Uni-Tech Associates S.A.

Trust, Fiscal and Marketing Services

A Guide
to
IHT Mitigation

2025/26

Transferrable Main Residence Allowance
And Related Matters

For Professional Intermediaries Only

Author:

J N Chadwick TEP

Index

1. Introduction

Estate Duty was introduced in 1894, some say to help fund the Boer War. Often referred to as death duty, Dennis Healey changed this to Capital Transfer Tax in 1975 and promised to make the pips squeak under the then Labour Government who borrowed proposals drafted by the prior Conservative Government as commissioned by Iain McLeod, the Tory Chancellor of the Exchequer for all too short a period.

In 1986 the Thatcher Government introduced Inheritance Tax which more or less replicated Estate Duty, as it had been prior to 1974, bringing back the Gift with Reservation aspects to make life more complicated for those seeking to protect family wealth from the tax man.

Twenty years later Gordon Brown introduced alterations to trust tax law which very largely destroyed the making of Potentially Exempt Transfers (PETs) via the medium of trusts, more officially called settlements, certainly the objectives being to increase the tax take for the exchequer even if not to help fund the democratisation of Iraq and Afghanistan! Surprising how history seems to repeat itself.

However, we now return to the Budget changes of 2006, in relation to IHT, and all the problems arising therefrom with the objective and hope of being able to provide a clearer understanding of the position as it now is.

There is a huge temptation to map out how matters have been varied in the hope of providing some limited historical context. But the mind of a person who is now seeking information and advice does not need to be tainted with that which has been as it complicates a subject which is, at the best of times, not particularly light reading.

Consequently, this guide will deal with IHT as it now is without harking back to options as they were.

A considerable number of advisers are tending to proffer advice which concentrates on the situation upon a person's demise, encouraged in part by the 2007 Autumn Statement combining spouse/civil partner nil rate bands, if available, upon the demise of the survivor.

Thereby with Wills and such trusts/settlements as are effective and established at the time of death, testamentary planning covers the approach and commands the proponents' tactical position. In certain circumstances, such planning may be adequate where resources are limited or restricted to a particular type, e.g. bricks and mortar.

Nevertheless, there exists an alternative, which takes a different tactical view, and relates to taking steps which become effective during the person's lifetime and should be undertaken at younger ages if at all possible. This is known as inter-vivos planning, which is a posh way of saying established and effective during lifetime.

This guide will touch upon arrangements put in place and effective during lifetime rather than at the time of a person's demise. This particular view is based on the quite simple advantages which arise from the way the tax law has been drafted and adopted as part of the taxing statutes.

The tax laws are always open to alteration, as the Budget of 2006 highlighted, but generally, providing prior steps taken to ameliorate the impact of tax were strictly within the letter of the law, then such tax changes have not been retrospective. There have been a number of instances where retrospection has arisen, but such circumstances normally arise where steps were taken against concepts which were not within the spirit of the law or, quite frankly, cheekily took advantage of poorly drafted legislation. Mitigation steps of a risky nature are not the subject of this guide.

Arrangements described are acceptable currently to HMRC – Capital Taxes – and copy letters confirming these matters are available in relation to the trust structures covering concepts detailed. This does not mean that such options will exist indefinitely. Rather it means that, if changes to the tax law occur and you have, prior to such changes, taken sensible steps to reduce the impact of taxation, all within the existing law as then was, then that benefit will remain with those who resolved to cement matters rather than leave the protection of family wealth to chance.

Before moving on to the content of this IHT Guide, a comment or two on existing tax breaks in relation to certain asset classes. ISAs and PEPs as may have built up over the years are attractive as it concerns income tax and capital gains tax, but when it comes to IHT the upshot of a 40% tax liability can seriously damage your wealth. The older person should remember that "all that glisters is not gold" and foregoing limited tax benefit on one front may be preferable to a large slug of capital being deducted on a demise.[1]

Another zone of interest and sometimes a rather hard sell is the use of AIM shares to provide an IHT rate of 20% from April 15th 2026 after such holdings have been owned for more than 2 years. Person's still building wealth may find the risk a worthwhile temptation, but those who are seeking to protect family wealth may find such holdings a contradiction in terms. Certainly, large holdings might be regarded as foolhardy. **Please note that from April 2026, Agricultural and Business Property Reliefs (APR/BPR) are capped at £1m for 100% relief, with 50% relief on value above this and for AIM shares.**

Publicly quoted stocks and shares as owned by individuals, cash deposits, building society accounts, gilts and unit trusts/investment trusts/OEICS all profile for IHT with limited exceptions. Generally, these types of asset class are a more secure investment, especially for those who have finished empire building and the risk inherent therein. Also, single premium bonds as issued by life assurance companies if owned directly by the policyholder will also have a liability to IHT along with the investments mentioned above. Importantly, all such holdings may, when held within the right structure, be moved out of the estate of the individual but still provide, via properly established carve-out or resulting trusts, capital payments back to the individual concerned. Subject to the type of investment vehicle selected the capital payments back to the individual – known as reversions - may include rolled up income and capital growth or only capital growth. Significantly, not only may IHT be mitigated but income tax and capital gains tax may also be tempered when compared to such investment being held on a direct ownership basis.

Last but not least, a vital point to be considered when comparing testamentary planning with inter-vivos planning is the small matter of the IHT nil rate band (NRB). At present until the end of fiscal year 2029/30 the value of any gifts that may be made without a liability to IHT – i.e. at a rate of 0% - is [2]£325,000 per person.

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[1] Note that AIM and BPR instruments have been available to ISAs since 2013
[2] Please see page 12 – The TMRA now RNRB

Also, effective from 9th October 2007 spousal and civil partner nil rate bands will be transferable to the surviving party as to any percentage element of the NRB not deployed during the last seven years of the demised spouse's or partner's life on their death.

Thereby a husband and wife may each make an inter-vivos gift of a sum up to the available individual Nil Rate Band and this figure may be increased by the available annual exemption of £3,000 per annum per person, which may include the prior year if not already deployed, giving a further £6,000 each of asset value without any IHT liability. On the assumption that the husband or wife survives a full seven years, then not only will the value of the gift be fully outside the estates of both, but there will be available a completely new NRB eight years hence at whatever level as may then pertain. Once again this may be enhanced by deploying annual exemptions and any available uplifted NRB year by year during the interim. Capital growth and yield will be instantly outside the estate of the donor as from the date of the gift. (This is not the case for defined gift plans i.e. FIP (see page 26). Such plans provide yield and capital growth for the benefit of the giftor).

Hence an individual may, when only planning on a testamentary footing, deploy the then available NRB, whereas an individual planning on an inter-vivos basis may very well enjoy two or more bites at the NRB cherry, plus exemptions and NRB uplift, subject to longevity. A very real potential advantage for lifetime planning which, subject to a person's ethos, may be further enhanced if a discounted plan is chosen as described later in this Guide (see page 24, the ETB concept operating within the PET regime).

This should also help to underline the importance of IHT planning at a younger age for each person rather than delaying matters in the hope that the problem will fall away. Doing nothing may be easy on the grey cells but incredibly hard on the next generation, unless financial masochism is a worthy new doctrine.

Consideration should also be given to spousal and civil partners not ignoring uplifted NRB and annual exemptions as may be available which may be moved fully or in part out of the IHT net, subject to survival for the inter-vivos period, available each fiscal year. However, NRB uplift now probably deferred to fiscal year April 2030/31.

For ease of reading surviving spouse, widow or widower relates to the situation for a partner or surviving partner of a civil partnership.

In the text of this IHT Guide the following terms apply:-

1. Discretionary Trusts are known as 'settlements' holding 'relevant property' for IHT purposes. Such transfers by the settlors are known as 'chargeable lifetime transfers – CLTs.

2. Bare Trusts are known as 'trusts'. Transfers by the donors are Potentially Exempt Transfers – PETs – and are not treated as relevant property during the donor's lifetime.

See page 6 for qualification reference the Nil Rate Band – NRB.

Advisory Notes: UK Inheritance Tax Reform (2025–2027)

1. **Shift from Domicile to Residence-Based IHT (from 6 April 2025):**

   UK IHT will now apply to individuals deemed "long-term UK residents," defined as those residents in the UK for at least 10 out of the preceding 20 tax years. This replaces the previous domicile and deemed domicile regime. Worldwide assets will be within IHT scope for such individuals.

2. **Nil-Rate Bands Frozen Until 2030:**

   The IHT nil-rate band (£325,000) and residence nil-rate band (£175,000, where applicable) remain frozen until at least April 2030, increasing the effective tax burden over time due to inflationary asset growth.

3. **Capping of APR and BPR (from April 2026):**

   Reliefs for Agricultural Property and Business Property will be subject to new value caps, limiting the amount of qualifying property shielded from IHT. This change may require restructuring of farming estates and business succession plans.

4. **Taxation of Unused Pensions and Death Benefits (from April 2027):**

   Most pension funds and lump sum death benefits that were previously exempt will become IHT-liable from this date. Strategic pension drawdown and legacy planning should be reviewed in light of this shift.

5. **Reforms to Trust Taxation (effective 2025/26 tax year):**

   The standard rate band for trust income taxation has been abolished. Instead, each trust will now benefit from a £500 income threshold; income above this is taxed at trust rates. Trustees may consider redistributing trust structures or realigning income strategies accordingly.

2. Basic Fiscal Information 2025– 2026 Income Tax

Bands	Tax Year 2024 to 2025	Tax Year 2023 to 2024
Basic Rate	£12,571 - £50,270	£12,571 - £50,270
Higher Rate	£50,271 - £125,140	£50,271 - £125,140
Additional Rate	Over £ 125,141	Over £ 125,141

Inheritance Tax Rates and Allowances

Main Rates[3]	Tax Year 2025 to 2026
Basic rate	20%
Higher rate	40%
Additional rate	45%
	Tax Year 2024 to 2025
Inter spouse or civil partnership Transfers and Normal Expenditure	Nil
Death Rate	40%[4]
Lifetime Rate	20%
Nil Rate Band (NRB)	£325,000
Annual Exemption	£3,000
Small Gift Allowance (Birthdays, Weddings etc)	£250
Business Relief available on certain assets	100 or 50%
Resident Nil Rate Band	£175,000
Potentially Exempt Transfer (PET)[5]	0%
Chargeable Transfers above available NRB on Relevant Property	20%

Allowance/Rate	**2025/26 Level**	**2026/27 Level (and onward)**	**Notes**
Nil Rate Band (NRB)	£325,000	£325,000	Frozen until April 2030
Residence Nil Rate Band (RNRB)	£175,000	£175,000	Frozen until April 2030

[3] Apply to non-savings, non-dividend income, including income from employment, property or pensions not subject to the Scottish Rate of Income Tax. These rates are applicable in England and Northern Ireland different rates are in place in Scotland and Wales https://www.gov.uk/government/publications/rates-and-allowances-income-tax/income-tax-rates-and-allowances-current-and-past

[4] Reduced to 36% for Estates leaving 10%+ to Charity.

[5] Gift inter-vivos period 7 years, taper relief, applicable to gifts, in excess of the nil rate band, tax reduced by 20% in year 4 and for each year thereafter reduction increases by 20% until nil after 7 full years should a demise occur during the inter-vivos period

IHT Rate (on death)	40%	40%	No change
IHT Rate (lifetime chargeable transfers)	20%	20%	No change
Taper Relief	Yes	Yes	No change
APR/BPR (Agricultural/Business Relief)	100%	100% up to £1m, 50% above	From April 2026
AIM Shares (BPR)	100%	50%	From April 2026
Deemed domicile for IHT	15/20 years	10/20 years residence	From April 2025: Residence-based, not domicile
IHT “tail” for leavers	3 years	10 years	From April 2025
Trust Income Tax Rate	45%	45% (above £500)	Standard rate band abolished; £500 threshold applies
Trust Dividend Rate	39.35%	39.35% (above £500)	As above
Trust Standard Rate Band	£1,000	Abolished	From April 2025
Trust income threshold	N/A	£500 (across all settlor’s trusts)	From April 2025

Summary: Exit and Periodic Tax Charges (2026/27)

Event/Charge Type	Pre-April 2025	2026/27 (and onward)	Notes (changes highlighted)
CLT Lifetime Rate	20% above NRB	20% above NRB	No change

10-Year Periodic Charge	Up to 6% above NRB	Up to 6% above NRB	No change
Exit Charge	Fraction of 6%	Fraction of 6%	No change
Deemed Domicile	15/20 years	10/20 years UK residence	Residence-based, not domicile-based
Excluded Property Trusts	Based on domicile	Based on settlor's UK residence status	From April 2025
IHT "tail" for leavers	3 years	10 years	From April 2025

Trust Income Taxation (2026/27)

Trust Income Type	Pre-April 2025	April 2025 Onwards (updated)
Standard Rate Band	£1,000	Abolished
Income Tax on Trusts	45% above £1,000	45% above £500 (across all settlor's trusts)
Dividend Tax on Trusts	39.35%	39.35% above £500
Income below threshold	20%/7.5%	£500 p.a. threshold: income written down to £0

Residence Nil Rate Band (RNRB) Withdrawal Threshold

Estate Value Threshold for RNRB Withdrawal	2026/27+	RNRB Available	Notes (changes highlighted)
£2.35m	2026/27+	£0	Threshold frozen until April 2030

APR/BPR and AIM Shares Relief (2026/27)

Relief Type	2025/26	2026/27+ (highlight changes)
APR (Agricultural)	100%	100% up to £1m, 50% above
BPR (Business)	100%	100% up to £1m, 50% above
AIM Shares (BPR)	100%	50%

Key IHT Changes (2025–2030) – Summary Table

Area	Pre-April 2025 Regime	Post-April 2025 Regime (highlight changes)
IHT Scope	Domicile/deemed domicile	10/20-year UK residence test
Excluded Property Trust	Based on domicile	Based on settlor's residence at charge date
IHT "Tail"	3 years after leaving UK	10 years after leaving UK
Trust Income Tax	£1,000 standard rate band	Abolished; £500 threshold applies
APR/BPR	100% unlimited	100% up to £1m, 50% above (from April 2026)
AIM Shares	100% BPR	50% BPR (from April 2026)
Pensions in IHT	Generally, exempt	Generally subject to IHT (from April 2027)

Capital Gains Tax: 2025–26 Summary

1. CGT Rates

Taxpayer Type	Total Income + Gains	Rate on Other Assets	Rate on Residential Property
Individuals (Basic Rate)	Up to £37,700	18%	18%
Individuals (Higher Rate)	Above £37,700	24%	24%
Trustees	N/A	24%	24%

> Carried interest is taxed at 32% across all taxpayer types. > Business Asset Disposal Relief (BADR) applies at 14% from 6 April 2025, rising to 18% in April 2026.[1]

2. Annual Exempt Amount (AEA)

Taxpayer Type	2025–26	2024–25
Individuals	£3,000	£3,000
Trusts	£1,500	£1,500

[1] *BADR is a relief that allows qualifying business disposals—such as shares in a trading company or a sole trader business—to be taxed at a reduced CGT rate. Conditions include a minimum 5% shareholding (for unlisted companies), ownership and officer status for at least two years prior to disposal, and the business being actively trading. The lifetime limit for relief remains £1 million.*

3.i. The Existing Settlement & Trust Regime

Generally, the majority of settlements will now fall within the term "discretionary settlement", whereby the settlement assets are Relevant Property and the inter-vivos gifting of such assets are, for IHT purposes, known as chargeable transfers, as compared to Potentially Exempt Transfers (PETs), as is still possible into a "Bare Trust".

Since March 22nd 2006, the making of Potentially Exempt Transfers into a settlement, other than a bare trust, is no longer possible unless to establish disabled settlements. Thus, making a gift of value into a settlement is now a chargeable transfer, such asset value being Relevant Property, and the gifting of any value in excess of the NRB will cause a lifetime rate to impinge upon that excess value at a rate of 20%. PETs on the other hand into bare trusts are limitless, which provide for larger sums above the NRB moving out of an individual's estate after the full seven year inter-vivos period. Bare trusts are not considered to be settlements per se, as a beneficiary is deemed to own the asset/s gifted outright and are treated as <u>absolute</u> gifts outside the settlement tax regime and consequently may still accommodate a PET under the IHT regime via bare trusts.

From 6 April 2025, the excluded property status of non-UK assets in trusts is determined by the settlor's long-term residence status, not their domicile. Trust assets may become subject to IHT if the settlor becomes a long-term resident. Trusts may move in and out of the IHT net depending on the settlor's residence status at the time of a chargeable event.

<u>Settlements</u>

Chargeable transfers fall within the Relevant Property regime of discretionary settlements, this notwithstanding that there may be a class of beneficiaries who are designated as having an interest-in-possession. All Relevant Property falls under the discretionary settlement tax regime, which is a rather complicated regime within the IHT legislation. Apart from the 20% lifetime rate tax charge there are also those charges which may arise on settlement value leaving the settlement by way of trustees' appointments, known as

1) an "exit charge", which is expressed as a fraction of the initial lifetime rate charged at inception or as a fraction of a charge which arises on every rolling ten-year anniversary of the settlement, known as a periodic charge;
   and
2) the "periodic charge" on excess value then held in settlement above the available settlement NRB, as then applies, arising every ten years.

<u>Non-Income Producing Assets – Lump Sum Life Policies – Bonds</u>

The interest in possession class of beneficiaries are entitled to all income, if any, as it arises regardless. However, any underlying settlement asset invested into single premium bonds, which are lump sum life policies, is deemed for income tax purposes to be non-income producing. Consequently, such income arising under such lump sum life policies accumulates without a tax profile for full discretionary settlements and interest in possession discretionary settlements. For other asset classes, the income tax consideration is expanded at Section 4 below at page 13 [and under Section 9, The Two Discretionary Settlement Options outlined on pages 29-31].

NB. Where Discretionary settlements and Bare trusts are holding non-income producing assets, i.e. single premium bonds and capital redemption policies no CGT will apply at any time.

Avoiding the Relevant Property regime, other than via PETs into bare trusts, may only arise via testamentary trusts which provides: -

a. an immediate post death interest for any person, (a deemed interest-in-possession trust) including a widow/er, who must take a beneficial interest-in-possession either at the time of death via the Will or intestacy law arising and by way of deeds of variation;
b. a bereaved minor's trust where capital has to be paid across on or before age 18. However, a PET may be made from an immediate post death trust in a bereaved minor's trust, thereby giving a deemed interest in possession; or
c. a variant on b. above, whereby the capital may be retained up to age 25 or sooner with a small exit charge arising subject to the number of years elapsing between 18 up to 25.

Trusts for the disabled also qualify but are not subject matter of this guide and may be described as "deemed interest-in-possession trusts" into which PETs may be made. Options ii. and iii. will generally be of little interest to parents who do not wish offspring to go off the rails at young ages! Option i. ties you down to operating measures upon a demise which may probably have been better dealt with earlier for reasons given above in the introduction. Consequently, the majority of planning interest will centre around, firstly, chargeable transfers within the available nil rate band in order that no IHT lifetime rate at 20% is paid as assets move into settlement (other than as may apply in relation to CGT) and/or secondly, PETs as are still possible within the bare trust alternative as a combination package during the lifetime of the parents or parent or others.

Bare Trusts

The bare trust needs explanation, since the taxing authorities do not treat such bare trusts as an actual settlement for the purposes of income tax and capital gains tax. However, when it comes to IHT, any passage of assets into the bare trust is nevertheless deemed an absolute gift to the person who is in receipt of the gifted assets via the bare trust. All the capital gains after the initial gift and income are taxable upon the person who is in receipt of the gifted assets. When assets are gifted to a Donor's minor child, the income tax profile will be upon the Donor until the child is age 18. Thus, since the person is regarded as having taken the assets absolutely by way of the gift from the donor, it is possible to make a PET for IHT purposes.

This is a valuable benefit, since the gifting of assets via a PET steps around the problem of the NRB ceiling, after which any value transferred faces the 20% lifetime charge, as PETs are limitless. How long will this advantage remain available bearing in mind the political agenda to block off every escape hatch available? Pondering matters may be a luxury with an expensive price tag. PETs should be recorded by the donor or trustees and there are registration requirements with HMRC as is the case with chargeable transfers into settlements.

A Stealth Tax via the Frozen Nil Rate Band (NRB)

Plus, a complicated sweetener with a Transferrable Main Residence Allowance (TMRA)

a. The IHT Nil Rate Band is to be frozen at the £325,000 level until 5th April 2030. The NRB was originally fixed at the £325k level in 2009/10. Thereby many years will have passed without any uplift, a stealth tax if ever there was such a thing!

NB. Creating more than one settlement within the Settlor's NRB

b. For the settlor, the NRB at £325,000 per person, is available on a recycled footing after the 7 years inter-vivos period. Importantly also that facilitates the establishment of Relevant Property Settlements at outset, all of which must be executed on separate days from each other, providing each settlement also with its very own NRB of £325,000. Such settlements, as established initially within the Settlor's NRB, provide very real tax planning advantages within the non-contentious mitigation format for protecting family wealth and managing the 10 year periodic charge via "Reversions" which do not profile for the 'exit charge' in any event – see point 3 below. However, the value of capital exited during any 10 year period will be added back to qualify the periodic charge.

Taking action during an individual's lifetime, rather than the testamentary/Will position, offers so much more potential benefits on the mitigation front while providing very considerable flexibility for the beneficiaries and the Settlor who is not locked out of the capital deployed plus any growth as may arise. The IHT mitigation concepts operating via specific sequential reversions allows for the Settlor to be provided for as needs require for the remainder of life but allowing such capital to move outside the estate of the Settlor after the 7 year inter-vivos period. Each spouse/civil partner, acting as a couple, may start to shift £650,000 out of the joint estate today, with the prospect of being able to repeat the process at the end of the inter-vivos period of 7 years allied with potential capital reversions for the Settlor/s as complies with the sequential bespoke reversions established at settlement execution.

3.ii. Summary of CLT's, 'Exit & Periodic' IHT Charges.

Transfers to Relevant Property settlements will be treated as chargeable lifetime transfers (CLT's), so that an immediate IHT charge of 20% will be payable where the Settlor's available Nil Rate Band [now £325k]) is exceeded. Note it is not just the gift into this particular settlement that needs to be assessed when seeing if the Nil Rate Band is exceeded but include any chargeable gift made in the previous seven years. PETs are not included during the Settlor's lifetime. However, be aware of the order of gifting should the settlor's demise occur during the inter-vivos period.

Additional charges will also be made:

- A periodic charge of up to 6% on the value of settlement assets in excess of the IHT NRB at each 10 year anniversary.
- An exit charge proportionate to the periodic charge when capital leaves the settlement between execution and subsequent 10 year anniversaries may be payable. No exit charge arises if the CLT at inception is within the Nil Rate Band. However, value exited over the 10 year period will be added back at this time of a periodic charge.

Reversions – Ideally utilising more than one settlement

Under the HMRC correspondence it has been confirmed that properly structured reversions under the "chargeable lifetime transfer" regime will be deemed to have entered into and fall under a settlement value for settlement valuation purposes, i.e. added back for a periodic charge.

3.iii. Tax Traps for the Unwary - The Order of Gifting

The Question: should PETs or CLTs be established first or second when dealing with Bare Trusts and Settlements holding Single Premium Life Assurance Bonds?

a. The Clients Perspective

The majority of clients will be keen to take advantage of the available NRB, presently £325,000 per person, without paying the 20% lifetime rate applicable to any excess value gifted. Such excess value will generally be gifted via PETs in the hope the donor will survive the 7yr gift inter-vivos period when such gift becomes fully IHT exempt. Failing which taper relief is available in yrs 4 to 7 inclusive, reducing the IHT liability.

b. The Situation

However, in the event that a client does not survive the inter-vivos period what is the implication of making a PET first with a CLT executed sometime later?

The result is dictated by IHTA 1984 S.7(1)(b) which stipulates that each disposition (gift) made in any inter-vivos period (7 yrs) has to be qualified by reference to any previous dispositions in that same period. Each chargeable transfer, as occurs when the individual dies, is taken in chronological order, which means the PET which is now a chargeable transfer will have occurred in priority to the CLT providing they were executed in the same inter-vivos time zone of years.

c. The Result

Consequently, where the PET predates a CLT, and the client dies before the end of the inter-vivos period any original PET value now becomes a chargeable transfer, and such value will be offset firstly against the Nil Rate Band as was earmarked for the CLT.

This will upset the assumptions of the client who anticipated that the NRB would be available to be deployed on the value held within the Settlement, as opposed to the PET value.

Consequently, the Trustees of the Settlement may now find that some, if not all, of the value held within the Settlement is exposed to the death rate of 40% on such original value within the Settlement. Further, the Trustees may face further liability in the event that Exit Charges, which prior to the Settlor's demise were nil, because the value gifted into the Settlement was within the Settlor's available NRB, will now also have an IHT liability. The last complication for the Settlement Trustees will be the Periodic

Charge, which arises at the end of every ten year period of the Settlements existence. Taper Relief may ameliorate the impact for the Trustees.

d. Resolution

All these technical IHT problems are easily avoided providing the client establishes a CLT, into a Discretionary Settlement, first, within the clients available NRB and the PET subsequently, either into a Bare Trust or absolutely to his chosen beneficiary/ies.

e. Other Considerations

Arising from gift inter-vivos period and the chronological rule, it is possible for the unsuspecting to find that a 14 year shadow exists. This occurs when the gaps between the dispositions are longer, e.g., 7 years and 11 months. This is because of the umbilical cord between the two events and that until both gifts are fully exempt then the risk of looking back to any other disposition within that same inter-vivos period may catch out certain IHT planning strategies, up to 14 years is possible.

Being aware should prevent the unexpected tax traps giving any future problems.

Last, but not least, each Settlement has its very own NRB and by keeping values within the available NRB it is possible to manage the impact of the Exit and Periodic Charge which impacts on Discretionary Settlements.

Please see gov.uk website for:

IHTM14513 - Lifetime transfers: the charge to tax: potentially exempt transfers (PETs): cumulation:

https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm14513

3.iv. The Transferrable Main Residence Allowance (TMRA) now Residence Nil Rate Band (RNRB)

a. This aspect of lifetime IHT planning is even more important when considering the new Transferrable Main Residence Allowance now the Residence Nil Rate Band (RNRB) for those who have estates valued in excess of £2million or have no direct descendants to whom the property may pass.

b. The RNRB was phased in from 6th April 2017 at £100,000, rising in equal £25,000 annual increases in years 18/19, 19/20, 20/21 to the level of £175,000 frozen until April 2030.

c. The RNRB is not available unless the nominated residential property is left to direct descendants. Buy to let properties do not qualify and estates valued in excess of £2million presently will have the allowance withdrawn at the rate of £1 for every £2 of value over the £2million threshold up to 20/21 tax year.

Consequently, estates with value in excess of the following sums will presently not qualify for any RNRB:-

Estate Value	Year
£2.20m	2017/18
£2.25m	2018/19
£2.30m	2019/20
£2.35m	2020/21 onwards

d. RNRB may be transferred to a surviving spouse/civil partner where there is an unused portion arising from the first to die. Also downsizing to a less valuable residence on or after 08/07/15 will allow the RNRB element of the NRB applicable on the sold property to be held over and used on assets of equivalent value providing the less valuable property still passes to direct descendants as must the assets standing in for the RNRB element of the NRB.

e. IHT is still very largely a voluntary tax.

Please see gov.uk websites:
https://www.gov.uk/guidance/inheritance-tax-residence-nil-rate-band

https://www.gov.uk/government/case-studies/inheritance-tax-residence-nil-rate-band-case-studies

IHTM14513 - Lifetime transfers: the charge to tax: potentially exempt transfers (PETs): cumulation:
https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm14513

for further information.

4. Technical Structure and Tax Points Concerning Interest-in-Possession Flexible Discretionary Settlements (IinPDS)

Income Tax

The full Discretionary Settlement, i.e. where capital and income may be held with the widest powers of appointment or accumulated for a wide class of beneficiaries, will be taxed upon such trust income at the trustee rate of 45%, assuming the Settlor and spouse are not able to benefit in any form from the trust and children of same may not benefit prior to age 18. Further consideration should also be given to the very complex administrative tax pool rules.

From April 2025, trusts with total income not exceeding £500 per annum (apportioned across all trusts by the settlor) have this income written down to £0 for income tax purposes. Above this, all income is taxed at 45% (or 39.35% for dividends).

However, an interest-in-possession discretionary settlement (IinPDS) will be taxed at the beneficiaries' income tax rate, i.e. those beneficiaries who have the right to income. Nevertheless, there are exceptions, namely where the Settlor has carved out reversions for IHT mitigation purposes, in which case the Settlor's income tax rate will apply regardless of the yield mandated to the interest-in-possession class. After the demise of the Settlor, the then recipient beneficiaries of the income share will deploy their individual income tax rates against such income. Thereby IinPDS non-UK resident beneficiaries may avoid income tax, subject to the jurisdiction of residence, or have income tax rates applied at a lower than 40% or 45% rate, subject to their individual total income. Non-income producing assets, i.e. single premium bonds, may step around income tax. See Section 8 – Concepts for Consideration.

Inheritance Tax

Providing individual interest-in-possession beneficiaries with equal or differing shares as to entitlement to the settlement income is no longer of consequence under the IinPDS, since upon a demise of such a beneficiary there is no aggregation of capital to his estate in proportion to his income share from the settlement. Instead, the capital remains in the settlement and may be taxed every 10 years – the periodic charges – or be appointed out by the trustees in whatever capital sums selected by the trustees under their powers. Prior to 22nd March 2006 an interest-in-possession, which qualifies the beneficiaries' right to a share in income, also qualified the deemed ownership of capital. Thus, trustees could force PETs upon such beneficiaries when capital was appointed away from any interest-in-possession beneficiaries to others only able to enjoy capital appointments.

This is no longer the case for settlements established after 22nd March 2006 so that trustee powers to make capital appointments to beneficiaries, having or not having an interest-in-possession, may now only be liable for an exit charge if the Settlor's nil rate band was exceeded as and when the relevant settlement was established at inception or by subsequent contribution, or when the ten year anniversary valuation breaches the Nil Rate Band available to each settlement established on separate days. If this is not the case, then the exit charge will be nil regardless of where the capital is directed by the trustees.

Trust Flexibility

The interest-in-possession class beneficiaries will enjoy a defined share of the settlement income, but this will not qualify in any way a right to any share in trust capital although, an indicative share is stated. The beneficiaries' share of settlement income, as defined by the settlement deed, allows a beneficiary to renounce his/her interest in such share of the income without any income tax consequences, IHT or CGT implications.

Under the ECB settlement deeds, any renouncement of a right to a share of income by an interest-in-possession beneficiary will cause such right to income to pass on a stirpital basis, i.e. down the blood line in equal shares. Such right to income may be reduced or nullified by the exercise of the trustees' powers to appoint capital out to beneficiaries or to fresh settlements, who need not be, but may be, members of the interest-in-possession class.

5. Concept Options

Concept Name	Details	Asset Class
Estate Control Bond (ECB) Flexible Settlement Version Only Chargeable Transfer No Discount	Offshore series of surrenderable single premium endowments, with multiple lives assured. Each policy has a distinct maturity date which is retained by the Settlor – a carve out – all other policy rights are gifted, the death benefits and other rights i.e. extension and surrender facilities into an interest in possession discretionary settlement, a Lifetime Chargeable Transfer for IHT purposes. Each policy, of which there may be up to 100, has a maturity date which is termed a reversion. When a reversion becomes due, the trustees can decide to pass it to the Settlor in whole, in part or not at all. Any policies extended will not be treated as new gifts i.e. chargeable transfers. Any reversion value will not profile for a periodic or exit charge. Policies may be appointed to beneficiaries in specie but will cumulate for 10 year periodic charge. No exit charge providing value within available NRB at inception or periodic anniversary. Any gains on policies will be subject to income tax. Any policies intact (seven years after the initial gift) will be free of IHT. Growth will be outside the estate from day one. Minimum Premium £100,000	Open Architecture

Concept Name	Details	Asset Class
Estate Transfer Bond (ETB) PETs Discounted Only	Offshore series of non surrenderable single premium endowments, written as sole or joint grantee and sole or joint lives assured and the policies are structured to have a distinct maturity benefit and death benefit. The death benefits are gifted into a bare trust, a PET. The sequential maturity benefits are retained by the Donor. Each policy, of which there may be up to 100, has a maturity date which is termed a reversion. When a reversion becomes due, the Donor can decide to take it in whole, in part or not at all. Any policies extended will be treated as a new PET which may be discounted. Extended policies are not subject to income tax. Any gains on matured policies will be subject to income tax except on death. Any policies intact (seven years after the initial gift) will be free of IHT. Any growth will be outside the estate from day one. Minimum Premium £100,000	Open Architecture

Concept Name	Details	Asset Class
Flexible Inheritor Plan (FIP) Single Premium Bond PETs/Chargeable Transfers Maybe Discounted	FIP is a defined gift scheme – the size of the gift is determined at outset and will not grow over time and is an offshore single premium whole or joint life bond sole grantee. The Settlor(s) and Donor(s) is/are the life or lives assured – survivor basis. An interest in possession discretionary (chargeable lifetime transfer) settlement or bare (PET) trust can be deployed. The Settlor(s)/Donor(s) receives growth and income on whole investment. It is an appropriate scheme for people who require a variable income stream and wish to make a fixed gift which may be discounted. The gift value is fixed and provided it is below the NRB at inception then no problems of chargeable lifetime transfers, when using the interest in possession discretionary settlement, exit and periodic charges do not arise. **Minimum Premium £100,000**	Best suited to cash deposit orientated investors
Concept Name	Details	Asset Class
Estate Management Bond (EMB) Chargeable Lifetime Transfer No Discount	Offshore series of non-surrenderable single premium endowments, grantee being life assured, and policies have maturity and death benefit only. Policies gifted into an interest in possession discretionary settlement. Trustee power to extend maturity dates and thereby not treated as a new gift i.e. Lifetime Chargeable Transfer and no income tax. Reversions/maturities will profile for periodic charge aggregation. As for ECB but with no surrender facility. Death benefits payable gross to Trustees for benefit of beneficiaries. **Minimum Premium £100,000**	Open Architecture

6. Flexible Settlements or Discounted Trusts

Asset value gifted into settlements under the lifetime chargeable transfer regime, so as to have the "Relevant Property Settlements", may be either the flexible type or the not quite so flexible discounted settlement type. PETs on the other hand may be of the not so flexible type when making gifts within the structure of a bare trust. So, what are the differences and possible advantages of a flexible type settlement where no discount occurs in relation to the value of the assets gifted compared to a non-flexible discounted settlement/bare trust?

The flexible type settlement structure provides for three important flexible benefits as allowed within the limits of gifting under the Nil Rate Band (NRB), being a lifetime chargeable transfer of relevant property. There seems little point in paying the 20% lifetime rate applicable to excess gifted value over the NRB when PETs into bare trusts avoid same and are able to soak up all excess value as required for such excess NRB value. However, flexible settlements operating within the Nil Rate Band threshold provide the following vital advantages.

<u>The first</u> benefit is that during the lifetime of the Settlor the trustees <u>may</u> appoint policies in specie thereby providing capital to beneficiaries in need of financial assistance for whatever reason; an alternative is for trustees to provide loans if so desired. Under the flexible type settlement, it is because of the very fact that the trustees may defeat the Settlor's reversion that no discount applies, since nobody would purchase in the open marketplace at any price such reversions that they may not receive. However, the ability for beneficiaries to be financially empowered at any time during the Settlor's lifetime is vital in the real world when financial pressures may arise at any time. Under the non-flexible discounted type trust members of the family are *<u>locked out</u> of the capital and growth, with the exceptions of the reversions to the Settlor, until such time as the Settlor's demise.

**This is because the value of the trust must be retained by the trustees as the reversions must be paid to the Settlor come hell or high water until no more.*

<u>The second</u> benefit relates to the Settlor who may have established to have reversions of, say, £30,000 each year. However, such money may not be required, and it is perfectly acceptable for the trustees to defer the reversion to a later or a number of later years either for the full sum or some of the amount as may be desired, the power to defer being vested with the trustees. Thereby, the trustees may allow some, none or all bespoke policy maturities/reversions to the Settlor as required.

<u>The third</u> benefit is that such deferral in full or in part is IHT neutral and will also be <u>income tax neutral</u> as applies to the bond investment within the settlement, also keeping such asset value out of the Settlor's estate. Under the discounted trust type the Settlor/Donor must have the reversions, even if the asset value is put back into a gifted trust via a PET or chargeable transfer and income tax will profile if due and such value will have fallen back into the estate of the Settlor/Donor for IHT purposes.

The value of the reversions to a Settlor and/or in-specie appointments to beneficiaries will in each 10 year period be cumulated for the purposes of the periodic charge.

Discounted Settlements/Bare Trusts

Not so Flexible Discounted Concepts

The obvious benefit is that a discounted value applies against the full value of the gifted assets; thereby assume assets gifted into the discounted type trust is £200,000. The deemed loss to the Donor's estate may be only £100,000 because of the reversions via policy maturities established to return capital in any event during lifetime to the Donor over, say, the next twenty years. A full medical will be obligatory if the discount is to be quantified for the policyholder up to age 90. The benefit will be that, should the policyholder die within the inter-vivos period, then the value falling back to their estate will be only £100,000 not the £200,000 gifted at outset.

So where for IHT purposes has the other £100,000 discounted value gone?

The answer is into the ether, and it will avoid IHT liability. Nevertheless, should the policyholder survive the full seven years, then the discount now serves no purpose as all the asset value of the gift is now an exempt transfer so no more benefit is to be had on that front. The truth of the matter is that the flexible settlement type is far better for managing the package of asset value contained therein.

Discounted PETs, for surplus value over and above the NRB, will feature if required, plus the fact that the administration is very simple under the Bare Trust regime.

Establishing a discounted settlement type within the lifetime chargeable transfer relevant property regime rather than a PET approach seems to be pointless except in very rare circumstances. Assuming no prior gifts have been made, PETs should be executed after any lifetime chargeable transfers when executing gifts, allowing two or three days to lapse between the events i.e. chargeable transfers and then PETs. This avoids looking back 7 years from the chargeable transfers in the event of the Settlor's demise during the inter-vivos period.

7. Dealing with Inter-vivos Cross Settlements

The use of the available nil rate bands by individuals and husbands and wives provides the potential for passing considerable wealth to the next generation without any inheritance tax liability.

The vast majority of individuals will baulk at this proposition since it is assumed that all rights will be lost as to the capital and yield arising therefrom, this also in the knowledge that each spouse may reasonably wish to leave such capital value to his or her surviving spouse in order to provide for that spouse's needs as a widow/widower.

So, may this problem be satisfactorily resolved?

The answer is yes by means of deploying properly structured settlements so that capital reversions may be structured on a sequential annual footing as selected by the Settlor on a bespoke basis relevant to the Estate Control Bond.

The establishment of two settlements, independently established by both the husband and the wife or civil partners, will or may pass asset value in excess of half a million by means of a chargeable transfer. Further, after the demise of one of the spouses/partners, loans to survivor will build a bona fide debt against the survivor's estate which should be repaid to the settlement upon the demise of the survivor/partner thereby reducing any excess value of the underlying estate of that person which otherwise has a liability to IHT. The survivor being added to the Appointee Class of the demised parties settlement.

After the inter-vivos period - 7 full years - a new set of nil rate bands will be acquired in conjunction with any uplift as has arisen to the nil rate band during the 7-year period since the making of the original gift. In addition, any capital growth will also fall outside the estates of the husband and wife as Settlors of capital into settlement from the date of the execution of the settlement/s.

The Phizackerly case requires that trustees, prior to making any loan/s to a surviving spouse/civil partner, qualify that the assets settled by each settlor do not arise from assets gifted to them from the other spouse/civil partner, the parties.

Thus, where there is a poor party and a wealthy party and the poor party settles asset value, which was a gift from the wealthy party, then FA 1986 S.103 will apply, the effect being that, should the poor party predecease the wealthy party, then the wealthy party may not borrow value he/she previously gifted and have the borrowing deducted as a debt against his/her estate. However, the poor party may borrow from the settlement/s of the wealthy party, assuming the wealthy party predeceases the poor party, and the debt will be deductible. Loans must be repayable on demand.

Ideally, asset value will come independently from both parties for cross settlements to be effective for a surviving party to have loans as a deductible debt from his/her estate.

8. Concepts for Consideration

1. **Estate Control Bond –** Cluster Endowment Contracts.

   A flexible settlement type, via a chargeable transfer, operating within the Nil Rate Band.

2. **Estate Transfer Bond**

   A PET into a Bare Trust. Gift value may be discounted. Deferrable reversions.

3. **The Flexible Inheritor Plan**

   Ideal for cash and building society deposit accounts.
   A PET into a bare trust or a CLT within the available Nil Rate Band. Gift value may be discounted.

4. **Estate Management Bond**

   A less flexible settlement type, via a chargeable transfer, operating within the Nil Rate Band with additional potential tax benefits.

The Estate Control Bond (ECB)

The concept is based upon single premium cluster endowment policies. There may be up to 100 policies with a minimum value of £2,000. Policies are written on a sole grantee multi lives assured basis, meaning on the death of the Settlor the policies **do not vest.**

The policy owner will select a maturity date for each policy i.e. a reversion date. This can be structured to provide regular, or irregular, access to capital invested, plus growth, to meet projected future living costs, the policy maturities arising on an annual sequential basis as selected at inception by the owner on a bespoke basis.

Each policy is a separate property and may be treated differently to other policies.

Since a chargeable transfer for IHT purposes will have occurred, any chargeable gifts made in the previous seven years will have to be accounted for to determine if any tax is due, i.e. to qualify to what extent the NRB has been deployed. PETs are not taken into consideration. **NB**. See Order of Gifting at page 15/16.

Once issued the policies are gifted, by the owner, into an interest-in-possession settlement for the benefit of his chosen beneficiaries. This is a chargeable transfer. However, the Settlor **does not gift** the maturity benefits of each policy - these are retained for his benefit alone. Any policies that do mature will do so via a resulting trust and will profile for income tax on any policy gain only if such policy gain is reverted to the settlor. There is no liability to Capital Gains Tax.

Even though the trustees must have regard to the Settlor's needs, they do have powers under the settlement to defer* any policy maturities or reversions. Therefore, the transfer into settlement will be for full policy value, since the Settlor may be denied a reversion. Thus, there is no discounted value applicable to the gift.

*[Please see page 21:- when trustees extend policies/deferrals, such matters are IHT/income tax neutral – the third benefit].

The trustees also have the ability to make appointments to beneficiaries during the Settlor's lifetime, but not to the Settlor. These can be made in specie. This may be important as the income tax point is moved from the Settlor to the recipient beneficiary.

Any appointments to beneficiaries, at least in the first 10 years of the settlement, will avoid the small exit charge if settlement values have not exceeded the settlement Nil Rate Band at the inception and any subsequent 10 year valuation. This will be the case providing gifts into the ECB are below the Nil Rate Band at outset in order to avoid paying the 20% lifetime rate applicable on value in excess of the Nil Rate Band.

If reversions/maturities are made to the Settlor or appointments are made to beneficiaries, they must be 'added back' or accumulated on the 10 year anniversary to determine if the then settlement value is in excess of the NRB. If the settlement is in excess at this anniversary, then a small tax charge of up to 6% on the excess is made.

After seven years from the execution of the settlement all the policies and their underlying value will be outside the estate of the Settlor, this notwithstanding that policy maturities may still arise in the hands of the Settlor at some later time.

In the event that the demise of the Settlor occurs within seven years from the execution of the settlement, then only the original gifted value will fall back into the Settlor's estate, any growth being exempt.

During the lifetime of the Settlor no annual 5% tax free withdrawals are available, since reversions require that the Settlor, if so minded, takes all the policy value and not just a portion of each policy. After the Settlor's demise, or if trustee appointments of policies in specie have been made during the Settlor's lifetime, then 5% annual tax free drawdown may be taken from the remaining policies held directly by the beneficiary or still held in the settlement.

After the demise of the Settlor, under existing legislation, a widow or widower may be added as a beneficiary for capital appointments. This allows loans to be made by the trustees to the relevant party, repayable on demand, such loans building a bona fide debt against the estate of the surviving party, but please take note of the Phizackerly case detailed at page 23.

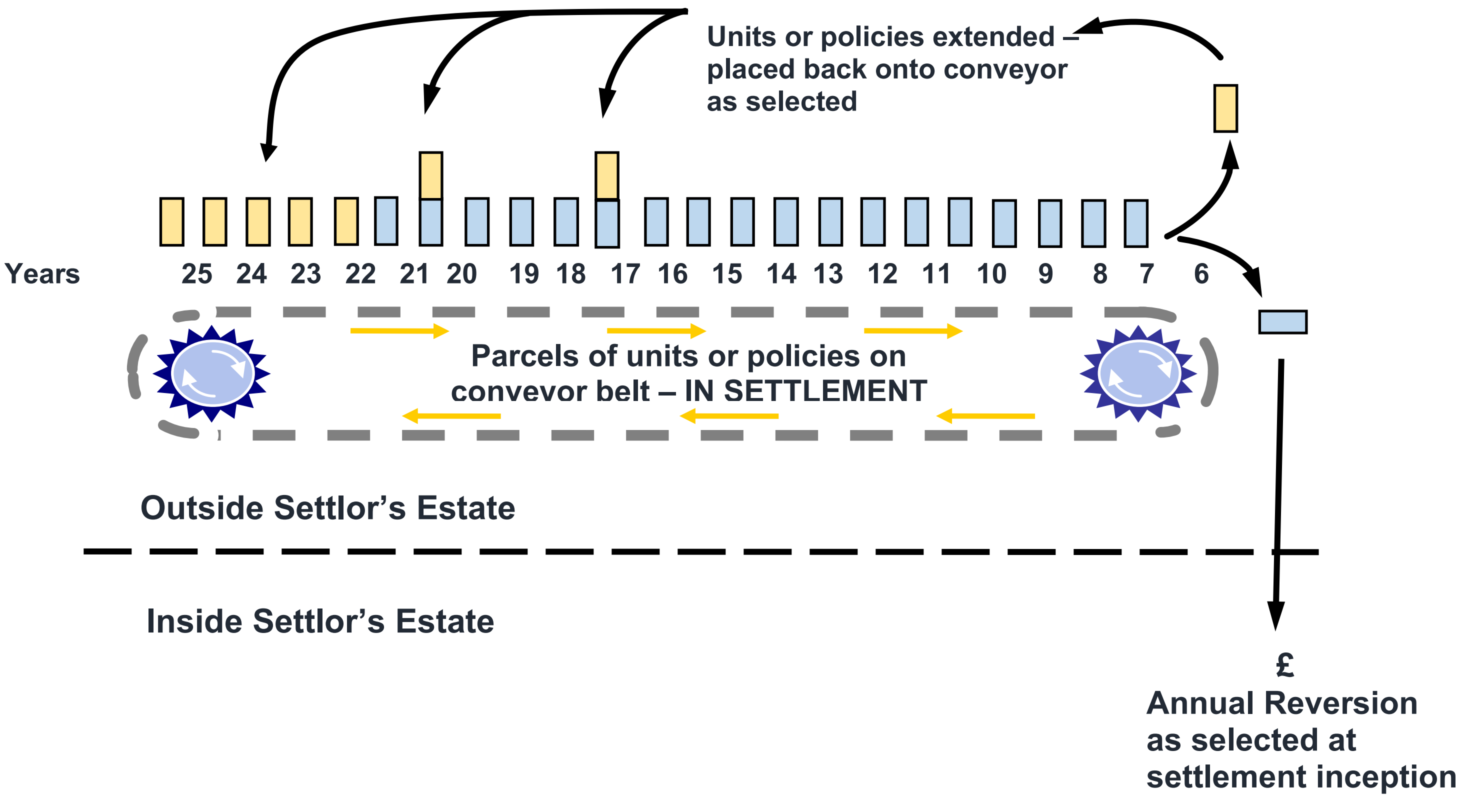
Please note that, just because the IHT rules have moved from a PET regime to a chargeable transfer regime, with a limit on tax free transfers being within the Nil Rate Band for chargeable transfer purposes, it does not mean that the fundamental principles in relation to GWR have changed. In fact, it is exactly the same as before on that particular front.

It is that there is a number of **technical tax traps** which need to be monitored under the regime thereby needing adjustment to accommodate a different tax regime as a result of the Government's politically driven agenda.

Last but not least, it is not possible to arrange for the ECB to be based on a bare trust structure. This is because under a bare trust the beneficiaries may call for the policies as of right and the policies may then be surrendered, leaving the Settlor with no prospect of any reversions via policy maturities.

Estate Control Bond

Parcels of units or policies earmarked for reversion to settlor



Every year a parcel of units or policies comes up for reversion, but trustees are empowered to defeat or defer any part or all of each reversion - specifying deferred reversion dates

Extended Units/Policies

The Estate Transfer Bond (ETB)

The structure of the ETB replicates the ECB with one major variation, namely the policies are **not surrenderable**. Therefore, a gift can be made into a bare trust which will qualify as a PET.

In simple terms, the donor retains policy maturity values for himself and gifts the policy death benefit to the chosen individual/s. The structure does not allow the flexibility of appointments to beneficiaries. Asset value will only pass to the intended beneficiaries as and when the donor's or surviving donor's demise occurs.

The use of the bare trust, which equates to an absolute gift of the death benefit, avoids a chargeable transfer under the IHT legislation, allowing individuals to still make unlimited gifts via a PET.

The donor selects the policy maturities, the reversions, on a bespoke basis to provide the required sequential policy maturities on a year by year basis. Subject to the donor's state of health and the grouping of the sequential annual policy maturity dates, the donor will benefit from a discounted PET in relation to the total premiums paid under the ETB.

Any discounted plan will require a full medical for underwriting purposes.

The discount arises since the donor will be in receipt of the policy maturity value at a later date if the donor is still alive, i.e. the reversion. In the event that policy maturity is extended there will be another discounted PET upon the donor based on the value of the extended policy/ies and the new selected maturity date at that time, subject again to the health of the donor. In the event that policies are encashed upon maturity the normal income tax position applies as detailed under the ECB concept, but any deferral will be income tax neutral.

Policies are issued on a sole or joint survivor life assured basis, the ownership being as beneficial joint tenants. This allows the survivor to take the policy maturity value as a sole owner after the demise of the first party. However, each donor's PET, as duly discounted, will, in the event of either party dying during the seven year inter-vivos period, fall back to the estate of the demised party for qualifying any IHT liability as may arise with taper relief as may be applicable for that individual spouse if written on a sole grantee footing.

The joint life survivor basis allows a degree of comfort knowing that the survivor will be entitled to policy maturity values as may be needed, or the deferral option is still available if so chosen, thereby increasing the prospect of asset value leaving the estate after another inter-vivos period.

Bearing in mind that after every inter-vivos period the donor has recycled to him the NRB deployed seven years previously, it may or will make sense to establish a number of new chargeable transfer trusts like ECB, whereby any deferral of policy maturity dates will be neutral for IHT purposes rather than a new discounted PET upon the donor, as is the case for ETB.

Upon the demise of the donor or surviving donor all the death benefit value of the policies will vest for the benefit of the person or persons to whom the death benefit equitable rights were gifted. Providing the gift – a PET – was made at least seven years previously, then all the value will be free of any IHT liability. Policies vesting within the inter-vivos period will benefit from the discounted valuation, in conjunction with taper relief on that element gifted in excess of the nil rate band in relation to years 4 to 7 inclusive where policies vest and there if no surviving spouse/partner.

Policies vesting by dint of a death claim enjoy **income tax free** uplift on policy gains as may have arisen. There is no requirement to execute multiple trusts. However, stipulating which policies' death benefits have been given to which individuals will help to retain clarity of purpose.

The Flexible Inheritor Plan (FIP) – A Defined Gift Scheme

How does the Plan Work? For Cash Deposit Holdings

When you take out a Plan, it is primarily your age and sex that will determine the maximum size of a capital gift (the Guaranteed Minimum Sum Assured) which you can make to your intended beneficiaries in relation to the premium paid. You are able to select any amount up to this maximum as your PET, i.e. the GMSA as detailed below.

The PET or chargeable transfer you make is termed the Guaranteed Minimum Sum Assured (GMSA). This is a fixed sum and is expressed as a percentage of your investment. It is this amount that will be paid to your chosen beneficiaries on your death.

Importantly, although you have NO access to the value of the GMSA, you do have access to any monies that are in excess of this amount. These may be drawn on regularly or as one off withdrawals. <u>These monies will include the yield and growth on ALL of your investment, including on the GMSA</u> for the remainder of your life. Further, 5% annual income tax free withdrawals are available as a proportion of the original total investment for up to 20 years. Any annual excess withdrawals will profile for income tax.

Table 1 below contains the maximum GMSA based on individual's sex and age.

Age	Smoker	Male	Female
Up to age 70	No	85%	90%
Over 70	No	80%	85%
Up to age 70	Yes	80%	85%
Over 70	Yes	75%	80%

Table 1

As soon as the plan is set up, the GMSA will be assigned into the settlement/trust immediately. The assignment of the GMSA is a PET or chargeable transfer for the purposes of Inheritance Tax.

Under the terms of the settlement/trust, the trustees will hold the GMSA for your nominated beneficiaries on your death.

Since you select the value of the GMSA, the higher you set the value the less scope you have for withdrawals in the future, but your beneficiaries will be guaranteed to receive a higher amount.

On your death the bond ends and the trustees hold the value of the GMSA for your beneficiaries. Any excess value over the GMSA is the residual value in the bond and will form part of your estate and may be subject to IHT.

If you have survived seven years, the GMSA will not form part of your estate and will not therefore be liable for IHT.

If you die within seven years, then the value of the GMSA will be potentially discounted for IHT purposes. The value of the discount will depend on your age and sex and state of health when you take out a Flexible Inheritor Plan. Also, market interest rates will have a bearing on the discount given.

Table 2 below details a sample of the standard potential discount factors available for clients whose health is considered standard for their age. You can rely on these standard discount factors if the Settlor elects to be medically underwritten, which will provide an accurate assessment of the state of health and thereby provide a more detailed calculation of the discount that might be expected.

	Estimated Discount applicable to the GMSA	
Age Attained	Male	Female
60	65.7%	69.2%
70	49.2%	54.2%
80	32.0%	37.7%
90	19.1%	23.7%

Table 2

In addition to the benefit of the discount on the value of the GMSA, with a death occurring between three and seven years after taking out a Flexible Inheritor Plan, a reduced level of IHT may be payable on the element of any gift in excess of the nil rate band. See Table 3 below for further details.

Remember that, if there is any residual value in the bond on death over and above the value of the GMSA, then this element forms part of your estate and therefore maybe subject to IHT.

Years Since Gift	IHT Payable
Between 4 and 5 years	80% of full rate
Between 5 and 6 years	60% of full rate
Between 6 and 7 years	40% of full rate
Between 7 and 8 years	20% of full rate

Table 3

The concept allows the settlor/donor to make a discounted gift of capital for IHT purposes, but may retain income for life from such gifted capital, all within the framework of the tax legislation.

The Estate Management Bond (EMB)

The cluster single premium unit linked endowment policies are issued on a non-surrenderable footing with two equitable rights namely a Maturity Date and a Death Benefit.

The policies are issued on a sole grantee life assured basis and are duly gifted by the grantee into an interest in possession discretionary settlement. Thereby the Settlor makes a valued gift within the Settlor's Nil Rate Band as a Chargeable Transfer for IHT purposes.

The policy Maturity Date may be deferred to a later date by the Trustees; hence there is no discounted value upon the value gifted at inception by the Settlor. Any deferment by the Trustees of a policy Maturity Date, reversion for the Settlor, will be tax neutral on all fronts. Any actual reversions to the Settlor will be an exit charge for IHT purposes and consequently will aggregate for the ten year periodic charge applicable for relevant property. Policies may revert in specie to the Settlor or mature in which case any policy gains will be liable to basic rate income tax and, if applicable, higher rate income tax at the Settlor's marginal rates.

Upon the demise of the Settlor, the policies held by the Trustees will vest and such gross policy value will be initially held as a cash sum by the Trustees. The Trustee powers provide for capital appointments forward to members of the 'Appointee Class' only after the demise of the Settlor. The same is true in relation to the making of loans by the Trustees also to the members of the 'Appointee Class' as may merit consideration.

Further, the Trustees may purchase further investment unit trust or life assurance policies as may be regarded as viable and tax efficient investments after such Settlor demise. Thus, the settlement may continue as a vehicle providing protection from a wide variety of problems as may otherwise afflict family wealth apart from the tax considerations.

Underlying policy gains will be outside the Settlor's estate from settlement execution and after seven years, the inter-vivos period, the original capital value gifted will also be outside the Settlor's estate. This notwithstanding that policy reversions/maturities may fall back to the Settlor, on the basis of the bespoke sequential policy maturity dates, as selected by the Settlor, as and when the original policies were purchased. Trustee powers applicable to policy deferments are identical to the ECB concept as detailed previously.

9. The Two Discretionary Settlement Options

Why do we favour Interest in Possession Discretionary Settlements for IHT Plans as compared to a Full Discretionary Settlement?

A settlement is a legal relationship between the person wishing to create a settlement; the Settlor, and one or more persons willing to undertake the office of Trustee whereby certain assets are placed under the control of the Trustee upon Trust to be held for the benefit of certain persons, Beneficiaries. The certain assets being the capital gifted.

There are three main types of Trust an Absolute Trust, an Interest in Possession Discretionary Settlement and a Full Discretionary Settlement.

Here we are only going to concern ourselves with Interest in Possession Discretionary Settlements and Full Discretionary Settlements.

Full Discretionary Settlements

In a Full Discretionary Settlement, the Trustees are the legal owners of any assets held in the settlement and the Trustees have 'discretion' about how to use the settlement‘s income i.e. to distribute or accumulate.

Interest in Possession Discretionary Settlement

An Interest in Possession Discretionary Settlement is a form of legal arrangement which gives a person or persons a present right to the present enjoyment of property – i.e. income.

At least one or more of the Beneficiaries in an Interest in Possession Discretionary Settlement will have the right to receive any income generated by the settlement.

The Beneficiary or Beneficiaries with the right to enjoy the income for the time being is said to have an Interest in Possession and is colloquially described as an income Beneficiary. Such Beneficiary normally having such income share mandated directly to the relevant Beneficiary/ies.

A settlement can give the Interest in Possession to a Beneficiary for a fixed period, for an indefinite period or, more usually, for the rest of the Beneficiary's life.

Inheritance Tax and Capital Gains Tax

Both types of settlements are relevant property settlements so they will be treated identically for the purposes of IHT and CGT. The principal advantage of both these settlement types is that no inheritance tax is charged upon the death of a potential beneficiary because no Beneficiary has a right to any defined interest in the settlement assets.

So why would anyone use one type of settlement in preference to another?

Some may consider a Full Discretionary Settlement more versatile because:

- The Settlor does not want to commit income to any 'named' Beneficiary or Beneficiaries.

- Matters of Interest in Possession Beneficiaries being subject to Divorce and/or Bankruptcy (but only to potential future income).

These are matters that should be considered but not in isolation of the very different treatment of Income!

Income Tax

An Interest in Possession Discretionary Settlement provides that any income will be paid to the Interest in Possession class of beneficiaries and in most cases, they will be taxed at their personal marginal rate of tax. Policies of insurance and assurance are non-income producing assets and will not give rise to income tax for the Settlors or beneficiaries at any time unless policies mature or are surrendered, i.e. encashed.

Whereas for a Full Discretionary Settlement the Trustees retain full discretion to distribute income to any one or more of a named beneficiary class or to accumulate such income.

Taxation of Income for:-

A] Interest In Possession Discretionary Settlements

The Trustees are normally chargeable to income tax on income received, so

- rent and trading income are chargeable at the basic rate (currently 20%)

- UK dividend income is chargeable at the starting rate for dividends (currently 10%) and the tax credit attached to the net dividend meets the Trustees' liability

- savings income, such as bank interest, is chargeable on the Trustees at the lower rate (currently 20%) Such income usually has tax deducted at source by the bank or building society, and this is taken into account in taxing the Trustees.

The trust standard rate band (£1,000) is abolished from April 2025. All trust income above £500 (apportioned across all trusts created by the same settlor) is taxed at 45% (or 39.35% for dividends).

The relevant beneficiaries who are entitled to the income as mandated from the settlement after tax and trustee expenses and are taxed on this in the normal way. They are entitled to credit for tax paid by the Trustees or deducted at source. If Beneficiaries are starting rate taxpayers or non-taxpayers, they will be able to reclaim some or all of the tax paid, though tax credits on dividends cannot be paid. If they are liable at higher rates, further tax will be due. Single premium life assurance policies are deemed 'non-income' producing within the settlement and thereby any income is capitalised until such policy/ies mature or vest with or without any income tax liability as may apply. This point is also relevant for the Full Discretionary Settlement.

B] Full Discretionary Settlements

The Trustees are liable to any income tax arising. The settlement has basic rate band of £1,000 within which tax is payable at 7.5% or 20%. (£1,000 split between number of Trusts (except bare Trusts) established by settlor to a minimum of £200.)

Above this band income is taxable at 45% or dividend income at 39.35%. These rates of income tax apply when Trustees accumulate income rather than distribute income in any year. In the event Trustees elect to distribute income in any tax year then the effective tax rate on dividends will be 45.6% as the 7.5% dividend tax credit is not offset within the tax pool, and Trustees have to be mindful of the complicated tax rules covering such matters.

Conclusion

On the face of it making the decision to create a Full Discretionary Settlement makes sense, to many people as no decision has to be taken 'now' as to the direction of capital and income. However, the income taxation, administration, and cost of administration, of a Full Discretionary Settlement compared to an Interest in Possession Discretionary Settlement is a 'nightmare'. Thereby the best solution is a settlement that offers the best of both worlds. This is essentially what you have with the Interest in Possession discretionary type settlements holding deemed non-income producing assets providing, in certain circumstances, some very useful income tax benefits.

Settlement deeds give the trustees wide powers to decide who shall benefit from the settlement funds at any given time, the Discretionary or Appointed Class of Beneficiaries that identify specific people to Benefit from the funds unless and until the Trustees exercise those powers; subject to the concept variations as apply between the various IHT mitigation plans.

Therefore, in many situations it is clear that there is no rational to utilise a full Discretionary Settlement with the costly administrative burden when a simple solution is already at hand.

Returning to the Divorcee/Bankruptcy aspect touched on above within an Interest in Possession Discretionary type settlement, holding non-income producing single premium policies, then it should be remembered that even though there are Interest in Possession beneficiaries, who are entitled and will have income mandated to them, this is relevant only if there is any income arising in the settlement. With the trustees owning non-income producing assets there is therefore no income arising in the settlement for creditors or divorcees to target.

Also, the income tax is applied at the rates applicable to the life office and any income tax on policy gains may be deferred, mitigated or in certain instances avoided.

Appendix: Definitions of New Terms and Regime Changes

Long-Term Resident (LTR):

An individual who has been UK tax resident for at least 10 out of the previous 20 tax years. LTRs are subject to UK IHT on their worldwide estate.

IHT "Tail" Provision:

After ceasing to be UK resident, a former LTR remains within the IHT net for up to 10 years, depending on the length of previous UK residence.

Excluded Property Trust (EPT):

A trust holding non-UK assets that, prior to April 2025, would have been outside the UK IHT net if the settlor was non-domiciled. From April 2025, EPT status depends on the settlor's residence at the time of a chargeable event.

Nil Rate Band (NRB) and Residence Nil Rate Band (RNRB) Freeze:

Both are frozen at £325,000 and £175,000 respectively until April 2030.

Business and Agricultural Property Relief (APR/BPR):

From April 2026, 100% relief is capped at £1 million per individual transferor or estate. Value above this receives 50% relief. AIM shares receive 50% BPR.

Trust Income Taxation:

From April 2025, the standard rate band is abolished. A new £500 income threshold applies across all trusts created by the same settlor. Income above this is taxed at 45% (or 39.35% for dividends).

Pensions and IHT:

From April 2027, most unused pension funds and death benefits are included in the taxable estate for IHT purposes, except for certain life policies purchased via pension funds or employer arrangements.

Please Note

UK Jurisdiction

This document only provides information concerning structure in order to mitigate tax.
No investment advice is provided accordance with the Financial Services Act 2000 which was amended by the Financial Services Act 2012 and the Bank of England and Financial Services Act 2016.
Further it is not intended to provide investment advice, via this document, in any degree whatsoever. References to non-income producing assets and securities/assets, which may
be held within same, are for information only and are not recommendations for
investment content at any time or in any way.

Investment advice may only be obtained via properly regulated entities and individuals as provided for under the Financial Services Act 2000 which was amended by the Financial Services Act 2012 and the Bank of England and Financial Services Act 2016.