

WAY Investment Services - The WAY Ascentric Inheritor Plans Terms & Conditions, Technical Guide and Tax Summary

Introduction

- The purpose of this document is to help investors and their independent financial advisers fully understand the Plans, how they work and the tax implications. Throughout it is assumed that the investor is UK domiciled/UK resident and that the trust is regarded as UK resident for tax purposes. The contents are based on WAY Investment Services' understanding of current law and HM Revenue & Customs practice, which can change at any time.
- This publication must be read in conjunction with other Plan related literature and then kept safe for future reference.
- Since each Plan caters for different needs, investors must rely on the recommendations of their professional advisers on whether such an arrangement is appropriate for their individual circumstances. WAY cannot give financial advice.

What Plans are available?

- WAY Investment Services (WAY) offers the following 3 inheritance tax (IHT) mitigation Plans from its Inheritor range to wrap around a pre-screened range of UK authorised unit trusts, OEICs and Exchange Traded Funds (ETFs) on the Ascentric platform:
 - The WAY-Ascentric Flexible Inheritor Plan
 - The WAY-Ascentric Gifts from Income Inheritor Plan
 - The WAY-Ascentric Inheritor Loan Plan
- Independent financial advisers (IFAs) must be registered with Ascentric to offer these versions of the Plans.
- All application forms, agreements, trust deeds, brochures and fund prospectus are available on the platform.
- A condition of all Plans is that WAY Tax and Trustee Advisory Services Ltd is appointed as sole trustee.

Main aims of the Plans

- Apart from providing investors with the opportunity to reduce their potential IHT liability during lifetime, the Plans also permit them to retain varying access to the underlying capital. The prime aims of each Plan can be briefly summarised as follows:
- The Flexible Plan
 - To remove the sum invested from the investor's estate for IHT after surviving 7 years
 - To allow the investor to receive, at the trustees' discretion, a proportion of the trust fund each year by way of annual reversions
- The Gifts from Income Plan
 - To immediately remove surplus income from the investor's estate for IHT
 - To allow the investor to receive, at the trustees' discretion, up to 50% of the trust fund by way of reversions on both the 5th and 10th anniversaries
- The Loan Plan
 - To freeze the value of the loan capital for IHT in the investor's estate and enable any growth to occur outside it
 - To allow the investor to have flexible access to repayment of the original loan
- By necessity, the Flexible and Gifts from Income Plans involve the investor (settlor) investing in a portfolio of unit trusts, OEICs and/or ETFs and then transferring these into trust. The Loan Plan, on the other hand, requires the settlor to make a cash payment directly to the trustees for investment purposes.

Ascentric Wrap Service

- A 'wrap' (or 'wrap account') is an internet-based investment account, which allows investors and their financial advisers to instantly view and analyse their portfolio and also deal online. The 'platform' is the administrative system for the wrap and permits investments to be managed conveniently in one place.
- In terms of the Plans:
 - all investments and cash deposits are made and held on the Ascentric platform in individual trust-related accounts
 - all online transactions are carried out by the trustees
 - the settlor and his/her IFA have viewing access to the Plan wrap account
- An individual account will be opened in the name of the trustees for each Inheritor Plan created so that the assets of each trust are held independently. Each trustee account will contain a sub-account to hold assets that from time to time belong to the settlor. The trustees hold the sub-account assets as bare trustees for the settlor and this avoids the need for the settlor to hold their own account on the platform and thus incur the platform charges. The trustees will transfer or liquidate assets in the settlor's sub-account upon instruction from the settlor.
- Overall, the Ascentric platform enables trust assets to be managed and administered in an efficient manner.

- Further information on the Wrap Service, including details of the charges, can be found on www.ascentric.co.uk

Key features of the Trust

- The Plans use a specially designed interest in possession trust (with discretionary powers) that allows its assets to easily pass down the family generations.
- Although not legally binding on the trustees, the settlor should keep the trustees regularly informed of how he/she would like the trust fund distributed by writing them a letter of wishes.
- Under the terms of the trust, the trustees have the power to appoint capital to a wide range of beneficiaries (the Appointed Class) but in the meantime any income received by the trustees, after offsetting expenses, is payable to named Beneficiaries (usually, the settlor's children).
- The Appointed Class automatically includes the income Beneficiaries and their children, grandchildren, great grandchildren (born or future born), together with their respective spouses/civil partners. The settlor has the opportunity to add other potential beneficiaries (excluding the settlor and his/her spouse or civil partner) when completing the trust deed. Thereafter, the trustees have the power to make additions to the Appointed Class.
- Apart from enjoying an interest in possession from inception, the income Beneficiaries will also eventually become entitled to the trust capital unless the trustees exercise their powers to the contrary. The income share of a Beneficiary cannot be changed by the trustees.
- If an income Beneficiary dies, their right to income will pass to his/her living children in equal shares or be passed further down the bloodline under the 'per stirpes' rule. If there are no descendants alive, his/her share in the income will accrue proportionately to the surviving income Beneficiaries. However, if the deceased is the sole income Beneficiary and is not survived by children/other descendants, the trust will then fail and its assets will pass back into the settlor's estate unless the trustees can make an immediate and absolute appointment of the entire trust fund to somebody in the Appointed Class. If this situation could arise, the settlor should extend the Appointed Class at outset to include alternative beneficiaries, who may potentially benefit in these circumstances, and subsequently keep the trustees up to date with his/her wishes.
- In the case of Flexible and Gifts from Income Plans, capital payments are earmarked for the settlor in the form of reversions. These are subject to the trustees' power to reduce, postpone or defeat them. Under the Loan Plan, the settlor is entitled to receive loan repayments on demand.
- The trust also offers great flexibility for the trustees to meet the changing needs of the beneficiaries. They have discretion to advance capital or make loans to any beneficiary and, if appropriate, can create further trusts. The trustees must not take any action that could jeopardise their ability to, say, repay the settlor's loan under the Loan Plan.
- To ensure the Plans are IHT effective, neither the settlor nor their spouse/civil partner can be a beneficiary of the trust or a trustee. When the settlor dies, the widow(er)/surviving civil partner can be added to the Appointed Class and, at the trustees' discretion, can benefit from the capital in the form of payments or, perhaps more preferably, by way of loans, which may reduce the value of the survivor's estate for IHT if still outstanding at the time of their death.
- All the trusts are governed by the law of England and Wales.

WAY Tax and Trustee Advisory Services as sole trustee

- Trustees are responsible for administering the trust fund on behalf of the beneficiaries in accordance with the terms of the trust and trust law. Trustees must be seen to exercise their duties responsibly and impartially. Since their role is often onerous, choosing competent people to act as trustees can be a major issue for settlors. To remove these concerns and provide peace of mind, WAY Tax and Trustee Advisory Services Ltd are appointed as sole trustee.
- As a corporate trustee, WAY Tax and Trustee Advisory Services Ltd offer an independent and professional trust administration service that includes performing the following duties:
 - reviewing the continuing suitability of trustee investments at least once a year with the settlor's IFA
 - making impartial decisions regarding reversion payments and whether to appoint capital to a beneficiary
 - dealing with trust management expenses and reconciling the trustee bank account
 - handling other trust paperwork (eg reversions, loan payments and repayments)
 - distributing income to the named beneficiaries according to their individual shares

- preparing annual trust accounts
- completing annual tax returns and paying income tax and/or capital gains tax (CGT) when due
- meeting HM Revenue & Customs (HMRC) reporting requirements regarding IHT entry, periodic and exit charges
- keeping up to date with trust and tax legislation
- The trustees will not offer investment or tax advice. This remains the responsibility of the settlor's IFA, who will also act as investment adviser to the trustees.
- Please refer to the fee schedule and terms of business for information on the fees applicable and the service provided.
- As Plan provider, WAY have viewing access to the Plan wrap accounts and will extract/produce relevant information to aid the trustees in carrying out their duties.

Commitments

- The normal minimum investment limits are as follows. These may be altered at WAY's discretion:
 - Flexible and Loan Plans - minimum lump sum investment is £100,000. No further investments can be made
 - Gifts from Income Plan - minimum annual investment of £5,000 for at least 4 consecutive years
- Investments must be chosen from a pre-screened range of unit trusts, OEICs and ETFs. The purchase of accumulation units is not permitted. The IFA will provide a prospectus in respect of each recommended fund.
- Entering into formal agreements with Ascentric and WAY Tax and Trustee Advisory Services Ltd are an integral part of each Plan.

What are the Risks?

- The amount that the trustees or, where appropriate, the settlor will receive at a later date cannot be guaranteed as this will depend on how well the investments perform and other influencing factors such as currency movements and future changes in charges or tax legislation.
- In addition, the future spending power of money received from the Plan will be reduced by inflation if investment returns do not keep pace.
- The value of investments and any income from them can go down as well as up. Some investment funds also carry a higher level of risk than others. Past investment performance is not necessarily a guide to future investment returns. Any other risks associated with the investment funds are shown in the related prospectus.
- The settlor cannot be certain of receiving a reversion (Flexible and Gifts from Income Plans only) since the trustees have discretion to decide otherwise.
- Since tax legislation and HMRC practice may be subject to change, which cannot be foreseen, the tax implications stated in this publication are not guaranteed. The settlor must rely on the advice of his/her legal and financial advisers.

Cancellation Rights

- The settlor has the right to change his/her mind and cancel the initial investments (Flexible and Gifts from Income Plans) within 14 days of receiving the individual Cancellation Notice from Ascentric. If this happens, the amount refunded for each investment will be reduced by any fall in value since acquisition. For Loan Plans, the cancellation rights vest in the trustees but the settlor can call in the loan at any time.

Overview of how the Plans work

Common features

All Plans share a number of common characteristics:

- By only allowing a Plan to be set up by a single settlor and at the same time excluding their spouse/civil partner from benefiting, married couples and registered civil partners can each set up their own individual plans without infringing the gift with reservation provisions. This permits maximum flexibility and can greatly increase the IHT effectiveness of the trust. The trustees have the power to add the widow(er)/surviving civil partner as a potential beneficiary following the settlor's death.
- At the same time as appointing WAY Tax and Trustee Advisory Services as sole trustee, the settlor decides on the identity of the income Beneficiaries and if more than one, specifies their respective shares of any trust income. All percentages must add up to 100%.
- No medical evidence is required for any of the Plans.
- Part of the settlor's cash investment is used to pay the charges incurred for setting up the arrangement (the established costs). The trustees will also retain a sum to meet future expenses. The balance of the money held by them will be invested in a portfolio selected by the IFA from a pre-screened range of mainly growth orientated unit trusts, OEICs and ETFs. Since the trustees must be able to separately identify income and capital elements, only income units/shares can be purchased.
- The settlor is assessed on all income received in the trust. As part of the Plan's annual review, any residual income, after offsetting trust management expenses, will be paid by the trustees to the Beneficiaries named in the trust deed and in the proportions stated.
- The trustees have the discretion to appoint trust capital at any time during the 80 year perpetuity period to any members from the Appointed

Class, which automatically includes those beneficiaries entitled to the income. Similarly, the trustees can grant loans to any of the beneficiaries.

- The trust fund is potentially subject to IHT charges every 10 years (the periodic charge) and whenever capital is paid to a beneficiary (an exit charge).

Main differences

The main differences between the Plans are as follows. The tax treatment of each Plan can be seen in the Tax Summary.

Flexible and Gifts from Income Plans

- After paying the various establishment costs, the settlor invests the rest of his/her capital or surplus income in the portfolio recommended by the IFA, which will later be gifted into the trust. This will include a 3% investment in a specific cash unit trust (no initial charges).
- The trustees will then sell the cash unit trust and hold the proceeds as a cash reserve.
- Under the terms of the trust, the gifted investment is divided into specified percentage shares (Relevant Shares). These Shares comprise of reversions which are scheduled to revert back to the settlor 'in specie' if he/she is alive on specified annual anniversary dates (Relevant Dates) unless the trustees exercise their powers to the contrary. 'In specie' means that the units/shares are not converted into cash prior to transfer.
 - In the case of the Flexible Plan, the size, number and pattern of annual reversions are chosen by the settlor at outset. Each Relevant Share consists of a proportionate number of the units/shares held by the trustees and part of their capital cash balance
 - For the Gifts from Income Plan, the trust carves out 2 fixed reversions - 50% of the trust fund value on the 5th anniversary and the remainder on the 10th anniversary
- Reversions therefore enable the settlor to have potential access to the trust capital and still benefit from any increase in stockmarket performance. Other than this facility, the settlor is excluded from benefiting from the trust fund.

The Loan Plan

- Rather than establishing the trust with a gift, the settlor enters into a formal loan agreement with the trustees to make a cash loan. This loan is interest free and repayable on demand.
- The trustees will arrange for payment of the authorised set up costs from the loan and set aside 3% of the balance to create an initial cash reserve. The remainder is invested in a portfolio chosen by the IFA.
- Under this Plan, the settlor does not have potential enjoyment of reversionary payments. Instead, he/she retains access to the amount originally lent to the trustees.
- The settlor can ask the trustees to repay the loan in part or in full at any time (eg regular loan repayments to provide an 'income'; occasional lump sums when needed; or not take any repayments in the knowledge that the loan can be called in should circumstances unexpectedly change).
- If the settlor wants to take loan repayments straightaway, he/she must specify the rate at which these are to be received in the Plan Application Form.
- The settlor's only entitlement from the trust is therefore a contractual right to repayment of the loan. Once the loan is repaid, no further payments can be made to the settlor by the trustees.
- On death, the value of any unpaid loan can pass under the settlor's will to his/her spouse/civil partner or another beneficiary.

Investment panel

- A wide range of OEICs, unit trusts and ETFs has been carefully chosen. WAY funds are also included. All offer income units and generally a low yield. The main reasons for selecting growth orientated investments are tax efficiency and the potential for enhancing investment returns for the beneficiaries. For example:
 - Since the trusts are settlor-interested for income tax, all trust income is taxable on the settlor. By minimising the amount of income arising to the trustees, the amount of possible higher rate tax is reduced
 - As the trustees have the power to charge all expenses to income, the likelihood that the trustees will have to make an income payment to the named Beneficiaries is also greatly reduced
 - Returns primarily in the form of growth enable the trustees to take advantage of the more favourable capital gains tax (CGT) regime
- The trustees can initially invest in a maximum of 12 funds.
- If the IFA wishes to recommend funds not currently featuring on the panel, these must first be verified as suitable for inclusion by WAY before submitting the Plan Application Form.
- All investment recommendations must be in line with the stated objectives of the trust and will ultimately require the approval of the trustees prior to implementation.

Advantage of 'in specie' transfers

- By making all reversions to the settlor 'in specie', the settlor is not forced to encash the investments at a time of low prices. The units/shares will therefore be re-registered on the platform in the name of the settlor, who can then decide whether to retain or sell them.

Mechanics for setting up a plan

General

- The settlor completes the trust deed, appoints WAY Tax and Trustee Advisory Services Ltd as sole trustee and formally agrees to their terms of business. In the case of a Loan Plan, the settlor and trustees will additionally sign a Loan Agreement.
- At the same time, the settlor, the trustees and the IFA complete a Plan Application Form, which includes the settlor authorising specified establishment/ongoing charges, a request from the settlor for his/her IFA to act as investment adviser for the trustees and confirmation from the IFA that the fund recommendations for the Plan meet with the settlor's approval. The Form also incorporates an initial letter of wishes for the settlor to complete.
- In addition, the settlor, trustees and the IFA complete an Ascentric Application Form.
- The settlor will also need to sign stock transfer forms for each fund in the initial trust portfolio if a Flexible or Gifts from Income Plan is being established. These enable the units/shares to be eventually transferred to the trustees.
- All these documents must be left undated and returned to WAY, together with a cheque from the settlor made payable to 'FundsDirect Nominee Client Account' for the amount to be gifted or lent. WAY will insert dates and, where applicable, details of the units bought by the settlor. An Identity Verification Form for the settlor must be provided by the IFA.
- On receipt of these items, WAY will keep the trust deed and stock transfer form and send the rest to Ascentric, who will arrange for the cheque to be paid in and also set up related Plan accounts for the settlor and the trustees on the platform.
- All Plan investment purchases will be made on the platform by the trustees as soon as the cheque has cleared.
- An interest bearing cash account will automatically be created in the settlor's platform account. The trustees will open a cash account in their name (ie a trustee bank account) to deal with all receipts and payments relating to the trust.
- The trust deed will eventually be returned to WAY Tax and Trustee Advisory Services Ltd for safe-keeping.

Flexible and Gifts from Income Plans

- The cheque will be credited to the cash account in the settlor's sub-account. The various establishment charges will be deducted before the balance is invested in the recommended portfolio, including a mandatory 3% in the Elite Income Plan Cash Trust. This particular investment does not attract any initial charges. The holdings (income units only) will be purchased in the settlor's name and held in the settlor's account during the cancellation period before they are transferred to the trustees. Details of the units purchased will be recorded in the stock transfer form signed by the settlor and sent to Ascentric.
- However, the units cannot be transferred into the legal ownership of the trustees and thereby properly constitute the trust until expiry of the 14 day cancellation rights (assuming these are not exercised).
- The settlor shall be deemed to have received the Cancellation Notice as from 72 hours after the same was put into first class post properly addressed to him/her.
- If any of the funds becomes ex-dividend during these 14 days, the income due belongs to the settlor and will be remitted to his/her cash account. The same procedure applies if any deposit interest is paid on the cash account.
- Once the Elite Income Plan Cash Trust has been transferred to the trustees, it will be encashed and the proceeds deposited in their cash account.

Loan Plan

- In this instance, the cheque/payment is credited to the trustees' cash account. After deducting the establishment costs and keeping 3% of the amount remaining as a working balance in the account, the trustees will use the remainder to purchase units/shares in accordance with the adviser's recommendations
- The trust is immediately constituted on receipt of the loan by the trustees.

Delay in processing an application

- Where documentation received by WAY is incomplete or incorrect, the financial adviser will be advised that the application cannot be progressed further until the relevant information is received. WAY will not accept any responsibility for any loss incurred by the settlor or the financial adviser resulting from such delay.

Charges

- As mentioned earlier, details of the fees charged by WAY Tax and Trustee Advisory Services Ltd (as corporate trustee) and Ascentric (as platform provider) can be found in their respective terms of business and/or fee schedules.
- In addition, WAY (as Plan provider) charges an initial 2% set up fee based on the amount initially invested by the trustees. A recurring fund based monthly Plan fee, equivalent to 0.65% a year, will also be charged to the trust.
- WAY fees will be reviewed on a regular basis and 3 months notice will be given to the settlor and the trustees prior to the introduction of any changes.
- The deduction of adviser remuneration in the form of commission and/or fees is a matter of agreement between the adviser and the settlor.
- When making investments, the trustees may also suffer initial charges levied by the individual funds. Internal annual management charges will also be made within the funds. Full details can be obtained from the fund prospectus.
- Under the terms of the trust deed, expenses incurred by the trustees in managing the trust will be offset against trust income unless decided otherwise by the trustees.

Trustee cash accounts

- The trustees are required to operate a trustee bank account on the platform so they can administer and keep accurate records of all trust income and capital transactions.
- Proceeds from the sale of the Elite Income Plan Cash Trust holding (Flexible and Gifts from Income Plans) will be placed in the account as will the loan made by the settlor under a Loan Plan. Income distributions from the underlying investments and rebates in fund charges will periodically be remitted to the account. Trust management expenses will be paid out of trust income wherever possible.
- It is very important that income arising to the trustees is separately identified since the named Beneficiaries under the trust are legally entitled to receive the trust income after deduction of expenses.
- If the payment of expenses will cause the bank account to go overdrawn and the trustees have not already sold sufficient units/shares to raise the necessary funds, Ascentric will alert the trustees so that action can be taken. Any sale of investments may be applied pro-rata across all reversions.
- Since the capital element of the cash account balance is a capital asset of the trust, a proportion of it forms part of each investment parcel that can potentially revert back to the settlor of a Flexible or Gifts from Income plan. The income portion, however, will be distributed to income beneficiaries, subject to the deduction of trust expenses.

Reversions (Flexible and Gifts from Income Plans only)

- For the Flexible Plan, the reversions (of Relevant Shares) take place on the selected Relevant Dates, which are annual anniversaries from when the trust was created.
- In the case of the Gifts from Income Plan, the trust carves out 2 fixed reversions for the settlor – 50% of the trust fund value on the 5th anniversary and the remainder at the 10th anniversary. Annual contributions to the Plan must cease immediately if the trustees allow a reversion to take place.
- Prior to each Relevant Date, the trustees must decide whether to allow the Relevant Share to revert to the settlor or to defer it in part or in total or to defeat it altogether (and/or appoint the capital to the beneficiaries). The trustees will consider the needs of the settlor and the beneficiaries as part of their decision making process.
- Although deferred reversions greatly enhance the flexibility of a Plan, they can also affect the IHT position of the trustees by increasing the value of the trust fund for periodic charge calculations.
- If units/shares revert back to the settlor, this is a disposal for CGT and may give rise to a tax liability for the trustees. Furthermore, if they are retained by the settlor instead of being cashed in and the proceeds spent, they will form part of his/her estate for IHT. CGT holdover relief cannot be claimed in these circumstances.

Mechanics of reversions

- Approximately 6 weeks before each Relevant Date, WAY will advise the trustees, the settlor and the IFA of the forthcoming reversion and send them a current valuation of the trust investments, including the capital cash balance, and a breakdown of how these are divided between the various Relevant Shares.
- The trustees will also be sent a 'reversion pack' that contains:
 - a Deed of Deferral for their completion if they are postponing the reversion partly/fully to a future date. This requests details of the shares/units being deferred and their revised reversion date(s)
 - stock transfer forms to be completed for any shares/units being transferred back to the settlor
 - a cash transfer instruction, if applicable, to transfer the relevant share of the capital cash balance to the settlor
 - details of the income cash balance

- Apart from considering whether to defer the forthcoming reversion and also the possible exercise of any other discretionary powers, the trustees will also review their investment portfolio under the advice of the financial adviser. They will document the reasons for any decisions.
- If the reversion is to be deferred in any way, WAY must receive the completed Deed of Deferral before the Relevant Date, otherwise a deemed reversion to the settlor occurs. WAY will chase the trustees shortly before the Relevant Date if a notification of their decision has not been received.
- Where a reversion is to take place, stock/cash transfer forms must be signed before this date and registered with Ascetric so that the various components can be transferred into the settlor's name.
- Where units/shares are being reverted to the settlor, the trustees will generally postpone making any investment switches recommended by the adviser and/or disposals needed to raise cash for topping up the trustee bank account until after the Relevant Date.
- Each reversion will be administered pro-rata by reference to the remaining proportions of Relevant Shares (e.g. where the initial gift has been divided into 10 equal Relevant Shares and the first year's Relevant Share is fully reverted, this would involve one-tenth of each holding being transferred to the settlor. If the same happened again on the next scheduled reversion, one ninth will be reverted).
- After the Relevant Date, a revised valuation and breakdown of the trust fund will be sent to the trustees by WAY.

Plan anniversary

- In addition to carrying out a review of the trust assets and performing other duties, the trustees will pay any cash income surplus to the named Beneficiaries in the proportions stipulated by the trust deed.
- They will also arrange for annual trust accounts to be prepared.

End of the Tax Year

- After 5 April each year, the trustees will complete a self assessment tax return and ensure any tax due on trust income and capital gains is paid by HMRC deadlines. They will provide the settlor with relevant details of the trust income for inclusion in his/her own tax return.

If the settlor no longer requires access to capital

- **Flexible and Gifts from Income Plans**
 - The settlor should inform the trustees at the earliest opportunity via a letter of wishes that he/she no longer wants to receive reversions so that they can take this into consideration at future reversion dates.
- **Loan Plan**
 - The settlor can give up right to part or all of the unpaid loan in favour of the trust beneficiaries by executing an appropriate deed. This will be a gift for IHT (ie a chargeable lifetime transfer) unless covered by the settlor's annual £3,000 exemption.

What happens on death of the settlor?

- The Trusts are capable of lasting for up to 80 years and can therefore continue beyond the death of the settlor. The settlor's personal representatives are responsible for informing WAY of the settlor's death. Transactions occurring between the date of death and WAY being so informed cannot be reversed.
- **Flexible and Gifts from Income Plans:**
 - The potential reversions back to the settlor now cease and the trust capital is held wholly for the benefit of the beneficiaries.
 - The trustees can decide whether to distribute the trust fund or retain the assets within the trust. Distributing capital is not always desirable, particularly where a young beneficiary may be involved. Tax may also be an influencing factor. By continuing with the trust, capital can be appointed over several years, may pass to future generations or perhaps be used to fund loans to the settlor's widow(er)/surviving civil partner.
- **Loan Plan:**
 - If the loan has not been fully repaid, the outstanding amount remains in the settlor's estate for IHT. Any balance (ie capital growth) in the trust fund is held for the beneficiaries.
 - Unless there is a clause to the contrary in the deceased's will, the settlor's personal representatives will generally be obliged to call in the loan balance. This may not be the most appropriate course of action (eg enforced encashment, tax, charges). Frequently, the settlor will amend their will so that the right to the remaining loan repayments passes free of IHT to the surviving spouse/civil partner. Alternatively, the settlor may insert a suitable clause in his/her will to write off any outstanding balance and so increase the amount eventually passing to the trust beneficiaries.
 - If the loan has already been repaid to the settlor and spent, the assets within the trust are outside his/her estate.

All Plans

- If applicable, the settlor's widow(er) or surviving civil partner can now be added by the trustees to the Appointed Class and can benefit at their discretion without the trust fund forming part of his/her estate for IHT.

- The overall IHT effectiveness of the trust can also be increased further if the trustees exercise their discretion to grant loans instead of making capital payments, which may attract exit IHT charges. If loans remain outstanding when the surviving spouse or civil partner dies, they will normally be allowable debts in his/her estate for IHT.

Final distribution of the trust fund

- The trustees could encash the various investments and pay out the proceeds to their chosen beneficiaries. This may create a CGT liability to the trustees.
- As an alternative, the trustees could consider selling sufficient units/shares to utilise their annual CGT exemption (and any brought forward losses) and then transfer an appropriate number of those remaining to each of these beneficiaries. These transfers are also disposals for CGT. However, assuming that holdover relief is available, this can be claimed jointly by both parties to defer the tax arising. The recipient beneficiary would become potentially assessable to CGT on subsequent sale or gifting of the holdings but can offset any gains against his/her own full annual CGT exemption. The beneficiary also has the option to stagger encashment over different tax years.
- Professional tax advice is essential if there is an intention to claim holdover relief. This must be obtained before an 'in specie' transfer to a beneficiary takes place.
- Similar advice should be taken if the proposed sale or transfer of units/shares would produce a capital loss for the trustees.
- Making capital distributions to beneficiaries can give rise to IHT exit charges.

TAX SUMMARY

This summary assumes that the settlor, the trustees and the beneficiaries are resident and domiciled in the UK for tax purposes. It further presumes that the underlying investments are UK authorised unit trusts/OEICs and so pay interest and dividends net of tax or are ETFs that are deemed to carry a tax credit by HMRC. Please remember that tax rules can change at any time. The settlor and the trustees must rely on their own tax advice.

Inheritance tax

There are 3 occasions when a potential charge to IHT may arise:

- on transferring assets into the trust
- on every 10th anniversary of the trust
- when capital leaves the trust

No IHT implications arise when a named Beneficiary (or a member of the Appointed Class) dies.

Creation of the trust

HMRC reporting requirements

- Form IHT100 and IHT event form 100A will need to be completed by settlor/trustees of a Flexible Plan if the cumulative total of all chargeable transfers made by the settlor, including the current gift, made in the last 7 years is more than the current nil rate band.
- Form 41G (Trust) must be submitted by the first named trustee to register the trust.

Flexible Plan

- After deduction of any available annual £3,000 exemption, the gift into trust is a chargeable lifetime transfer for IHT.
- If the gift, together with any other chargeable transfers made by the settlor in the previous 7 years, is within the current nil rate band, no charge to IHT will arise.
- If the gift takes the settlor's cumulative total over the nil rate band, the excess is immediately taxed at the lifetime IHT rate of 20%, assuming the trustees pay the tax. This is known as the 'entry charge'.
- Additional IHT may be payable if the settlor dies within the 7 years. Taper relief would be available if the settlor survives for 3 years and reduce any tax liability that falls upon the gift.
- If the IHT is paid by the settlor rather than the trustees, the settlor is treated as making a chargeable transfer of the gift and the tax. The gift therefore has to be 'grossed up' to reflect the total loss to the settlor's estate. In this instance, the settlor effectively pays a rate of 25% on the excess over the nil rate band.
- If the settlor lives for 7 years, the gift is outside the settlor's estate. However, it may be taken into account if subsequent potentially exempt transfers are made and then become chargeable following death of the settlor.
- Any growth in the value of the trust fund is outside the settlor's estate.
- If the settlor dies within 7 years, the original value of the gift remains in the estate and will use up part of the nil rate band when calculating IHT.
- Reversions retained by the settlor do not represent a gift with reservation.
- If the trustees defer a reversion in part or in total, this does not constitute a transfer of value because reversions are always subject to the trustees' overriding power to postpone or defeat them and so do not have a market value.

Gifts from Income Plan

- This particular Plan is designed to take advantage of the “Normal Expenditure out of Income” exemption.
- The regular annual contributions will be regarded as exempt and immediately fall out of the settlor’s estate, regardless of their size, provided they satisfy all the following conditions:
 - they form part of a regular pattern of gifts
 - they are made out of net income (including income from ISAs)
 - they leave the settlor with sufficient income to maintain their normal standard of living without having to resort to capital
- All investment growth is also outside the settlor’s estate.
- The units/shares gifted into trust are purchased by the settlor out of surplus income for the purpose of making the gift.
- This exemption has to be claimed retrospectively on death by the settlor’s personal representatives, who will submit HMRC IHT Form IHT403 as part of the probate process. Since it is important that the settlor keeps a record of the gifts, it is recommended that he/she has a IHT403 on file and inserts the required details each time a gift is made so that the relevant information is readily available on death.
- As in the case of the Flexible Plan, the reversions are not regarded as a gift with reservation and do not give rise to a transfer of value if deferred by the trustees.

Loan Plan

- No gift has been made at outset since there has been no reduction in the value of the settlor’s estate.
- The gift with reservation rules do not apply as the settlor is only entitled to loan repayments.
- The outstanding loan always remains an asset of the settlor’s estate, which will not reduce unless/until loan repayments are taken and either spent or gifted.
- Any growth is instantly outside the settlor’s estate.

During lifetime of the trust

The trust fund is potentially subject to a periodic IHT charge on each 10th anniversary of its creation and an exit charge when capital is distributed to a beneficiary. The maximum charge in both instances is 6%. Any tax due is payable by the trustees.

For significant sums, it may be possible to reduce the impact of the periodic charge by creating a series of separate trusts on different days so that each effectively has their own nil rate band. The order of gifts can also perform an important role. The settlor should seek the advice of their financial adviser in this respect before setting up the Plan(s).

HMRC reporting requirements

- On each 10th anniversary, the trustees must complete IHT Form 100 and IHT event form 100d even if no IHT is due.
- Similarly, when capital is distributed to a beneficiary, the trustees must submit IHT Form 100 and IHT event form 100c to HMRC.

Periodic charge

- In simple terms, a periodic charge will occur if the value of the trust fund on the 10th anniversary plus the cumulative total of any chargeable transfers made by the settlor in the 7 years before creating the trust and any capital payments made to the beneficiaries in the last 10 years (excluding reversions paid out to the settlor) exceed the then nil rate band. The excess will be charged to IHT at 6%.
- Chargeable transfers include chargeable lifetime transfers and any potentially exempt transfers that have subsequently become chargeable due to the settlor’s death.
- In the case of the Loan Plan, the value of the trust fund is reduced by the amount of any outstanding loan to the settlor at the time. However, for very large loans, where growth could result in a periodic charge, multiple loan plans should be considered at outset.

Exit charge

- Exit charges will generally be nil in the first 10 years of the trust if the initial transfer into the trust did not trigger an IHT liability and there are no related trusts or any additions to the trust since inception.
- Reversions or loan repayments back to the settlor do not attract an exit charge. Similarly loans granted by the trustees to beneficiaries are not subject to exit charges.
- If the trustees decide to exercise their power of appointment and distribute capital to a beneficiary, an exit charge may arise on the value of the property leaving the trust.
- This is based on the tax rate applicable at inception or at the last periodic charge and will be scaled down according to the number of complete 3 month periods that have expired since then.
- If the tax rate at the last periodic charge was zero, there will be no exit charge.

Other taxes

HMRC reporting requirements

- The trustees must complete an annual return of income and capital gains - Form SA900 (Trust and Estate Tax Return) plus relevant supplementary forms. Tax due must be paid out of the trust funds.
- The trustees will provide the settlor with appropriate information regarding the trust income for self assessment purposes.

Capital Gains Tax

- Transferring unit/shares into trust is a disposal for CGT and could give rise to a CGT liability for the settlor if they have grown in value since being purchased.
- Subject to an annual exemption, the trustees are liable to CGT at 18% on chargeable gains arising to them. Examples include investment sales, passing reversions back to the settlor and appointing capital to beneficiaries. Deferral of a reversion is not a disposal for CGT purposes.
- Trustees are eligible for an annual CGT exemption equal to 50% of that available to an individual.
- If the settlor has created more than one trust (excluding pensions) since 6 June 1978, the trustees’ annual exemption will be shared equally between them, subject to a minimum of 10% of an individual’s allowance for each trust.
- Where units/shares are reverted back to the settlor, their individual base costs will reflect the current value at the date of transfer.
- In specie transfers by the trustees to UK resident beneficiaries should be eligible for holdover relief, which would need to be claimed jointly by both parties. Under this relief, the beneficiary effectively inherits the trustees’ base costs for future CGT purposes.

Income Tax

- Since the trust is regarded as settlor-interested for income tax, all trust income is assessed on the settlor as it arises.
- The Loan Plan will cease to be settlor interested when the loan has been fully repaid. A similar position will be achieved for all Plans following the death of the settlor.
- Trustees pay tax at the basic rate but will not be subject to further liability if the income is received with a tax credit (i.e. 10% and 20% for dividends and interest respectively). Withholding tax may be deducted on the income arising on certain investments.
- Trust expenses are not an allowable deduction for income tax but will be used to determine the amount of income, if any, payable to the income Beneficiaries.
- If the settlor is liable to extra tax on the trust income, he/she has a statutory right to recover this from the trust. If the settlor chooses not to reclaim the tax, HMRC may deem the tax paid to be a further gift (although this is likely to be covered by the annual or normal expenditure exemption). However, WAY do not recommend reclaiming the tax as it may give rise to gift with reservation implications.
- Beneficiaries in receipt of trust income are not liable to further tax but cannot reclaim or offset any of the tax deducted at source from that income.

Pre-owned asset tax

- HMRC have confirmed that the Plans are not caught by this particular tax.

Information in this document is based on WAY’s understanding of current law and HMRC practice as at November 2009. Every care has been taken to ensure the material is correct. WAY does not offer investment and tax advice and can accept no liability for any actions based on the contents of this publication. The investor must obtain legal, tax and other appropriate advice on his/her own individual circumstances from his/her professional advisers before entering into a Plan. Legislation and taxation could change in the future.

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