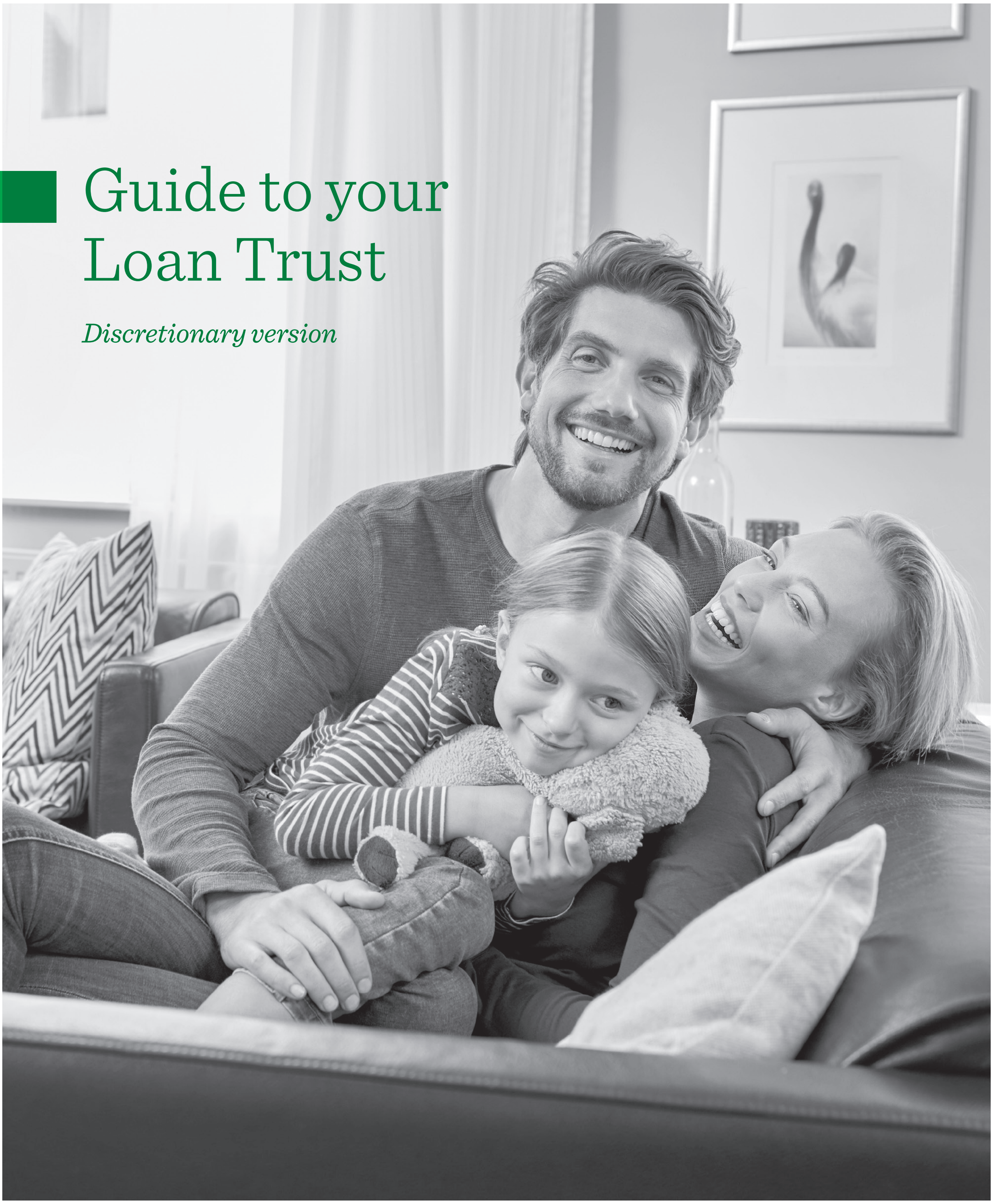
Quilter

# Guide to your Loan Trust

*Discretionary version*



Throughout this guide when we say 'Quilter', we mean Quilter Life & Pensions Limited.

This guide is written for you as the person setting up the trust (the 'settlor') but may also be of interest to your trustees and legal personal representatives.

# Contents

# What is the Loan Trust?

*Loan Trusts are for people who want to potentially reduce their inheritance tax (IHT) liability but can't quite give up access to their capital.*

The trust gets its name because you set it up by appointing trustees (which may include yourself) and then make an interest-free loan to them of the capital that you wish to invest. The loan is repayable on demand – in other words, you can continue to receive money from the trust up to the original investment (loan) amount. The trustees then invest the loan. Any growth achieved is held for the beneficiaries of the trust.

Using a Loan Trust allows you to access your original capital at any point but the growth will not be included in your estate for IHT purposes.

## *Benefits of a Loan Trust:*

- ☑ The Loan Trust is an alternative to giving away money for good.
- ☑ Growth on your capital is passed to your beneficiaries free from inheritance tax.
- ☑ You retain access to your capital through regular or ad-hoc withdrawals and you can claim back the balance of your outstanding loan at any time.
- ☑ If you no longer need access to the capital, you can waive all or part repayment of the loan.

## *The different roles involved in a trust*

**Settlor**
The person who creates the trust and lends a sum to be held by the trustees.

**Trustees**
The legal owners of the trust property. The trustees must administer the trust in accordance with the terms of the trust document, and manage the repayment of the settlor's loan and distribution of the growth to the beneficiaries.

**Beneficiaries**
The ultimate recipients of the investment growth made on the original loan. Beneficiaries are defined by the settlor when the trust is created.

# How a Loan Trust works

## *Setting up the trust*

The first stage in the process is for you, as the settlor, to make an interest-free loan, repayable on demand, from your savings to your appointed trustees.

The trustees use the loan to invest in a Quilter Collective Investment Bond (CIB) with the intention of achieving long-term capital growth.

The investment is not guaranteed and can go down as well as up in value, depending on market performance.

## *Any growth on the investment will not be liable to IHT*

Since you have made a loan rather than giving your money away, the value of the loan will remain an asset in your estate when calculating any potential inheritance tax (IHT) liability. However, any growth achieved on the loan will be outside your estate.

Any repayment of the loan you request, whether in whole or in part, will (providing you spend the money) reduce the value of your estate.

As the settlor (the creator of the trust) your sole entitlement is to have your loan repaid to you. You are specifically excluded from benefiting from any growth achieved by the investment.

## *Enjoy flexibility around who benefits from the trust*

You do not need to specifically name the beneficiaries of the trust at outset as the Loan Trust allows you to have wide classes of beneficiaries (such as children, grandchildren etc). You can also add classes of beneficiaries during your lifetime if you wish.

It is important to remember that although your spouse or civil partner can benefit after your death, they are not automatically included in the class of beneficiaries during your lifetime. Therefore, unless you choose to name them specifically when you create the trust, they cannot be added later and they cannot benefit from the trust during your lifetime.

Because the trustees can hold trust assets for a wide class of beneficiaries, this gives them flexibility over the timing, who benefits from the trust fund and who it should be paid to. If you would prefer to specify one or more beneficiaries which cannot be changed, you may want to consider the Bare Trust version of the Loan Trust instead.

## *Investing your trust fund*

The trustees invest the money you lent them into a Quilter Collective Investment Bond. The premium is spread equally across 1,000 identical life assurance policies. Within those policies the initial premium is used to purchase units in investment funds, and it is these units that provide the potential for capital growth. Any investment growth will be outside your estate for IHT purposes and held for the beneficiaries of the trust.

## *Choose limited or unlimited liability for your trustees*

We offer limited and unlimited liability versions of the discretionary Loan Trust:

- **Limited liability version -** the trustees' liability for repaying the outstanding loan to you is limited to the amount available in the bond (less any loan repayments already made to you) at the time you demand the repayment. This protects the trustees from being personally liable for any shortfall.
- **Unlimited liability version -** if you demand repayment of the loan, the trustees are personally liable for any shortfall in the bond if it does not meet the liability of the outstanding loan.

*Inheritance tax (IHT)* – The estate of an individual domiciled in the UK is liable to UK IHT if its value exceeds the nil-rate bands and it is not left to an exempt person, e.g. a spouse, civil partner or charity. The excess is taxed at 40%.

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*Nil-rate band (NRB)* – The first £325,000 in your estate is taxed at 0% for IHT purposes. This amount is frozen until April 2026 and is known as the nil-rate band (NRB). Any assets above the NRB and not covered by the RNRB (see below) are liable to IHT at 40%.

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*Residence Nil-Rate Band (RNRB)* – The residence nil-rate band is an additional nil-rate band available to your estate if you own a property and leave this to your children (including adopted, fostered or stepchildren) or grandchildren. It may also be available if you have downsized or sold your property since 8 July 2015. The RNRB is currently £175,000 and will be frozen at this amount until April 2026.

## *Accessing your capital*

You can request regular withdrawals from the trust to supplement your income, or occasional withdrawals for a specific purpose. These withdrawals are part repayments of the loan. Repayments can be requested at any time and at any level, providing the amount requested is not over the outstanding loan amount.

In total you are only entitled to the repayment of the loan amount shown in the Loan Trust deed (and any additional loan agreements) you have completed.

Once the loan is repaid, any amount in the trust fund will be held in trust for the beneficiaries. It would therefore be prudent for your trustees to keep a record of the outstanding loan and any loan repayments made to you.

## *Regular repayments*

If you would like the loan repaid in regular instalments, you can ask the trustees to start repayments immediately or at a later date. These repayments could be set up monthly, quarterly, half-yearly or yearly.

These are set up as automatic withdrawals from the bond which will be done by partially cashing in enough of the underlying investments across all the policies within the bond. These will start immediately if this was requested by the trustees on the bond application form.

If you request that the regular repayments should start at some point in the future, the trustees can ask us to set this up by completing the appropriate form and sending it to us. It is advisable that the trustees keep ongoing records of the outstanding loan.

## *Occasional and full repayments*

You can request a partial loan repayment from the trustees or a full repayment of the outstanding loan at any time. The trustees must act on any request from you to repay the loan in part or in full.

The trustees can make repayments either by partially cashing in enough of the underlying investments across all policies or by fully surrendering one or more of the individual policies within the bond. To do this they need to complete the relevant withdrawal form and send it to us.

## *The risks associated with this type of investment*

- Throughout this document we refer to various methods of repayment. We strongly recommend that you seek financial advice before requesting any repayments as there may be an income tax consequence associated with this transaction.
- Investment performance may go down as well as up. If the value of the trust fund goes down there may be inadequate funds to meet your demands for repayment of the loan. The trustees may have to meet any shortfall in relation to the outstanding loan from their personal resources (unlimited liability version only). This also applies where the value is reduced by charges.
- Before requesting any repayments from the bond, you should speak to your financial adviser about the tax implications for you doing so as settlor of the trust. Your trustees should also discuss the different options with their financial adviser before taking any action.

# Benefits of your Loan Trust being invested in our bond

*A Collective Investment Bond gives your trustees efficiency, choice and flexibility.*

## *Tax efficiency for you*

When a Collective Investment Bond is held within a Loan Trust, all growth on the investment will be free from UK IHT from the start.

As settlor, you are liable to pay any income tax on withdrawals from the bond while you are alive and a UK taxpayer. The trustees have the ability to take regular or occasional withdrawals from the bond to make any repayment of the loan you require, whether in full or in part.

Provided partial repayments do not exceed 5% of the original premium each policy year (or the cumulative total of these allowances), you will not be liable to income tax on the amount received at the time the payment is made to you – that liability will be deferred until the bond is fully cashed in.

If your repayments exceed 5% a policy year, the whole of the excess will potentially be subject to UK income tax.

Partial repayment of the loan can be for a specific amount or for an unspecified amount by fully cashing in a certain number of policies which comprise the bond. The tax calculation for these options is different and your trustees should speak to their financial adviser about the most appropriate method of withdrawal for your circumstances.

## *Choice of investments*

The Collective Investment Bond offers access to a wide choice of funds to invest in. The assets available to invest in include around 2,000 unit trusts and open-ended investment companies (OEICs) from over 120 fund management groups.

This allows the trustees to pick funds which appropriately maximise the potential for long-term capital growth for your beneficiaries, while balancing this with the need to repay any outstanding loan to you. The value of the investments can go down as well as up in value depending on market performance.

## *Flexibility*

Your trustees have access to capital whenever they need it by cashing in part or all of the bond. The investment will automatically have been split into 1,000 separate policies. The trustees can then partially or completely cash in policies, without cancelling the entire bond, when receiving occasional requests from you to repay the loan.

Trustees can also change the funds within their bond as often as they require, taking advantage of market movements and maximising capital growth.

We will send the trustees regular valuations to help them monitor the changing value of the bond. The trustees can also monitor the bond's performance through our online service.

## *Flexible advice fee options*

As part of the process of receiving financial advice a fee may be agreed with your financial adviser. Payment of this fee can be facilitated by Quilter when the Collective Investment Bond is set up. We provide two options for facilitating this fee, depending which party has received the advice. Please see the table below.

## *How are financial advice fees paid?*

| Who has received the advice? | Example |
|---|---|
| The **settlor** has received personal advice in relation to choosing to use the Quilter Loan Trust - such as IHT planning.<br>The fee is paid by adding an additional payment on top of the desired loan. | **Settlor's chosen loan amount:** £100,000<br>**Settlor's agreed initial fee:** £1,000<br>Total paid to Quilter: £101,000<br>Amount invested into the CIB: £100,000<br>Amount paid to financial adviser: £1,000<br>**Value of loan repayable to the settlor on demand:** £100,000 |
| The **trustees** have received advice in relation to the investment into the CIB - such as choice of funds.<br>The fee is paid for from the money loaned to them by you (the settlor).<br>With this option, the bond begins with a value which is lower than the loan amount owed to the settlor. | **Settlor's chosen loan amount:** £100,000<br>**Trustee's agreed initial fee:** £1,000<br>Total paid to Quilter: £100,000<br>Amount invested into the CIB: £99,000<br>Amount paid to financial adviser: £1,000<br>**Value of loan repayable to the settlor on demand:** £100,000 |

# How the trust works in practice

*The following fictional example shows how the Loan Trust works.*

*Mr Taylor is aged 50 and has substantial assets including a house worth over £550,000.*

He wishes to reduce his potential UK IHT liability and is prepared to use £150,000 to do so. However, ideally he would like to retain access to the capital, to supplement his income in the future. He would like to make provisions for his grandchildren but would like flexibility over how and when any benefits are distributed.

His financial adviser recommends that he sets up a Loan Trust (discretionary version). This arrangement would allow him to set up a trust without having to name specific beneficiaries. It also allows him to choose his trustees, and lend them a capital sum while still retaining full access to the capital through repayments of the loan.

The trustees are then able to use the loan to invest in a Collective Investment Bond.

Any growth on the loan would be outside Mr Taylor's estate for UK IHT.

Mr Taylor does not need access to the capital immediately, so waits to request a repayment of the loan until 10 years later. He then asks the trustees to repay him £7,500 a year, payable monthly, which is within his 5% tax-deferred yearly allowance.

The trustees do this by setting up a regular monthly withdrawal from the bond payable to Mr Taylor.

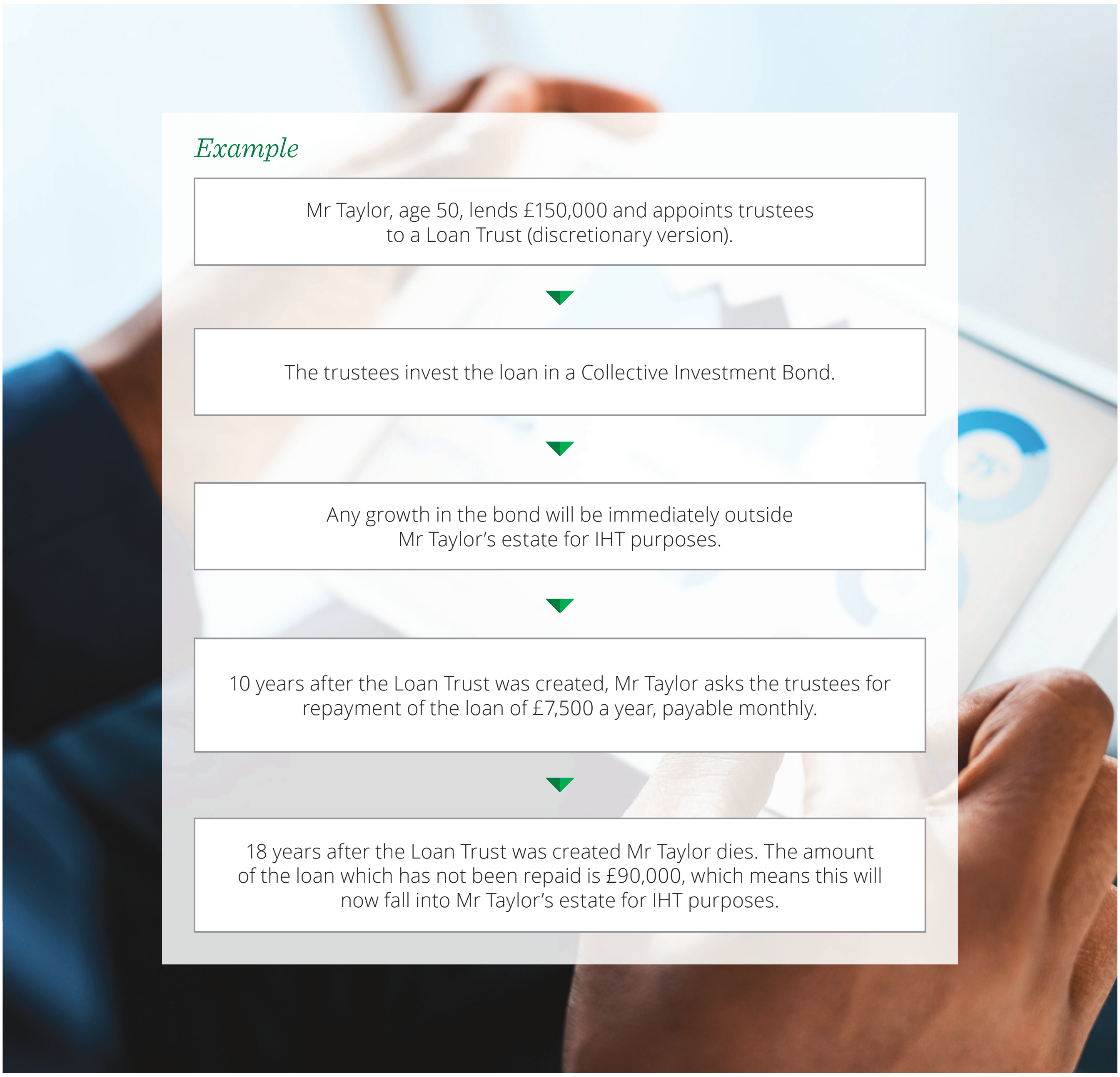
Mr Taylor dies eight years after he asked the trustees to start the regular loan repayments.

The part of the loan which hasn't been repaid falls into Mr Taylor's estate for IHT purposes.

The beneficiaries of Mr Taylor's estate will therefore be liable to IHT on any amount in Mr Taylor's estate in excess of the then NRB and RNRB (where available), including the amount of the outstanding loan. However, any growth on the outstanding loan is not part of Mr Taylor's estate and therefore is not liable to IHT on his death.

**Please note that this case study is entirely fictional and used for illustration purposes only.**

*This arrangement would allow him to set up a trust without having to name specific beneficiaries.*



### *Example*

Mr Taylor, age 50, lends £150,000 and appoints trustees to a Loan Trust (discretionary version).

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The trustees invest the loan in a Collective Investment Bond.

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Any growth in the bond will be immediately outside Mr Taylor's estate for IHT purposes.

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10 years after the Loan Trust was created, Mr Taylor asks the trustees for repayment of the loan of £7,500 a year, payable monthly.

▼

18 years after the Loan Trust was created Mr Taylor dies. The amount of the loan which has not been repaid is £90,000, which means this will now fall into Mr Taylor's estate for IHT purposes.

*Inheritance tax charges*– From a taxation point of view this type of trust is subject to the relevant property regime. This means the trust is potentially subject to three types of charges relating to IHT:

- **Initial charge –** when a gift is made into a discretionary trust. As you'll be making a loan rather than a gift, there will be no initial charge on the loan you make.
- **10-yearly periodic charge –** a charge assessed on the trust fund (after the deduction of any outstanding loan) every 10 years from creation of the trust.
- **Exit charges –** a charge calculated each time the trustees distribute part of the trust fund to the beneficiaries.
  *(Note: Exit charges do not apply to loan repayments.)*

Your financial adviser can explain the taxation of discretionary trusts to you in more detail.

*Chargeable lifetime transfer (CLT)* – A gift into a discretionary trust is regarded as a chargeable lifetime transfer (CLT). This gift may be liable to IHT immediately at the lifetime rate of 20% if the amount (plus any gifts in the previous seven years) exceed the nil-rate band (set at £325,000 until 2026). The value of the gift will remain in the estate for IHT purposes for seven years from the date of the gift.

*Probate* – When someone dies, the executors or administrators of the deceased (collectively known as the legal personal representatives) apply to the Court for authority to deal with the deceased's estate. This authority is called 'probate' for executors and 'letters of administration' for administrators.

# How the trust works in practice (Cont'd)

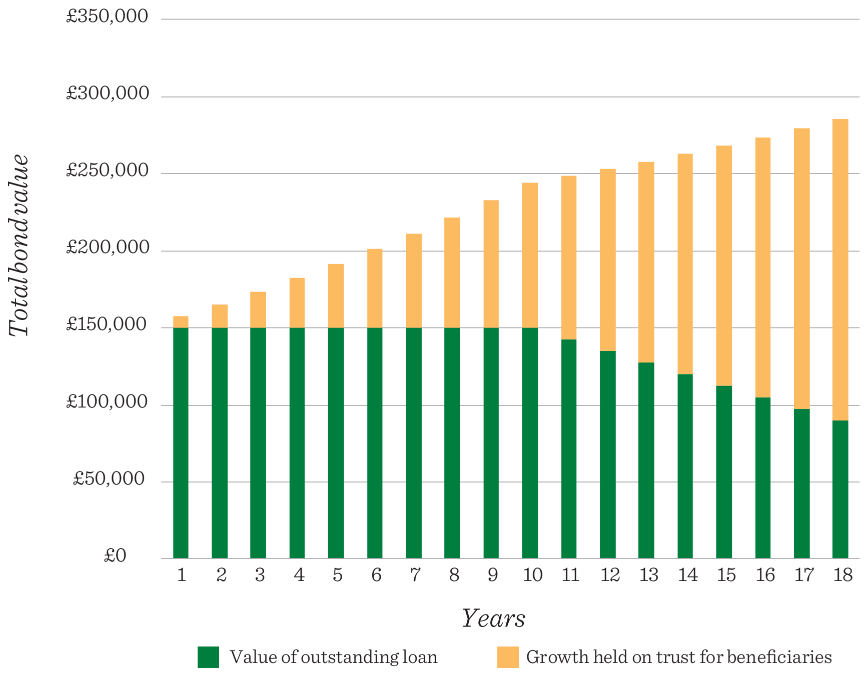
*The legal personal representatives of Mr Taylor's estate have three options available to them once probate is granted or letters of administration have been obtained in respect of the outstanding loan.*

1. The legal personal representatives of Mr Taylor's estate can demand repayment of the outstanding loan in full. The cash can then be distributed to Mr Taylor's heirs in accordance with his Will.

2. They can, with the agreement of the heirs of Mr Taylor's estate, waive the rights to the outstanding loan in favour of the beneficiaries of the Loan Trust. This would be classed as a transfer of value and treated as a CLT for IHT from the heirs of Mr Taylor's estate. This amount would be assessable for IHT immediately and if it exceeds the heirs' available NRBs, it would be liable to IHT at 20%. This amount would also form part of those heirs' estates for the next seven years. A draft deed is available from us.

3. They can assign the right to repayment of the outstanding loan to one or more of the heirs of Mr Taylor's estate. This would be achieved by deed. The legal personal representatives should seek legal advice before proceeding with this option.

We have illustrated the example of Mr Taylor in the graph below. It assumes an investment of £150,000 (the loan) and monthly regular repayments of £7,500 (5% of the loan) a year starting 10 years after the bond commenced. It also assumes investment growth at 5% a year after the deduction of fees and charges. However, you should note that this is not guaranteed as fund values can fall, which could result in the outstanding loan exceeding the fund value.




The value of the loan which has not been repaid at the time of Mr Taylor's death in year 18 will be in his estate for IHT purposes.

**IHT liability on the amount of the loan when Mr Taylor set up the trust:**

*£150,000 x 40% = £60,000.*

**IHT liability on the amount of the outstanding loan at the time of death:**

*£90,000 x 40% = £36,000.*

Assuming the loan repayments taken by Mr Taylor have been spent, this represents an IHT saving of £24,000.

The investment growth in this illustration amounts to £195,793 at the time of Mr Taylor's death. This will all be outside his estate for IHT purposes and will benefit his chosen beneficiaries.

*Risk to be aware of*– If you do not spend your loan repayments, these will continue to be part of your estate for IHT purposes.

You should also bear in mind that the fund value less the value of the outstanding loan will be assessed every 10 years from commencement of the settlement. If this amount exceeds the NRB, IHT may be payable. Your financial adviser can explain the 10-yearly periodic charge in more detail.

# Your questions answered

### *Am I automatically appointed as a trustee?*

As the settlor you are not automatically appointed as a trustee, but you can choose to name yourself as a trustee when completing the trust deed. Or, if you were not named in the trust deed at outset, you can be appointed as a trustee at a later date using a draft deed available from us.

### *Can I be the sole trustee?*

Yes, but this is not recommended for two reasons: firstly because if you are the sole trustee, there will be no one immediately available to administer the trust on your death and secondly because although it is perfectly possible to declare oneself as sole trustee, HMRC may question whether you can make a loan to yourself.

### *Can additional trustees be appointed in the future?*

Yes, additional trustees can be appointed at a later date.

### *Who can benefit from the trust?*

Anyone within the class of beneficiaries or named as beneficiary in the deed.

### *Can the beneficiaries be changed?*

Any person who falls within the class of beneficiary is automatically included. For example; any new grandchild of the settlor born after the creation of the trust automatically fall within the class 'descendant of the settlor'.

The settlor (or two existing beneficiaries where the settlor is deceased) can nominate any person who does not fall within the classes of beneficiary to be an additional beneficiary to the trust.

### *Can my spouse/civil partner benefit from the trust?*

Only if named in the trust deed at the time the trust is created. They cannot be added at a later date.

### *How often can I request that the trustees repay the loan?*

You can demand repayment of the loan at any time, in full or in part, up to the amount of the original loan. See page 6 for more details.

### *Can the trustees set up regular withdrawals to repay the loan?*

Yes, please see page 6 for more details.

### *What happens if the value of the bond is less than the value of the outstanding loan if I demand full repayment of the loan?*

It will depend on the version of the Loan Trust you choose. The *unlimited liability* version would result in the trustees having to fund the shortfall from their personal assets unless you agree to waive repayment of this amount. If you waive the shortfall then this will be regarded as a gift and classed as a CLT in your estate for IHT. If the *limited liability* version is chosen then you would only receive the value of the bond at the point of repayment.

### *Can I still receive money from the trust once the trustees have repaid the loan?*

No, as you are specifically excluded from benefiting from the trust.

### *Can the trustees pay money to the beneficiaries even though the loan has not been repaid?*

Yes, but the trustees are still liable to you, as the settlor, for the outstanding value of the loan.

### *Can the trustees cash in the bond?*

Yes, and they can apply for a new or a different investment vehicle. This does not affect your right to repayment of the outstanding loan but may give rise to an income tax charge/liability.

### *Can the trust continue after my death?*

Yes, the trust continues. The remaining trustees will continue to owe any outstanding loan to your estate and hold any growth for the benefit of the beneficiaries.

### *Do the trustees have to repay the loan on my death?*

No, but the value of the loan is an asset of your estate. The outstanding loan can be repaid to your legal personal representatives (LPR) to be distributed to the beneficiaries of your estate. Alternatively your LPRs can assign the loan to the beneficiaries of your estate who can recall the loan from the trustees as lump sum or regular payments. In either case there may be tax implications and we recommend seeking suitable advice.

### *Can I waive all or part of the loan in the future?*

Yes, you can do this by deed. This would be classed as a transfer of value and be treated as a CLT. Draft deeds are available from us. Please contact your financial adviser.

# Policyholder protection

The Financial Services Compensation Scheme (FSCS) acts as a safety net for customers of financial services providers.

If Quilter Life & Pensions Limited cannot meet its liabilities, the FSCS may arrange to transfer your bond to another insurer, provide a new bond or, if these are not possible, provide compensation.

For the Collective Investment Bond, the level of compensation you can receive from the FSCS is 100% of the claim with no upper limit.

Further information about compensation arrangements is available from the FSCS website ***www.fscs.org.uk***

# Further information

*Details of the Collective Investment Bond can be found in our brochures, Key Features Documents and Policy Terms. These are available from our website; platform.quilter.com*

Investors should be aware that the value of unit-linked contracts cannot be guaranteed as the price of units may fall as well as rise. Please remember that funds which hold investments in non-UK based currencies may rise and fall purely because of fluctuations in the exchange rate.

Certain investment income is subject to a non-reclaimable tax deduction at source in its country of origin.

The information in this document is based on Quilter's interpretation of UK law and HM Revenue & Customs practice as at August 2022. While we believe this interpretation is correct, we cannot guarantee it.

Tax relief and the tax treatment of investment funds may change. The value of any tax relief will depend on the investor's financial circumstances. We cannot accept responsibility for any losses arising from actions taken as a result of the information contained in this document.

All case studies are purely hypothetical.

*Trust registration*

A trust must register with HMRC's Trust Registration Service (TRS) if it is considered UK resident or has a UK tax liability, unless an exemption applies.

- A trust must register within 90 days of the date of the trust deed.
- The trustees must submit evidence of registration (available from the TRS) or confirm exemption from registration to Quilter within 90 days of the trust date.

Further details regarding trustregistration can be found here: ***platform.quilter.com/TrustRegister*** *platform.quilter.com*

*Please be aware that calls and electronic communications may be recorded for monitoring, regulatory and training purposes and records are available for at least five years.*



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