

Chargeable Transfer Trusts

The Case for Establishing More than One Trust

Chargeable Lifetime Transfers

Transfers to relevant property trusts 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 amount of Nil Rate Band (NRB - £285,000 for 2006/2007 tax year) is exceeded. Note it is not just the gift into this trust that needs to be assessed when seeing if the NRB is exceeded but any chargeable gift made in the previous seven years. PETs are not included.

Additional Charges will also be made:

- ▶ A periodic charge of up to 6% on the value of trust assets over the IHT NRB at each 10 year anniversary. It is important to note that the NRB is applied to the value of **each trust** if there is more than one.
- ▶ An exit charge proportionate to the periodic charge when capital leaves the trust between 10 year anniversaries may be payable.

For reasons of illustration we are assuming that the NRB will be £400,000 in 2016. This assumed increase is in line with recent increases of the NRB.

We also assume that no previous gifts have been made, for reasons of accumulation, apart from those indicated.

Establishing a Single Relevant Trust

If a single trust is established in 2006 and the gift is below the NRB, this trust will have to grow by more than £115,000 at the 10th anniversary (2016) when the NRB will be £400,000 for the periodic charge to be applicable. This is provided that no capital has been distributed from the trust.

If capital has left the trust, then, under normal circumstances (see reversions below), this is added back into the trust capital at the 10th anniversary and if this total exceeds the NRB, then a periodic charge would apply.

Providing no lifetime transfer charge nor a periodic charge has been applied, then no exit charge will be applied.

| | Trust |
|--------------------------------------|----------|
| Initial Transfer | £285,000 |
| Add Prior Transfers | £0 |
| Lifetime Transfer Charge | NIL |
| NRB £400,000 Max Growth ¹ | £115,000 |

Establishing More than One Relevant Trust

Since we know that each trust has its own NRB, it may be sensible, to maximise potential non taxable trust monies at the 10th anniversary, to establish more than one trust to accommodate gifts below the NRB.

| | Trust 1 | Trust 2 | Trust 3 |
|--------------------------------------|----------|----------|----------|
| Initial Transfer | £100,000 | £100,000 | £85,000 |
| Add Prior Transfers | £0 | £200,000 | £285,000 |
| Lifetime Transfer Charge | NIL | NIL | NIL |
| NRB £400,000 Max Growth ² | £300,000 | £200,000 | £115,000 |

It is important, for this strategy to work, that each trust is established on a separate day, and perhaps even have different beneficiaries. Otherwise they will be considered as one trust!

¹ To avoid 10th Anniversary Tax Charge

² To avoid 10th Anniversary Tax Charge

By adopting this strategy it can be seen that rather than only having the latitude of £115,000 of growth under one trust, with three trusts £615,000³ of growth can be achieved before a 10 year charge is applied.

If this is taken even further and, say, six trusts are established, even more scope for growth could be afforded.

| | Trust 1 | Trust 2 | Trust 3 | Trust 4 | Trust 5 | Trust 6 |
|--------------------------------------|----------|----------|----------|----------|----------|----------|
| Initial Transfer | £50,000 | £50,000 | £50,000 | £50,000 | £50,000 | £35,000 |
| Add Prior Transfers | £0 | £100,000 | £150,000 | £200,000 | £250,000 | £285,000 |
| Lifetime Transfer Charge | NIL | NIL | NIL | NIL | NIL | NIL |
| NRB £400,000 Max Growth ⁴ | £350,000 | £300,000 | £250,000 | £200,000 | £150,000 | £115,000 |

By adopting this strategy it can be seen that rather than only having the latitude of £615,000 of growth under three trusts, with six trusts £1,365,000⁵ of growth can be achieved before a 10 year charge is applied.

³ This figure is achieved by the addition of the maximum growth row i.e. growth available under each trust

⁴ To avoid 10th Anniversary Tax Charge

⁵ This figure is achieved by the addition of the maximum growth row i.e. growth available under each trust

Conclusion

The more trusts that are established the more room for growth is created before the trust(s) NRB is exceeded.

However, the trade-off is the prospect, for any parties involved, of additional trust administration. Consequently, keeping trust numbers to say 4 with 3 trusts at £50,000 each and one trust at £135,000 helps to provide adequate 'room for growth' without too many trusts to administer. **The last trust to be established should be the largest amount as it falls out of consideration for aggregation purposes.**

| | Trust 1 | Trust 2 | Trust 3 | Trust 4 |
|--------------------------------------|----------|----------|----------|----------|
| Initial Transfer | £50,000 | £50,000 | £50,000 | £135,000 |
| Add Prior Transfers | £0 | £100,000 | £150,000 | £285,000 |
| Lifetime Transfer Charge | NIL | NIL | NIL | NIL |
| NRB £400,000 Max Growth ⁶ | £350,000 | £300,000 | £250,000 | £150,000 |

By adopting this strategy it can be seen that rather than only having the latitude of £1,365,000 of growth under six trusts, with only four trusts £1,050,000⁷ of growth can be achieved before a 10 year charge is applied. The difference being what might be considered a sacrifice for simplified administration.

Reversions

Utilising more than one trust

Under the ECB Technical Brief it has been highlighted that Reversions under the "chargeable transfer" regime will be deemed never to have entered into or fall under a settlement value for trust valuation purposes.

⁶ To avoid 10th Anniversary Tax Charge

⁷ This figure is achieved by the addition of the maximum growth row i.e. growth available under each trust

Consideration should therefore be given as to where the bulk of 'reversions' should be located, within ECB or Legacy⁸, when utilising multiple trusts, i.e. which trust should have the immensity of reversions situated within it, or should they be spread evenly?

If we consider the four trusts strategy above, logic dictates that the trust established last, with least 'room for growth', should provide the majority of projected 'reversions' which the Settlor is most likely to actually require.

This allows for the other 3 trusts, with maximum room for growth, to be invested accordingly since they have less probability of exceeding the NRB at any 10th anniversary.

This structure will also ease administration in relation to reversions, since reversions will come from only one trust rather than several. Any reversions that do occur, but are not required, from the remaining trusts may simply be deferred year by year.

Since the tax profile of the Settlor differs under ECB and Legacy, it may be prudent to structure matters with this in mind when utilising more than one trust. ECB profile for income tax and Legacy for Capital Gains Tax (CGT).

It may be sensible therefore, utilising the 4 trust strategy, for the first three trusts, which will allow maximum growth, to be Legacy Trusts so the Settlor's CGT allowance and taper relief can be utilised, allowing growth to gently accumulate in the early years.

The larger trust should be the ECB concept as growth in the early years may be minimal and therefore any income tax chargeable limited.

⁸ The Legacy Trust holds a series of units of collective investments with differing maturity dates set by the Settlor

| | Legacy | Legacy | Legacy | ECB |
|------------------|---------|---------|---------|----------|
| Initial Transfer | £50,000 | £50,000 | £50,000 | £135,000 |
| Reversions | | | | |
| Year 1 | | | | £20,000 |
| Year 2 | | | | £20,000 |
| Year 3 | £5,000 | £5,000 | £5,000 | £20,000 |
| Year 4 | £5,000 | £5,000 | £5,000 | £20,000 |
| Year 5 | £5,000 | £5,000 | £5,000 | £20,000 |
| Year 6 | £5,000 | £5,000 | £5,000 | £20,000 |
| Year 7 | £5,000 | £5,000 | £5,000 | £15,000 |
| Year 8 | £5,000 | £5,000 | £5,000 | |
| Year 9 | £5,000 | £5,000 | £5,000 | |
| Year 10 | £5,000 | £5,000 | £5,000 | |
| Year 11 | £5,000 | £5,000 | £5,000 | £20,000 |
| Year 12 | £5,000 | £5,000 | £5,000 | |
| Year 13 | | | | |
| Year 14 | | | | |
| Year 15 | | | | |
| Year 16 | | | | |
| Year 17 | | | | |
| Year 18 | | | | |
| Year 19 | | | | |
| Year 20 | | | | |

Capital growth being built up in the Legacy Trusts will allow for a gradual move across to reversions from these trusts in later years, any increasing capital gain being offset against the Settlor's annual CGT allowance which with taper relief will maximise the tax free capital return after allowances.

Reversions under the ECB Trust with an income tax profile could, at some time later, possibly be deferred so as to maximise top-slicing income tax relief by deferring maturities to later years as the reversions under the Legacy Trusts, with capital gains, gently increase.

This boxing and coxing of reversions from trusts with differing tax profiles and deploying deferral options will give the best potential to not only mitigate IHT but also reduce CGT and income tax during the Settlor's lifetime.

Last but not least for ease of administration under the Legacy structure it is sensible to allow a trust to hold only the same stock in order that when only a part reversion is required the trustees are not seeking to deal in the re-registration of small amounts of units.

⁹ Note reversions under Legacy and ECB can be deferred without any tax consequences

The ETB concept is structured for the making of a PET and consequently is not limited by the nil rate band considerations applicable to Legacy and ECB, which deploy value under the chargeable transfer regime. The balance of reversions should be structured to take account of the re-use of previously used tranches of the client's nil rate band with a view to establishing in the future, at the relevant times, new chargeable transfer trusts, whereby deferral of reversions will not trigger new PETs upon the client, as is the case with ETB.

Also consideration should be given to the fact that such recycled value of previously used nil rate bands will require another 7 year inter-vivos period for IHT purposes to fall outside the Settlor's estate, with or without any discount.

Thus for the elderly, 75 plus, or those not enjoying the best of health, keeping reversions to a lesser quantity is probably the best tactic, certainly after the first seven years, since the ECB or Legacy trusts allow for larger potential reversions without the deferred value of reversions being a new PET upon the Settlor.

Further, do not lose sight of the tax free roll up behind ETB during the life and after the demise of the Settlor.

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