

Edward transfers £411,000 into a discretionary trust on 30/04/2021- he had made a previous chargeable transfer in 2020/21 of £100,000.

TAX PAID BY EDWARD		
Transfer		£411,000
Less: 2 x £3,000 AE		£(3,000)
Chargeable transfer		£408,000
Nil rate band 2021/22 x 0%	£325,000	
Less previous transfer	(£100,000)	
Available nil rate band		(£225,000)
		£183,000
Tax @ 25%		£45,750
Due date 31/10/2021		
<u>Prove tax is correct</u>		
(Chargeable gift + tax) x 20%		
(£183,000 + £45,750) x 20% = £45,750		

DEATH WITH SEVEN YEARS OF CREATING THE TRUST

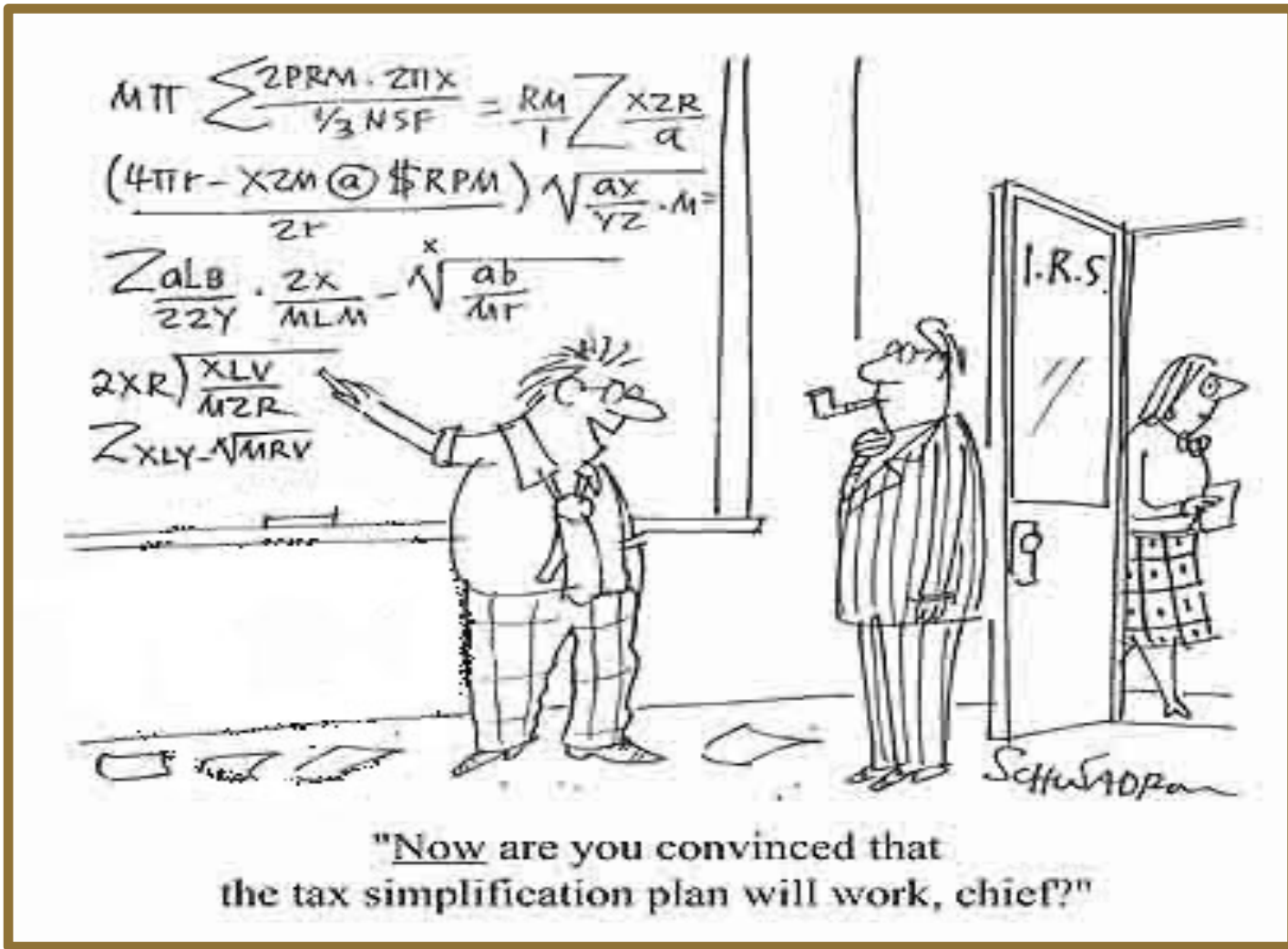
Possible further tax to pay if GIFT > NRB at death.

Charles dies between 4 & 5 years after making his settlement, the gift was £405,000 (let's assume tax was paid by the trustees) and the NRB available at the date of his death is still £325,000. As the gift has failed tax is now due on the gift recalculated using the full death rate reduced by tax already paid by Charles.

Settlement	£ 405,000
Less NRB	<u>£(325,000)</u>
	£ 80,000
IHT @40%	£ 32,000
Less taper relief(40%)	<u>£ 12,800</u>
60% chargeable (or 24% of £80,000)	£ 19,200
Less Entry Charge paid	<u>£ (16,000) see example 1</u>
Extra IHT due	<u>£ 3,200</u>

EXIT
CHARGES IN
THE FIRST
TEN YEARS





Are you sure this isn't more complicated than it needs to be?

EXIT CHARGES

Loan Trust

Any loan repayments made to the settlor, whenever made, are not subject to exit charges.

Discounted Gift Trust

Capital payments to the settlor are not subject to exit charges – the carved out rights were not settled property.

Discretionary will Trust distributions made within 2 years

If a testator creates a discretionary trust in his will, under s. 144 IHTA 1984, **any distributions from the trust within 2 years of death do not give rise to an IHT exit charge.**

RELEVANT PROPERTY TRUSTS

- When someone becomes absolutely entitled to trust property which is subject to a RP trust, e.g. a discretionary trust, then there is an IHT “exit charge”. The charge is based on the ‘loss to the trust’ principle
- If it is an “asset” being paid out, as opposed to cash, then a claim for hold-over relief is possible under s260 TCGA 1992
- This is because where there is an IHT charge, it should be possible to avoid CGT on the same transaction
- **No exit charge will be levied where income is distributed** by the Trustees to a beneficiary. If a beneficiary receives a distribution of income, the beneficiary will suffer **income tax rather than inheritance tax**. IHTA 1984, s.65(5)(b)
- No exit charge is levied on a transfer of **excluded property**. IHTA 1984, s.6.

EXIT CHARGE IN FIRST TEN YEARS

BASIC STEPS

1. Initial Value of the trust is the value of assets settled minus IHT paid by the trustees. BR, APR and/or AE is ignored when considering the initial value.
2. It is assumed that the trustees are making a chargeable transfer of the relevant property in the trust at the time of exit.
3. This assumed chargeable transfer, after deduction of the NRB, is taxed at the lifetime rate of IHT of 20% to determine the notional IHT payable. (N.B. this is not the actual IHT payable but just a necessary step in the calculation process).
4. This notional amount is then expressed as a percentage (%) of the value of the total assumed chargeable transfer to calculate the **effective rate** of tax in percentage terms.
5. The charge is calculated by multiplying **the effective rate** by 30% and then adjusting for the number of quarters since inception by multiplying by the fraction $N/40$ where N is number of quarters passed.
6. The maximum exit charge is therefore 5.85% (30% of 20% x 39/40), which will apply where there is a) no NRB available and where b) the exit takes place in the last quarter.

PROPORTIONATE OR EXIT CHARGE

PROFORMA - Actual rate x loss to trust

	£	£
Initial value of relevant property		I
Initial value of any related trusts		<u>R</u>
Total		A
NRB at time of exit	NRB	
Less Settlor's chargeable transfers in 7 years before creating the trust	<u>(S)</u>	
NRB Remaining		<u>(B)</u>
Value of trust in excess of NRB A-B =		VE
Notional IHT = VE x 20%		N
Effective Rate = N/A x100 (%)		ER(%)
Actual rate* = ER x 30% x n/40 (%)		AR(%)
<u>Exit charge = Loss to trust x AR</u>		<u>PC</u>

*Actual rate is grossed up if trustees pay tax – loss to trust principle.

HOW EXIT CHARGES ARE CALCULATED

(NO CHARGEABLE TRANSFERS IN THE 7 YEARS PRECEDING THE CREATION OF THIS SETTLEMENT)

Exit charge on a £200,000 distribution assuming trust property is valued at £500,000 at the 5th anniversary but based on initial value of £411,000

	£	£
Initial value of relevant property (I)		411,000
Initial value of any related trusts (R)		<u>0</u>
Total (A)		411,000
Nil Rate Band at time of exit (NRB)	325,000	
Less Settlor's chargeable transfers in 7 years before creating the trust (S)	<u>0</u>	
NRB Remaining (B)=	325,000	<u>(325,000)</u>
Value of trust in excess of NRB (VE)		86,000
Notional IHT = VE x 20% (N) =		17,200
Effective Rate = N/A x100		4.18%
Actual rate* = ER x 30% x 20/40		0.627%
<u>Exit charge = Loss to trust x AR</u>		<u>£1,254</u>



PRINCIPLE CHARGES

PERIODIC OR TEN YEAR ANNIVERSARY
CHARGES

CALCULATING THE 10 YEAR PERIODIC CHARGE

PREVIOUS DISTRIBUTIONS OF CAPITAL

1. When looking at the available nil rate band any previous distributions of capital will reduce the NRB available.
2. The HMRC guidance here is quite confusing as it refers to any changes which incurred exit charges – ref IHTM42086. The legislation in s66(5) then says were “charges are imposed” which is equally unclear.
3. The distribution only has to **be capable of incurring exit charges**, i.e. there doesn't need to be an actual charge for these to be included.
4. Appointments of capital will therefore be brought back in if they are potentially liable to exit charges (relevant property)
5. Some capital distributions made in respect of certain trusts are not included and we will cover these later in the session.

PERIODIC CHARGE

PROFORMA

	£	£
Current value of relevant property		T
Initial value of related trust		<u>R</u>
Total		A
NRB at time of PC	NRB	
Less Settlor's chargeable transfers in 7 years before creating the trust	(S)	
Less Yr 1-10 distributions	(<u>D</u>)	
NRB Remaining		(<u>B</u>)
Value of trust in excess of NRB A-B =		VE
Notional IHT = VE x 20%		N
Effective Rate = N/A x100		ER(%)
Actual rate = ER x 30%		AR(%)
<u>Periodic charge = Loss to trust x AR</u>		<u>EC</u>

HOW PERIODIC CHARGES ARE CALCULATED

(NO CHARGEABLE TRANSFER IN THE 7 YEARS PRECEDING THE CREATING OF THIS SETTLEMENT)

An example of a periodic charge calculation assuming trust property is valued at £670,000 at the 10th anniversary and there have been no distributions of capital in the first 10 years

	£	£
Current value of relevant property (T)		670,000
Initial value of related trust (R)		<u>0</u>
Total (A)		670,000
NRB at time of PC	325,000	
Less Settlor's chargeable transfers in 7 years before creating the trust (S)	0	
Less Yr 1-10 distributions (D)	0	
NRB Remaining (B) =	325,000	<u>(325,000)</u>
Value of trust in excess of NRB (VE)		345,000
Notional IHT = VE x 20% (N)=		69,000
Effective Rate = N/A x100		10.299%
Actual rate = ER x 30%		3.090%
Periodic charge = A x AR		<u>£20,700</u>

HOW PERIODIC CHARGES ARE CALCULATED

(ONE CHARGEABLE TRANSFER IN THE 7 YEARS PRECEDING THE CREATION OF THIS SETTLEMENT)

An example of a periodic charge calculation assuming trust property is valued at £670,000 at the 10th anniversary and there have been no distributions of capital in the first 10 years. However, there was a previous chargeable transfer of £100,000 within seven years prior to the creation of the trust.

	£	£
Initial value of relevant property (T)		670,000
Initial value of related trust (R)		<u>0</u>
Total (A)		670,000
NRB at PC	325,000	
Less Settlor's chargeable transfers in 7 years before creating the trust (S)	100,000	
Less Yr 1-10 distributions (D)		0
NRB Remaining (B) =	225,000	<u>(225,000)</u>
Value of trust in excess of NRB (VE)		445,000
Notional IHT = VE x 20% (N) =		89,000
Effective Rate = N/A x 100		13.284%
Actual rate = ER x 30%		3.985%
Periodic charge = Loss to trust x AR		<u>£26,700</u>

(5)

EXIT CHARGE
AFTER 10
YEARS

EXIT CHARGE

PROFORMA USES SAME ER UNLESS NRB HAS CHANGED!

	£	£
Current value of relevant property		T
Initial value of related trust		R
Total		A
NRB at time of last PC (or exit if changed)	NRB	
Less Settlor's chargeable transfers in 7 years before creating the trust	(S)	
Less Yr 1-10 distributions	(D)	
NRB Remaining		(B)
Value of trust in excess of NRB A-B =		VE
Notional IHT = VE x 20%		N
Effective Rate = N/A x100	SAME AS TYA IF NRB NOT CHANGED	ER(%)
Actual rate = ER x 30% x n/40		AR(%)
Exit charge = Loss to trust x AR		EC

HOW EXIT CHARGES ARE CALCULATED

Assume that the trust property in the first example (E/R 10.299%) grows in value to £720,000 when it is distributed on the 12th anniversary.

E/R on previous 10 year anniversary (Periodic charge) but calculated using current NRB*	10.299 %
Number of quarters since last 10 year anniversary (NQ)	= 8
Rate at which tax chargeable on trust assets distributed from trust (R) = $ER \times 30\% \times \frac{NQ}{40}$	0.618% = $(8 \times 10.299 \times 30\%)$ 40
Tax payable = trust assets distributed x A/R	£4,450 (£720,000 x 0.618%)

*Assumes NRB unchanged.
Recalculated if NRB changed

PARAPLANNERS ASSEMBLY 2021

THANK YOU FOR YOUR TIME

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