

# PARAPLANNERS ASSEMBLY

AN IN-DEPTH VIEW OF THE RELEVANT  
PROPERTY REGIME PART II

SPEAKER - STEVE SAYER TEP, APFS

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A WEALTH *of* DIFFERENCE

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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.

SETTLED PROPERTY, GROSSING UP & ADDITIONS

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DISCOUNTED GIFT TRUSTS AND LOAN TRUSTS

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PLANNING OPPORTUNITIES

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WHY IT IS IMPORTANT TO CONSIDER THE ORDER OF GIFTS



# SETTLED PROPERTY, GROSSING UP AND ADDITIONS

# GOOD NEWS!

- Grossing up is only required for entry and exit charges where the settlor or trustees pay the tax respectively, based on loss to estate and loss to trust principles
- Also required for cumulation calculations
- Not required for Ten Year Anniversary (Principal) charge calculations.

# ENTRY CHARGES

- If the settlor agrees to pay the inheritance tax on a lifetime chargeable transfer, the “**grossed-up**” rate must be used
- The grossed-up rate is payment / **0.80** - loss to the donor's estate on the transfer
- Important to identify **the gross gift** for cumulation purposes and its impact on subsequent chargeable transfers
- If the donor makes two chargeable lifetime transfers on the same day, but only agrees to pay tax on one of them, the gift on which the donor pays tax (i.e., the “net” gift), is treated as made first (*s.266(1) IHTA 1984*).

# EXIT CHARGES

- If the Trustees pay the tax on any exits, the distribution figure cumulated above must include this tax paid
- Beneficiary is receiving a sum that is net of tax
- Here we must gross up the exit charge calculations to account for the full loss to the trust, i.e. the loss due to the distribution and the IHT which is paid by the trustees because of the distribution.

# PROPORTIONATE OR EXIT CHARGE

## PROFORMA - ACTUAL RATE X LOSS TO TRUST

	£	£
Initial value of relevant property		T
Initial value of any related trusts		R
Total		A
NRB at exit	NRB	
Less Settlor's chargeable transfers in 7 years before creating the trust	(S)	
NRB Remaining		(B)
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>Proportionate 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

Exit charge in first ten years on a £200,000 distribution assuming trust property is valued at £500,000 at the 5<sup>th</sup> 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		411,000
NRB at time of exit	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 x 100		4.184%
Actual rate* = ER x 30% x 20/40		0.627%
Grossed up AR = $0.627 / (100 - 0.627)$		<u>0.631%</u>
<b>Exit charge is £200,000 x 0.631% = £1,262</b>		



# ADDITIONS AND S67 IHTA 1984

- Where property is added to a relevant property trust then when considering the settlor's previous cumulation we need to look at: chargeable transfers made
  - › in the 7 years prior to the trust being established AND
  - › in the 7 years prior to the addition of relevant property;
- We then reduce the NRB by the **higher total**;

## S67 IHTA

- For added property, any failed PET made by the settlor in the previous 7 years can reduce the NRB
- Care – Additions IF PETs have been made
- Health of settlor – impact future charges;
- Finally where property is added, the TYA charges are proportioned for the period the property has been relevant property.

DISCOUNTED  
GIFT TRUSTS  
AND LOAN  
TRUSTS

(2)

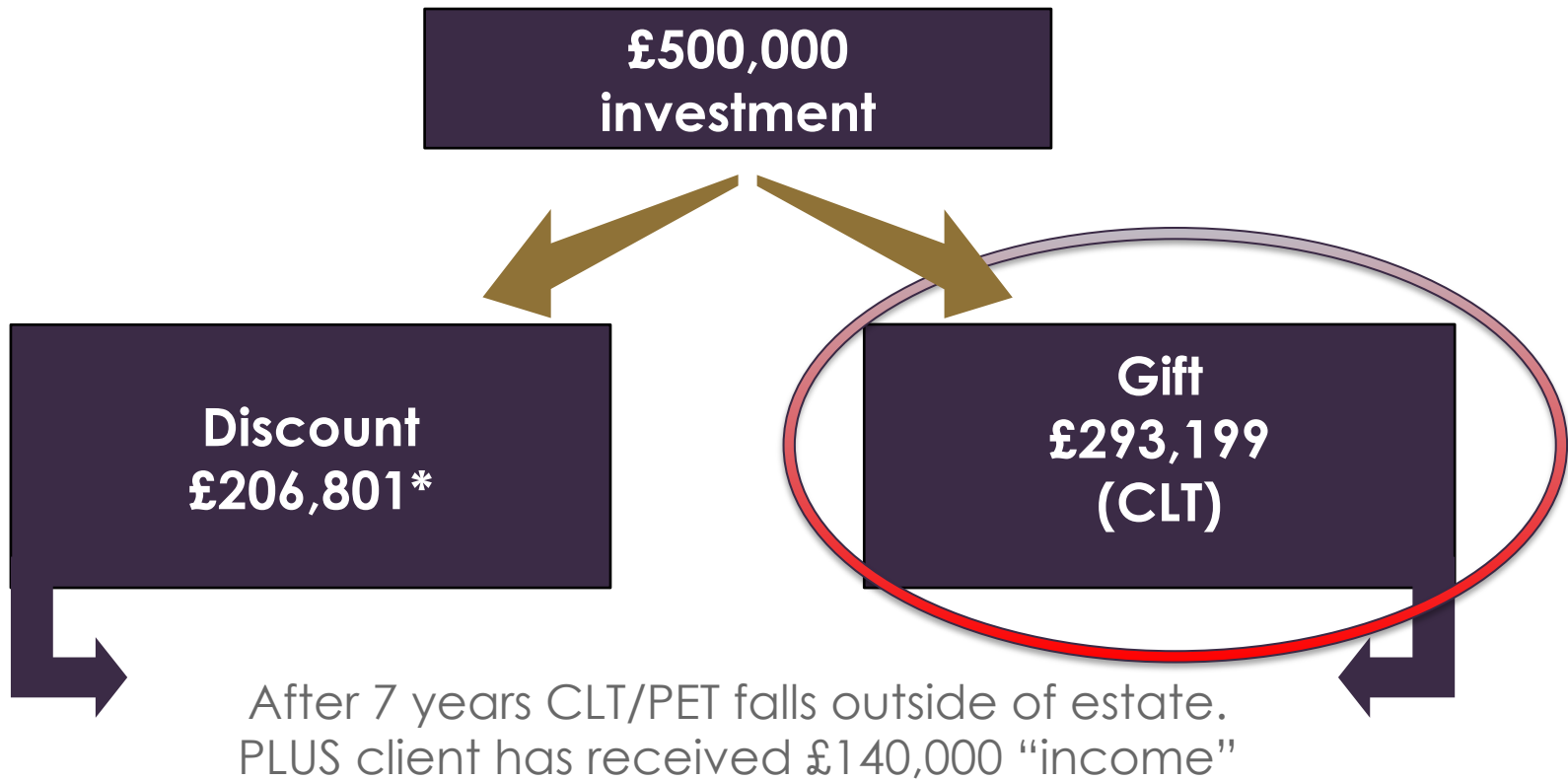
# DISCOUNTED GIFT TRUST

- The initial gift is the amount transferred less the value of the settlor's right to regular withdrawals which are valued on open market principles
- Capital payments to settlor are not subject to exit charges – as they were never settled property (carve out)
- DGTs Available as an Absolute or Discretionary Trust but principle charges and exit charges on apply to Discretionary variant
- Value of the trust property at the ten yearly anniversary is the value of the bond **less** the settlor's ongoing right to receive the regular withdrawals.

# DISCOUNTED GIFT TRUST

## HOW ARE PERIODIC CHARGES CALCULATED?

Firstly, let's consider the discount for a premium of £500,000 for someone aged 75 next birthday, taking 4% withdrawals monthly in arrears



# DISCOUNTED GIFT TRUST – 10 YEARS LATER

## HOW ARE PERIODIC CHARGES CALCULATED?

- **Client is aged 85 next birthday**
- After withdrawing £20,000 p.a. for 10 years, the bond is worth circa £527,360 assuming 4.5% net growth
- The value of the future income stream is calculated to be circa £133,323.

**What is the trust value for periodic charge purposes?**

# REVENUE AND CUSTOMS BRIEF 22 (2013)

## DISCOUNTED GIFT SCHEMES

- HMRC issued updated guidance in August 2013
- The note explains how the relevant property value for a DGT should be calculated at the 10 yearly review
- Fund value - less “assurance” factor – less future withdrawals!

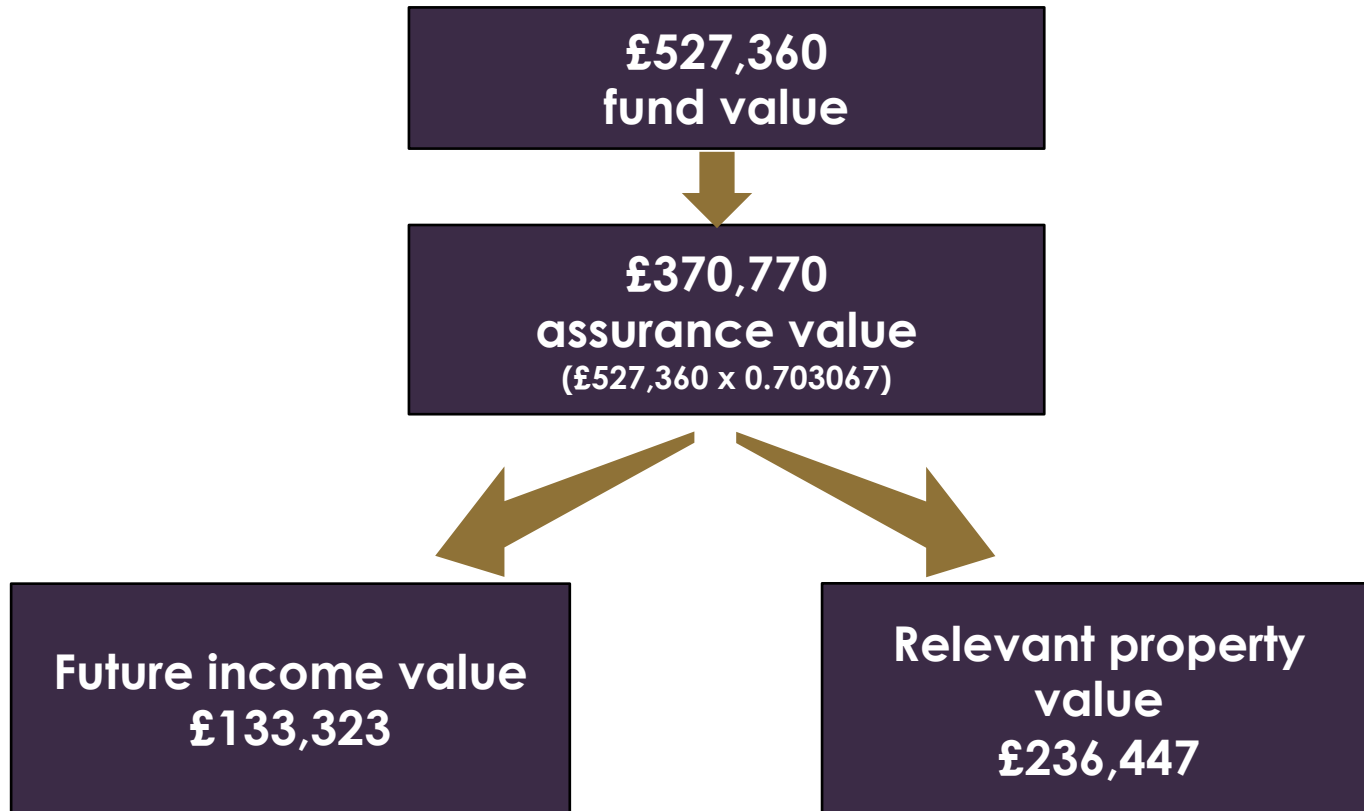
Where the retained rights are of pre-determined regular withdrawals, the total fund value is discounted to the expected date of death of the settlor. From this value is to be deducted the present value of the expected future withdrawals to be taken by the settlor based on their life expectancy and discounting those payments to the date that each payment is to be made.

<https://www.gov.uk/government/publications/revenue-and-customs-brief-22-2013-discounted-gift-schemes/revenue-and-customs-brief-22-2013-discounted-gift-schemes--2>

# DISCOUNTED GIFT TRUST – 10 YEARS LATER

## HOW ARE PERIODIC CHARGES CALCULATED?

The widow is aged 85 next birthday, taking £20,000 p.a. withdrawals monthly in arrears



**IHT 100d not required as value below 80% NRB!**

# DISCOUNTED GIFT TRUST – 10 YEARS LATER

WHAT IF THE SETTLOR HAS ALREADY DIED?

**£527,360  
bond value**



**Less assumed NRB of  
£325,000**



**£202,360  
periodic charge value**



**£12,141 periodic charge**  
(£202,360 x 6%)

**This makes a big difference to  
the case that we have just  
looked at!**



# LOAN TRUSTS

- Capital payments to repay the settlor (as **creditor**) are not subject to exit charges – as they were never settled property (subject to a loan) and no requirement to include as (D) for calculating A/R
- Value of the relevant property at the ten yearly anniversary is therefore the value of the bond **less** the settlor's debt obligation as creditor
- Note for reporting purposes the outstanding loan is included, so may not pass as an 'excepted settlement' for periodic reporting if relevant property subject to charge (VE) exceeds 80% of NRB – ref IHTM01624. Here an IHT100 and 100d may be required.



# PLANNING OPPORTUNITIES

# MINIMISING THE VALUE OF SETTLED PROPERTY

- Discounted Gift Trusts - Capital payments to settlor are not subject to exit charges – never settled property
- Loan Trusts – Loan never settled property
  - › Value of the trust property for exit taxes and principal charges are the trust assets less any loan or the capital value of retained benefits.
- Use of multiple trusts and ‘Rysaffe planning’
- Different settlement dates
- No same day additions.

# NEW INVESTMENT BOND IN TRUST

## INVESTMENT BONDS IN DISCRETIONARY TRUST

Investment of £300,000 in 10 years	£488,700
Nil rate band (NRB) (2031/32)	<u>(£377,000)</u>
Taxable	£111,700
Tax @ 6%	£6,702

## Is it possible to avoid this charge?

Assumes:

- No previous Chargeable Lifetime Transfers (CLTs) made in 7 years prior to creation of trust
- NRB in 2025/26 of £325,000 increasing by @2.5% per annum
- The assumed growth rate is 5.0% p.a. net of charges. The figures are for illustration purposes only and it should be noted that the value of investments can fall as well as rise and is not guaranteed. The client may get back less than they invest.

# MULTIPLE TRUSTS

- Rysaffe Trustee Co (CI) Ltd. V IRC (2003)
- Series of trusts created by same settlor over period of **different** days are not treated as “related” settlements
- Each trust will therefore have its own nil rate band
- Thus, for large investments, create several different trusts to reduce or eliminate the ten yearly charge.

# 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(%)
Periodic charge = Loss to trust x AR		<u>PC</u>

# EXAMPLE 1: MULTIPLE DISCRETIONARY TRUSTS

Set up three investment Bonds in Trust on three separate days

Each Investment of £100,000

	7 year cumulation (\$)	Value of trust fund at 10 year anniversary	Available Nil Rate band* (377,000-\$)	Value of trust in excess of NRB (VE)	Tax @ 6%
Trust 1	0	162,900	377,000	0	0
Trust 2	100,000	162,900	277,000	0	0
Trust 3	200,000	162,900	177,000	0	0

**£6,702 SAVING**

The assumed growth rate is 5.0% p.a. net of charges.

\* NRB of £325,000 in 2021/22 assumed to grow by 2.5% CPI from 2025/26 to £377,000.

# EXAMPLE 2: MULTIPLE LOAN TRUSTS

## Example:

- £300,000 Loan Trust
- £300,000 previous CLTs within seven years
- 5% pa growth over 10 years
- 5% p.a. withdrawals
- Net trust value **£150,000 plus £300,000 previous chargeable transfers with £4,380 periodic charge...or**

	7 year cumulation	Trust fund value at 10 year anniversary	Available nil rate band*	Taxable	Tax at 6%
<b>Trust 1</b>	300,000	£50,000	£77,000	-	Nil
<b>Trust 2</b>	300,000	£50,000	£77,000	-	Nil
<b>Trust 3</b>	300,000	£50,000	£77,000	-	Nil

\*Nil rate band of £325,000 assumed to grow by 2.5% CPI from 2025/6 to **£377,000**



# EXAMPLE 3: WHEN TO DISTRIBUTE

## EXAMPLE: 9 YEARS AND 264 DAYS

- £300,000 settled onto trust, 5% pa growth, Value at exit £488,700
- NRB £377,000.

	£	£
Initial value of relevant property (I)		300,000
Initial value of any related trusts (R)		<u>0</u>
Total (A)		300,000
NRB at time of exit (NRB)	377,000	
Less Settlor's chargeable transfers in 7 years before creating the trust (S)	<u>0</u>	
NRB Remaining (B)=		<u>(377,000)</u>
Value of trust in excess of NRB A-B (VE)		0
Notional IHT = VE x 20% (N)		0
Effective Rate = N/A x 100		0%
Actual rate* = ER x 30% x 39/40		0%
<u>Exit charge = Loss to trust x AR</u>		<u>£0</u>

\*Nil rate band of £325,000 assumed to grow by 2.5% CPI from 2025/26 to **£379,000**

# EXAMPLE 4: WHEN TO DISTRIBUTE

## EXAMPLE: 10 YEARS AND 1 DAY

- £300,000 settled onto trust, 5% pa growth, Value at exit £488,700
- NRB £376,900.

	£	£
Current value of relevant property (T)		488,700
Initial value of related trust (R)		<u>0</u>
Total (A)		488,700
NRB at time of last PC (as not changed)	377,000	
Less Settlor's chargeable transfers in 7 years before creating the trust (S)	0	
Less Yr 1-10 distributions (D)	0	
NRB Remaining (B)=		<u>377,000</u>
Value of trust fund in excess of NEB A-B = VE		111,700
Notional IHT = VE x 20% (N)		22,340
Effective Rate = N/A x 100		4.571%
Actual rate = ER x 30%		1.371%
<u>Periodic charge = Loss to trust x AR</u>		<u>£6,702</u>



# THE ORDER OF GIFTS

# USING MORE THAN ONE IHT-MITIGATION ARRANGEMENT?

- Clients may need to consider more than one trust arrangement to meet a variety of planning requirements
- Establishing different trusts in the correct order can have a significant impact on periodic tax payable on 10-year anniversaries of discretionary trusts.

# SERIES OF DISCRETIONARY TRUSTS

Brian has £600k to invest for IHT planning

Requirements;

- Needs flexibility over beneficiaries
  1. Wants immediate access, if required, of up to £200k but can afford to give up access to growth  
**Discretionary Loan Trust**
  2. Can afford to give away £200k as long as 5% p.a. available at pre-determined dates in the future via carved out rights  
**Discretionary DGT**
  3. Can afford to give away £200k with no access required  
**Discretionary Gift Trust**

# WHICH TRUST ARRANGEMENTS?

**Discretionary  
loan trust  
£200,000  
(Nil CLT) no  
withdrawals taken**

**Discretionary  
discounted gift trust  
£200,000  
(assume £100,000  
discount and  
£100,000 CLT )**

**Discretionary  
trust  
£200,000  
(£200,000 CLT)**

## Assumptions:

- Each fund grows to £400,000 at 10 year anniversary
- Relevant property under loan trust at 10 years is £200,000
- Relevant property under DGT at 10 years is £350,000
- Relevant property under the disc' gift trust is £400,000
- Nil rate band assumed to be £377,000 in 10 years
- No previous CLTs or available exemption.

**Ideally, in what order should these arrangements be established?**

# EXAMPLE ORDER 1 – TAX AT 10 YEARS

Trust 1 – discretionary gift trust

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Trust 2 - discretionary DGT

Trust 3 - discretionary loan trust

	7 year cumulation	Value of trust fund at anniversary	Available Nil Rate band	Taxable	Tax @ 6%
<b>Gift trust</b>	-	£400,000	£377,000	£ 23,000	£ 1,380
<b>DGT</b>	£200,000	£350,000	£177,000	£173,000	£10,380
<b>Loan trust</b>	£300,000	£200,000	£ 77,000	£123,000	£ 7,380

**Total tax payable**

**£19,140**

# EXAMPLE ORDER 2 – TAX AT 10 YEARS

Trust 1 – discretionary loan trust

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Trust 2 - discretionary gift trust

Trust 3 - discretionary DGT

	7 year cumulation	Value of trust fund at anniversary	Available Nil Rate band	Taxable	Tax @ 6%
<b>Loan trust</b>	-	£200,000	£377,000	£0	£ 0
<b>Gift trust</b>	-	£400,000	£377,000	£23,000	£ 1,380
<b>DGT</b>	£200,000	£350,000	£177,000	£173,000	£10,380

**Total tax payable**

**£11,760**



# EXAMPLE ORDER 3 – TAX AT 10 YEARS

Trust 1 – discretionary loan trust

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Trust 2 - discretionary DGT

Trust 3 – discretionary gift trust

	7 year cumulation	Value of trust fund at anniversary	Available Nil Rate band	Taxable	Tax @ 6%
<b>Loan trust</b>	-	£200,000	£377,000	£ 0	£0
<b>DGT</b>	-	£350,000	£377,000	£ 0	£0
<b>Gift</b>	£100,000	£400,000	£277,000	£123,000	£7,380

Total tax payable

**£7,380**

**£11,760 saving from order 1**

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# COMBINING DISCRETIONARY TRUSTS

## SUMMARY

- Settle discretionary loan trust first as there is no transfer of value
- Settle other chargeable transfers so that smaller CLT from DGT is made before larger amounts
- Care – general ordering rules like this only really work when the transactions occur around the same time. Once they are years apart the 14 year trap also needs to be considered as well...

# WHAT ABOUT INTERACTION OF CLTS AND PETS?

David makes the following gifts/transfers on 10 October 2020 & 20 April 2021.

**£250,000 to his son.  
This is a PET.**

**£300,000 into a  
discretionary trust. This  
is a CLT.**

He had made no previous gifts and has never used his annual exemptions.

David dies on 1 December 2024 (death within 7 years)

What is tax position if had done;      a. The PET first, or  
b. The CLT first?

(Assumed NRB in 2024/25 is £325,000)

# IHT POSITION ON DEATH IF PET MADE FIRST

- Failed PET has used up £244,000 of nil rate band (two annual exemptions of £3,000 used 2020/21 and 2019/20)
- £81,000 remains of the Nil Rate Band (£325k - £244k) for the gift to the discretionary trust of £297,000 (after the annual exemption for 2021/22)
- Thus £216,000 is taxed at 40% which is £86,400
- Taper relief reduces this to **£69,120** (David survived 3 complete years from the gift).

# IHT POSITION ON DEATH IF CLT MADE FIRST

- Gift to the discretionary trust has used up £294,000 of nil rate band (two annual exemptions used 2020/21 and 2019/20)
- £31,000 remains (£325k - £294k) for the PET of £247,000, after using the annual exemption for 2021/22) which has failed
- Thus £216,000 is taxed at 40% which is £86,400
- Taper relief reduces this to **£69,120** (David survived 3 complete years from the gift)
- **Thus, tax liability on death is the same.**

**So why is the order important?**

# THE 10 YEAR PERIODIC CHARGE – PET FIRST

Assume trust property is valued at £488,000 at the 10th anniversary and there have been no distributions of capital in the first 10 years. The failed PET (£244k) made in the 7 years preceding the creation of this settlement impacts upon the calculation.

Assume the nil rate band for 2031/32 is £377,000.

	£	£
Current value of relevant property (T)		488,000
Initial value of related trust (R)		<u>0</u>
A		488,000
NRB at PC	377,000	
Less Settlor's chargeable transfers in 7 years before creating the trust	244,000	
Less Yr 1-10 distributions	0	
NRB Remaining		<u>133,000</u>
VE		355,000
Notional IHT = VE x 20%		71,000
Effective Rate = N/A x 100		14.55%
Actual rate = ER x 30%		4.36%
<u>Periodic charge = Loss to trust x AR</u>		<u>£21,276</u>

# THE 10 YEAR PERIODIC CHARGE – CLT FIRST

Assume trust property is valued at £488,000 at the 10<sup>th</sup> anniversary and there have been no distributions of capital in the first 10 years. There were no previous chargeable transfers made in the 7 years preceding the creation of this settlement. Assume the nil rate band for 2031/32 is £377,000 .

	£	£
Current value of relevant property (T)		488,000
Initial value of related trust (R)		<u>0</u>
A		488,000
NRB at PC	377,000	
Less Settlor's chargeable transfers in 7 years before creating the trust	0	
Less Yr 1-10 distributions	0	
NRB Remaining		<u>377,000</u>
VE		111,000
Notional IHT = VE x 20% (N)		22,200
Effective Rate = N/A x100		4.55%
Actual rate = ER x 30%		1.365%
<u>Periodic charge = Loss to trust x AR</u>		<u>£6,661</u>

# ORDER OF GIFTS JUST REMEMBER...

- **If PET is made first and settlor survives it by 7 years**, but not the CLT, the PET would not affect the 10 yearly charges under any subsequent trust
- **If PET is made first and settlor dies within 7 years**, the failed PET will **ALWAYS** affect the 10 yearly and exit charges
- **If two CLTs are made within 7 years of each other**, the second will **ALWAYS** be affected by the first, no matter when the settlor dies.

**Also remember the fourteen year rule...which is not as relevant where gifts are made around the same time**



# PARAPLANNERS ASSEMBLY

THANK YOU FOR YOUR TIME

# IMPORTANT INFORMATION

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