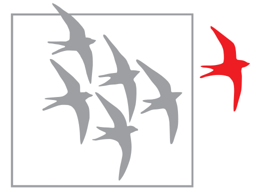

The WAY Inheritor Plans

Strategies for mitigating **Inheritance Tax** whilst retaining access to funds

WAY Investment Services Limited

In partnership with a number of specialist investment managers and selected financial intermediaries, WAY Investment Services delivers a range of services and strategies designed specifically to encompass the wide-ranging investment and financial needs of wealthy investors. The WAY Inheritor Plans are linked to the WAY Portfolios which are managed by WAY Fund Managers Limited. The bond versions of the WAY Inheritor Plans are offered in association with La Mondiale Europartner.

WAY Fund Managers Limited

WAY Fund Managers (WFM) provides collective portfolio services to discerning investors, primarily via 'portfolio style' unit trusts and OEICs.

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Introducing the WAY Inheritor Plans

Simple and effective solutions to two of life's most challenging dilemmas for the individual with substantial investment assets.

Many individuals spend a lifetime accumulating substantial investment assets. Most do this for two very good reasons: to ensure they will have an adequate income in retirement, and to guarantee their own and their family's financial security. Having built up the value of their investments, the question arises as to:

1. how can one most effectively convert a growth portfolio into an efficient source of rising income, and

2. is there a means of ensuring any residual value ultimately finds its way to chosen beneficiaries rather than the tax man?

WAY Investment Services has pleasure in introducing the Inheritor suite of Inheritance Tax (IHT) mitigation arrangements. There are two basic plans which offer a mix-and-match approach to this challenge. Every tax scheme available today has its own unique blend of benefits and restrictions. Generally the more immediately effective the arrangement is from an IHT perspective, the less flexibility is available.

The WAY Inheritor plans offer a wide range of benefits and flexibility so that most investors can utilise either one or a combination of the two plans to achieve their own desired combination of effectiveness and flexibility.

The **WAY Flexible Inheritor Plan** and the **WAY Discounted Inheritor Plan** both involve gifts into trusts with retained reversionary interests for the donor. As their names imply, the first offers tremendous flexibility with total IHT effectiveness after 7 years whilst the second offers an immediate discount on the value gifted into trust but with reduced flexibility. Most investors are drawn to the flexible option but a combination of the two, as described on page 9, can offer an attractive compromise between them. Following changes in the rules affecting the IHT treatment of gifts into trust (within the 2006 Finance Act) the establishment of WAY Inheritor Plans involves a chargeable transfer into trust. It is anticipated that investors will utilise their Nil Rate Band for IHT purposes to make gifts without incurring any immediate tax. For those investors with no exemptions available WAY offers a range of alternative strategies which do not involve chargeable transfers.

Unlike the majority of Inheritance Tax mitigation plans which are bond-based, the WAY approach offers planholders the option of investing directly into unit trusts/OEICs or within an offshore insurance bond wrapper.

The WAY Inheritor Plans

The **WAY Inheritor Plan** is a specially designed strategy for investing via leading 'portfolio style' collective funds whilst taking vital steps to protect one's wealth from future Inheritance Tax liabilities.

Inheritance Tax

The most reliable method of reducing Inheritance Tax is for an investor to gift assets to his/her beneficiaries while still alive. So long as he/she then lives a further 7 years after the date of the gift, the assets are deemed to be outside the estate and will not suffer Inheritance Tax on the donor's death. However, there are conditions on such gifts, the main one being that the donor may not retain any control over nor receive any benefit from the gifted assets (which would otherwise be 'gifts with reservation'). For an investor who relies on his/her capital to generate income this can therefore be problematical. The WAY Inheritor Plans overcome this challenge.

Chargeable Transfers into Trust

As from 22 March 2006 the gift of units/shares/policies into trust constitutes a chargeable transfer. This means that most donors choose to make such gifts within their Nil Rate Bands (NRBs) to avoid incurring a lifetime transfer charge. Those wishing to make gifts in excess of their NRB may make absolute gifts under the PET, Potentially Exempt Transfer, rules (see also the WAY Estate Transfer Plan) or defer further gifts for 7 years at which point the NRB will become available again.

There are specific rules about the calculation of any potential tax at the time of making a chargeable transfer. Any previous chargeable transfers (but not PETs) made within the previous 7 years are brought into account.

The WAY Inheritor Approach

The WAY Inheritor Plan is an ideal strategy for mitigating IHT via a chargeable transfer (generally within one's NRB) but without losing access to the gifted funds. The Plan uses an Interest-in-Possession trust to enable a donor (hereafter referred to as "settlor" of the trust) to direct trust income and capital to chosen and named (main) beneficiaries in stated proportions. Both versions of Inheritor offer sufficient flexibility to vary the allocation of capital between named beneficiaries and to include additional potential capital beneficiaries. Any future changes to beneficiaries' interests will have no personal IHT implications for any beneficiaries.

How the WAY Inheritor Plan Works

The investor decides how much of his/her assets should be placed within this tax mitigation arrangement and purchases units in one or more WAY portfolio style collective funds to this value, either directly or via a WAY offshore single premium insurance policy. He/she then gifts these newly-invested units/policies into a special Inheritor trust for the benefit of the main beneficiaries selected by the settlor. This gift constitutes a chargeable transfer (generally utilising the settlor's NRB) and the survival clock starts ticking. So long as the settlor survives 7 years from the time the gift is made then the gift will escape any Inheritance Tax which would otherwise have been payable on his/her death.

'Income/Capital' Reversions for the Settlor

The trust is a very carefully constituted instrument in which the settlor specifies a series of annual reversions from the trust back to him or herself. The settlor can utilise these reversions in lieu of 'income' and/or as capital withdrawals. Reversions will normally be made via 'in specie' transfers of units/policies so that the settlor may decide whether they should be kept and accumulated, passed on in part or in full to children or grandchildren or simply cashed in for value.

Additional Flexibility

The trust wording also lists a second class of beneficiaries (which will generally include the main beneficiaries plus their children and remoter issue) to whom assets may be appointed by the trustees on a discretionary basis. This allows the Trustees to make capital payments to beneficiaries, to cover contingency requirements of the settlor's family. The trustees are empowered to add further named beneficiaries to this appointee class at any time.

The Settlor

Potentially increasing 'income' is available in the form of annual reversions. Since the settlor has an interest in the trust (via future reversions) he/she is liable for any Income Tax which may arise in relation to income received by the trustees. To overcome the inconvenience of the settlor having a liability to tax on income that they have not received, the WAY Portfolio funds are managed under non income-yielding growth mandates, so that there will not normally be any income to account for in the unit trust version of the plan. The offshore bond asset held by the insured version of the plan is deemed to be a "non-income producing asset" and can roll up income and capital gains. There is no Income Tax charge on this version of the plan unless/until any policies are encashed, which will usually take place outside of the trust by the settlor or a beneficiary, who will consequently be the tax point for the income received.

The trustees are the tax point for Capital Gains Tax (CGT) on any disposals or deemed disposals of units within the trust. The trustees have their own annual exemption available, leaving the settlor's annual exemption available for any gains realised elsewhere in their investment portfolio. Where units are appointed to a beneficiary the trustees and that beneficiary may choose to hold-over the gain or loss on that deemed disposal. The offshore bond version is not subject to CGT.

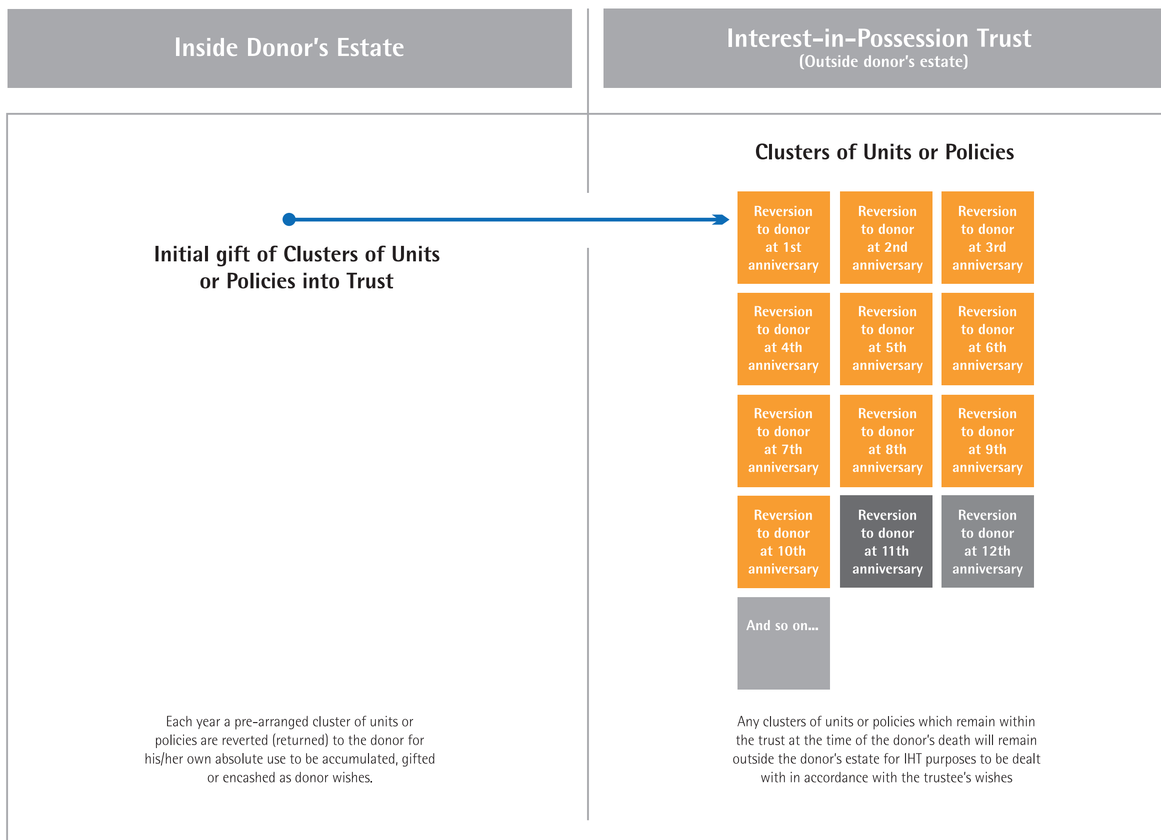
The Beneficiaries

The design of the plan is such that over time the value of the trust may grow at a faster rate than the value of the actual annual reversions to the settlor, depending upon investment returns and the rate of reversions made. Any net increase in value will be outside the settlor's estate for Inheritance Tax purposes, regardless of the date of death.

In the event that the settlor survives 7 years after making the gift then the value of the original gift will also be outside the settlor's taxable estate for Inheritance Tax purposes.

The death of the settlor will not trigger any immediate CGT liability on the growth in value within the unit trust version. However, the trustees will need to account for CGT on any subsequent realised gains, including on the occurrence of distribution of trust assets to the named beneficiaries where the gain is not held-over. Any liability will be net of the trustees' annual exemption.

Within the insured version the death of the settlor will not trigger any immediate Income Tax liability. However, the trustees will need to account for Income Tax on any gains subsequently realised by surrender of policies within the trust. However, it will normally be more convenient to appoint the policies to beneficiaries 'in specie', in which case the tax point will be the recipient beneficiary (when the policies are finally surrendered).



Two versions of the WAY Inheritor Plan

There are two distinct versions of the WAY Inheritor Plan. The **WAY Flexible Inheritor** offers no discount on the level of the initial gift, but offers significant other benefits in terms of permanent flexibility in lieu of this temporary potential benefit. For those requiring less flexibility, or are able to combine Plans, the **WAY Discounted Inheritor Plan** offers an immediate potential saving of IHT (because the deemed value of the gift is discounted from the full amount to reflect the retention value of the fixed reversions) but no flexibility.

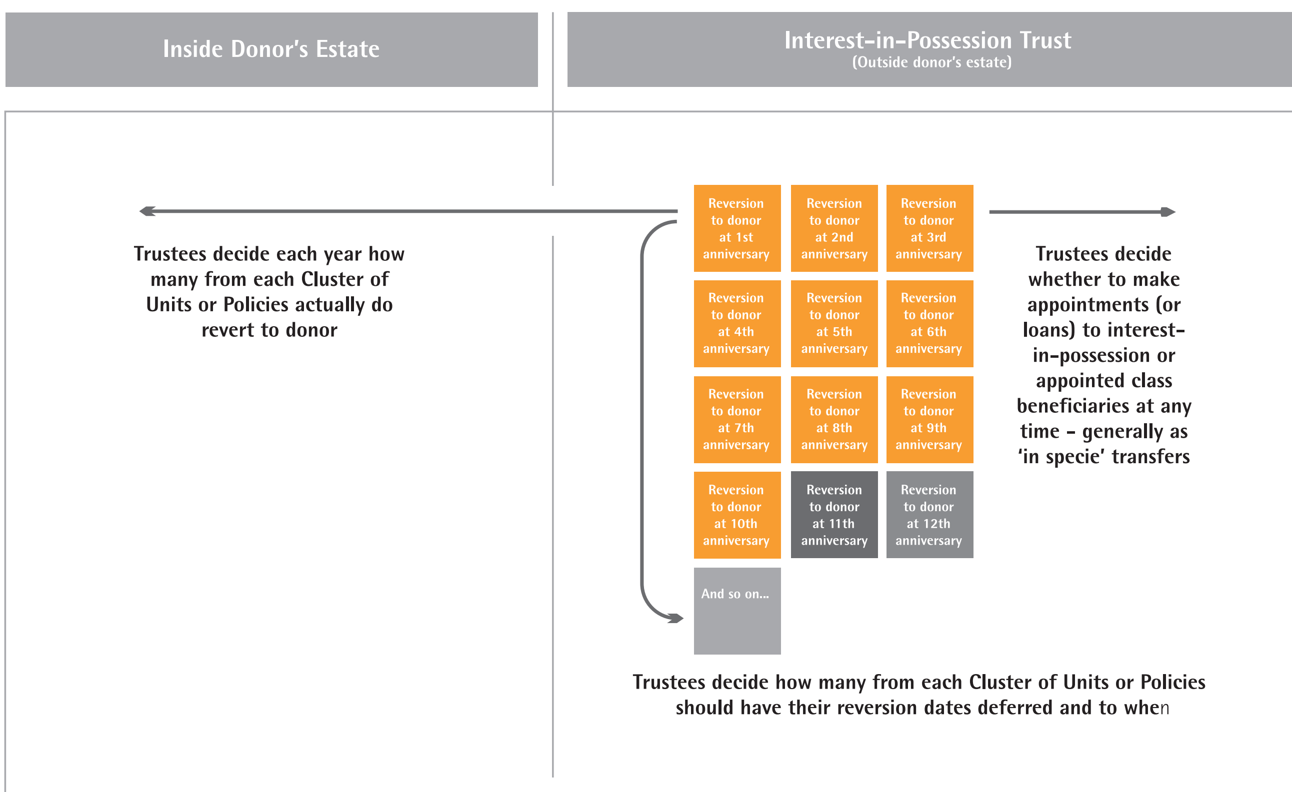
The WAY Flexible Inheritor Plan

The trust wording within the WAY Flexible Inheritor Plan affords the trustees an exceptional degree of control over the level of actual reversions made available to the settlor each year. The trustees may, at their sole discretion, decide to defeat or defer all or part of each individual prescribed annual reversion - which the settlor will have set at a generous level to take this into account.

Defeated reversions, or discrete parts thereof, may be deferred by the trustees who then specify future replacement reversion dates (defined within the Inheritor trust deed as the relevant date or dates as the case may be). There are no negative IHT implications of assets being reverted or even of reversion dates being deferred or defeated.

As a result of, and linked to, this flexibility over reversions, the trustees are granted further important powers - to lend or appoint assets out to beneficiaries if and when they think fit. This permits the trustees to assist the Settlor's family in times of need should it ever be necessary, regardless of the date of the Settlor's death.

(Please note that appointments of assets to beneficiaries out of the trust are potentially subject to a small exit charge for IHT, but only in instances where there was an initial charge or a periodic charge at the last 10 year point for trusts older than 10 years. Such a charge is unlikely but please refer to notes on page 10.)



The WAY Discounted Inheritor Plan

The trust wording within the WAY Discounted Inheritor Plan specifies a series of reversions from the trust back to the settlor. These reversions are fixed at levels chosen by the settlor at the time of settling the gift and neither the settlor nor the trustees may vary from that schedule which is laid down within the trust deed. It is therefore extremely important that careful thought is given to the level of reversions chosen because once set they are fixed for the duration of the Plan - in other words for the remainder of the life of the settlor.

Since reversions are irrevocably earmarked for the settlor there is no opportunity for trustees to grant loans or make appointments of trust assets to beneficiaries whilst the settlor is still alive. Once the settlor has died the Plan becomes totally flexible.

The value of any gift for IHT purposes is calculated as the 'loss to the settlor's estate' as a result of making that gift. This value, in the context of the WAY Discounted Inheritor Plan, is the gross amount invested and gifted, less the value retained by the settlor in the form of future reversions. As a result of the certainty that the settlor will receive these throughout the remainder of his or her life, the retained value of these reversions can be valued actuarially. The younger the settlor and the higher the reversion levels the larger the discount applied to the gift.

The level of discount which can be applied is calculated actuarially and assumes the settlor to be in 'normal' health. This must be substantiated with medical reports obtained at the time of initiating the plan.

Trustees

A minimum of two individual trustees or a one corporate trustee must be appointed to allow the exercise of dispositive powers (the powers to appoint assets). Since the powers granted to the trustees are very wide, the choice of who to appoint as a trustee should be very carefully considered. We recommend that at least one independent professional trustee should be appointed. Neither the settlor nor their spouse or civil partner may be appointed as a trustee, to avoid any question of a 'gift with reservation' arising or complications over 'associated operations'.

Why two similar but subtly different Plans?

The majority of investors may wish to use the *Flexible* Inheritor Plan as the mainstay of their Inheritance Tax (IHT) planning. This Plan offers potential freedom from IHT once the settlor has survived 7 years after making the gift. In addition to this, however, the plan offers a high degree of flexibility in the unknown years ahead.

Older and/or wealthier individuals and those with a fixed income requirement are amongst those who may wish to use the *Discounted* Inheritor Plan. Since scheduled reversions may not be defeated, the value of the gift into trust is reduced (discounted) by the value of the stream of future reversions remaining within the Plan. This discount is achieved at the expense of any possible flexibility over adjusting future reversions - the reversion levels are fixed for the whole duration of the Plan - and by denying the trustees the option to appoint assets to beneficiaries during the life of the settlor.

Combining the WAY Plans

Many investors find great difficulty in choosing between immediate potential IHT benefits and ongoing flexibility. In reality, most people do not need to make this difficult decision because an optimum solution is also available to them. This is to combine two schemes which between them offer the benefit of a discount *and* substantial flexibility. Please see comments on page 10 on establishing multiple trusts.

The Flexible Plan can readily be used in combination with the Discounted Plan to deliver both immediate benefits and ongoing flexibility.

Single Investor Plans Only

The WAY Inheritor Plans are designed as single settlor plans only. This is because we passionately believe that such arrangements offer the maximum flexibility. As an example, the Inheritor Trusts empower the trustees to add further named beneficiaries to the appointed class at any time. This means that they may add a widow or widower as a beneficiary (but only) after the death of the settlor - permitting appointments of capital or loans to be made to that person from their deceased partner's trust. Such a facility is of the utmost importance in long-term planning.

How is the discount calculated?

The discount applied to the gift into trust within the *Discounted* Inheritor Plan is based on the open market value of the non-defeasible reversions at the time of the gift. This is calculated actuarially, based on the level of annual reversions, assumptions about market growth and interest rates and the life expectation of the settlor.

HM Revenue and Customs may challenge discounted gift values in instances where death occurs within 7 years. In such cases it will be necessary for the settlor's estate/family to provide evidence of his/her state of health and/or life expectation **at the time of the gift.**

The WAY Inheritor Plans

Provision of Medical Evidence

WAY Investment Services can arrange for the medical underwriting of investors using the WAY Discounted Inheritor Plan. There is a small charge for this service.

HM Revenue and Customs have stated that they will not accept claims for a discount to the IHT charge on a gift in the absence of such medical underwriting. Furthermore, discounts will not be granted to investors who are 90 years old or over (or are rated to be equivalent to that age by the underwriter) at the time of making the gift.

Insuring the first Seven Years

Investors in the WAY Flexible and Discounted Inheritor Plans may choose to arrange level term assurance cover (in trust for the beneficiaries) to defray any additional IHT payable by the estate on death within seven years. Such cover, tailored for IHT, is readily available within the market.

Other IHT considerations

With careful planning and the use of reversions, WAY Inheritor is unlikely to incur future periodic and/or exit charges. However even where periodic charges do apply they will be at a *maximum* rate of 6% every 10 years, based on trust values in excess of the effective Nil Rate Band at each 10 year anniversary. This compares favourably with the IHT death rate of 40%. Remember also that 6% is equivalent to an annual compound charge of approximately 0.6% per annum which one would hope might be covered by the underlying performance of the trust assets.

Note that completion of the Revenue (HMRC) form IHT100 is compulsory where the value of the transfer into a WAY Inheritor Plan, when accumulated with previous Chargeable Lifetime Transfers made in the previous 7 years, is in excess of the Nil Rate Band (for unit trust / OEIC versions of the plan) or 80% of the Nil Rate Band (for insured versions of the plan).

Establishing more than One Trust

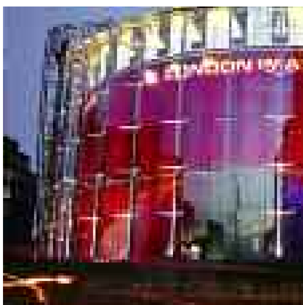
When completing trusts at or near the Nil Rate Band, investors might consider splitting their gifts so that each individual trust may subsequently have its own Nil Rate Band. In this case trusts should not be established on the same days and it may be prudent to have slightly different beneficiaries (e.g. one for son, one for daughter and one for combined - in each case with full appointed class flexibility). When combining Flexible and Discounted Trusts the Discounted Trust(s) should be settled first.

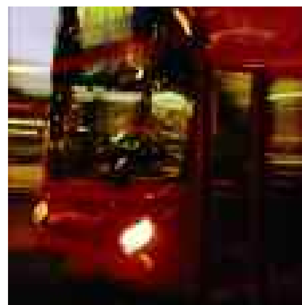
Please Remember

It should be noted that tax legislation may change from time to time and the value of any tax relief may depend on the settlor's individual circumstances. The information contained within this document is based on WAY's understanding of current law and HM Revenue & Customs practice as at April 2011. **Settlors should rely on their own tax advice. The stated tax implications cannot be guaranteed.**

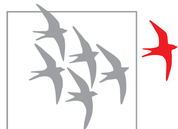
Reversions will be withdrawals of your original investment. Depending on the growth of the WAY units concerned, these 'drawings' may result in an erosion of your overall capital.

Past performance is not necessarily a guide to future performance. The price of units and the income from them can go down as well as up as a result of changes in the value of underlying investments. Changes in rates of foreign exchange may have an adverse effect on the value of and on the income derived from an investment. International investment includes risks related to political and economic uncertainties of foreign countries, as well as currency risk. An investor may not get back the amount originally invested.





The Manager/Authorised Corporate Director of the WAY Portfolio Funds referred to in this document is:



WAY Fund Managers Limited
Cedar House, 3 Cedar Park, Cobham Road
Wimborne, Dorset BH21 7SB

Telephone: 01202 855856
Facsimile: 01202 855850

Registered in England and Wales No. 4011838

Authorised and regulated by the Financial Services Authority Member of IMA

WAY Investment Services Limited
Cedar House, 3 Cedar Park, Cobham Road
Wimborne, Dorset BH21 7SB

www.wayinvestments.com

Telephone: 01202 890895
Facsimile: 01202 890894

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