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Introduction

The Friends Provident International Flexible Future Benefit Trust is designed to allow an investor to make gifts to a trust with a view to:

• long-term Inheritance Tax (IHT) planning whilst
• ensuring they can receive capital payments from time to time (which could, if necessary, be used to supplement income) with
• a measure of control over who will ultimately receive the benefits of the investment in the event of their death.

One of the main constraints to a person making a lifetime gift is the IHT gift with reservation of benefit rules. These can apply when an individual makes a lifetime gift, but continues to enjoy a benefit from the gift. In the context of a gift of an investment into trust, this would normally mean that the settlor could enjoy income from the investment or access to the trust capital from time to time.

In such circumstances, the value of the gift will normally continue to form part of the settlor’s taxable estate for as long as they enjoy the benefit. This means no IHT saving will be achieved as the value of the gift will remain in the settlor’s taxable estate and potentially be subject to IHT on death.

Even in cases where, for one reason or another, the gift with reservation rules do not apply, the income tax Pre-Owned Asset Tax (POAT) rules may apply. These rules can apply an income tax charge on any deemed benefit enjoyed by the donor (settlor).

Tax Counsel has confirmed that neither the IHT gift with reservation rules nor the income tax POAT provisions apply to the Flexible Future Benefit Trust, even though the settlor can enjoy capital payments from it in later years. Therefore the trust is fully effective for IHT purposes. The reasons for this are set out in more detail in this guide.
Gift With Reservation (GWR) rules

In order to ensure that an effective gift can be made which is not within the scope of the GWR provisions it is normally the case that the settlor must not retain any benefit under the trust. However, it is possible to allow the settlor access to some of the funds in the trust at future dates without adverse IHT implications provided those rights are pre-determined at outset and entitlement cannot be brought forward. Another term for this is that the settlor’s rights are ‘carved out’ from outset and are therefore not gifted. In such circumstances the GWR provisions will not apply.

Under the Flexible Future Benefit Trust, the settlor specifies in the Trust Deed, the dates on which they wish to become entitled to certain policies. These policies are grouped into policy funds. Any gift that is made to the trust is subject to the settlor’s pre-existing rights to the policy funds. They will only become entitled to the policy funds in question, if they survive to the appropriate entitlement date(s).

Once determined when the trust is created, the level and frequency of the settlor’s entitlement under the trust cannot be brought forward, as to do so would cause the GWR provisions to apply. Entitlement date(s) can be deferred without adversely affecting the GWR provisions (see Inheritance Tax on page 5).

Although the settlor is the appointor under the trust during their lifetime, the retention of this power of appointment by the settlor does not constitute a gift with reservation of benefit for IHT purposes, as the settlor cannot exercise the power for their own benefit.

Pre-Owned Assets Tax (POAT) rules

The POAT rules can apply an income tax charge when a person continues to benefit from property which they owned in the past but have given away and where the GWR rules do not apply. For the POAT rules to apply in relation to a trust, two conditions must be satisfied – there must be a settlement and the settlor must be able to benefit under the settlement.

In the case of the Flexible Future Benefit Trust, because there are two distinct interests under the trust, these need to be tested separately to see if the POAT rules apply. In this respect, because the settlor’s rights at the entitlement date under the trust are specifically ‘carved out’, and they are retained for the settlor’s absolute benefit, they do not form part of the settlement, and so they are not subject to the POAT rules. With regards to the discretionary trust part of the trust, the POAT rules will not apply as the settlor is not a beneficiary.

The tax anti-avoidance rules (continued)
The tax implications of the Flexible Future Benefit Trust

**Inheritance Tax (IHT)**

The IHT treatment of the trust at the following events is considered below:

- establishment of the trust
- death of the settlor
- deferral of entitlement
- ten-year anniversary and exit charges.

**Establishment of the trust**

**Lump sum gifts**

- When the trust is established, the settlor will be treated as having made a gift for IHT purposes. This will be a Chargeable Lifetime Transfer (CLT).
- For IHT purposes the gift, less any available annual exemption(s), will be a CLT. If this amount plus the amount of any other chargeable transfers made by the settlor in the previous seven years does not exceed the Nil Rate Band (NRB) for IHT (£325,000 in tax year 2014/15), there will be no IHT liability when the gift is made. If the settlor survives for seven years, no IHT liability will arise at all in respect of the gift. In the event that the settlor’s NRB is exceeded, the trustees are subject to a lifetime tax liability at 20% on the excess.
- Any CLTs to the Flexible Future Benefit Trust that cause an individual to exceed their NRB must be reported to HM Revenue & Customs (HMRC). In respect of the transfer of a life policy or Capital Redemption bond, the transfer is reportable using HMRC forms IHT100, IHT100a and D34. These forms are available on the HMRC website [http://search2.hmrc.gov.uk/kb5/hmrc/forms/ihtforms.page](http://search2.hmrc.gov.uk/kb5/hmrc/forms/ihtforms.page)

**Regular gifts from income**

If the settlor makes regular premium payments to the bond from income and the resulting transfers of value fall within the settlor’s normal expenditure out of income, no transfer of value will arise. For detailed information on how gifts could potentially meet this exemption please refer to our Flexible Future Benefit Trust – ‘Normal expenditure out of income’ exemption guide, on our website at [www.fpinternational.com](http://www.fpinternational.com).

**Death of the settlor**

- On the death of the settlor, provided they have survived the gift by seven years, the value of the remaining policy funds to which they have not become entitled will be outside of the settlor’s estate for IHT purposes.
- If the settlor does not survive their gift by seven years, and the transfer is not covered by the normal expenditure and/or the annual exemptions, then the potential IHT liability on the original CLT will have to be recalculated at full death rates.
- However, no IHT will arise if the gift, together with any relevant previous chargeable transfers, was within the settlor’s available NRB.
- If the NRB was exceeded, so that lifetime tax at 20% was paid by the trustees on the initial CLT, the charge will increase to 40%. IHT taper relief may be available in which case the IHT liability will start to reduce once the settlor survives their gift by three years.

**Deferral of entitlement**

If the settlor decides to defer their entitlement date in respect of certain policy funds before they survive to those dates, this will not give rise to a CLT.

**Ten-year anniversary and exit charges**

The Flexible Future Benefit Trust is a discretionary trust. This means that specific IHT charging rules apply. Under these rules there may be IHT charges:

- on every ten-year anniversary of the trust – ‘the periodic charge’; or
- whenever property leaves the trust (e.g. when capital is advanced to a beneficiary or an absolute appointment of benefit is made) – the ‘exit charge’.

The key points in relation to these two charges are set out on the next page.
The periodic charge

The rate of IHT charged will be determined based on an assumed transfer by an assumed transferor (settlor). This will mean that it will broadly be necessary to take account of:

- the value of the property in the trust on the ten-year anniversary, certain additions made to the trust and the value, when they were set up, of any other trusts created on the same day. This is the ‘assumed transfer’ that is then being made. For these purposes the value of the property at the ten-year anniversary in the Flexible Future Benefit Trust will be the value of the bond at that time; and
- the settlor’s cumulative total of chargeable transfers (including any failed potentially exempt transfers) made in the seven years immediately preceding the creation of the trust (assuming there has been no added property) and any sums paid out of the trust in the ten years prior to the anniversary at the ten-year anniversary.

In cases where the settlor makes regular payments to the bond in trust, this will be ‘added property’. This means that the cumulative total of chargeable transfers will be the greater of:

- the amount in the seven years before the trust commenced; and
- the amount in the seven years before the last payment to the trust.

Of course, if those payments fall within the settlor’s ‘normal expenditure out of income’ exemption, no chargeable transfer will arise. However, they will still count as added property. This means if the cumulative total of chargeable transfers in the seven years before the payment of the additional premium is greater, that figure will be used.

As a result of the calculation of the tax on the assumed transfer, an effective rate will be established. The maximum effective rate will be 20%. 30% of this rate is taken and that is the rate that will be applied to the actual value of the trust property at the ten-year anniversary.

The maximum liability will therefore be 6% (30% of 20%) of the value of the trust property but frequently it will be much less or nil.

In cases where the settlor has:

- not made any chargeable transfers in the seven years before they create the trust, and no potentially exempt transfers have failed; and
- no payments have been made out of the trust in the last ten years; and
- there has been no added property,

there will be no tax liability provided the value of the trust property at the time of the periodic charge does not exceed the NRB applicable at the ten-year anniversary. Any excess over the then NRB will suffer IHT at an effective rate of 6%.

Example

Mike aged 48, creates a Flexible Future Benefit Trust on 10 November 2013 for £200,000.

Under the trust, Mike has set out that this entitlement to policy funds does not begin until 2030 – when he is 65.

Let’s assume that the value of the trust fund on 10 November 2023 is £300,000. It is then necessary to calculate any IHT periodic charge. Mike has made no chargeable transfers in the seven years before establishing the Flexible Future Benefit Trust and he has not paid any additional premiums. Furthermore, no payments have been made out of the trust in the first ten years. Assuming the NRB is £375,000 at the ten-year anniversary no IHT charge will arise.

Let’s now assume that the value of the relevant property in the settlement would have been £425,000 on the ten-year anniversary of the trust. Because Mike did not have a cumulation total for the seven years before he made the trust or made the last payment to the trust (i.e. premium to the bond), no addition would be made for this. IHT of £3,000 would therefore have arisen (6% of £50,000). This equates to a charge at 0.7% on the whole value of the relevant property.

When the settlor survives to an entitlement date under a policy fund and becomes absolutely entitled to the policies that comprise that policy fund, those policies will not be taken into account in determining the ten-year anniversary charge on the rest of the bond and other policy funds.
On the death of the settlor, the trustees will need to decide whether to cash in the bond and having made an absolute appointment, distribute the trust fund to the beneficiaries or to keep the bond in force inside the trust. If the bond is kept in force inside the trust, the periodic charge will continue to be relevant. If the bond is cashed in and the proceeds distributed, it will be necessary to consider the exit charge.

The exit charge

Exit charges will be based on the value of property leaving the trust or being appointed absolutely to a beneficiary. Typically this will happen after the settlor’s death.

Under similar plans, HMRC take the view that no exit charge will arise on payments made to the settlor because this property is already treated as being held absolutely on bare trust for them. It has been confirmed by Tax Counsel that a similar rationale will apply to the Flexible Future Benefit Trust.

First ten years

Exit charges within the first ten years will be nil if the value of the initial CLT when added to the settlor’s appropriate seven year cumulative total, is below the available NRB at the time the property is paid out of the trust. This means that if this total does not exceed the available NRB when the trust was created or future premiums are paid, there will potentially be no exit charge. If an exit charge does arise, it will be apportioned according to the number of quarters (three-month periods) that have expired since the trust was created.

After ten years

The amount of any exit charge occurring after the first ten years will depend on the rate of IHT charged at the last ten-year anniversary (if any) and the length of time (in quarter years) that the property has been in the trust since the last periodic charge. If there was no charge at the previous ten-year anniversary, there will be no exit charge.

Example

In November 2029, three years after Mike’s death and six years since the first ten-year anniversary (when a 0.7% IHT rate was charged), the trustees of Mike’s trust make a part cash-in of the bond and pay £50,000 to a beneficiary. The IHT charge will be £50,000 x 0.7% x 24/40 = £210.

The occasion of a periodic charge and transactions that can give rise to an exit charge, such as capital payments to the beneficiaries, also have to be reported to HMRC even if no actual tax liability arises. These reporting requirements only apply if the cumulative total of the assumed transfer exceeds 80% of the then NRB. HMRC forms IHT 100c and d (and form D34 where a life policy or Capital Redemption bond are involved) are used for reporting purposes.
**Income tax**

It is assumed that the settlor, beneficiaries and the trustees are UK resident and domiciled. If this is not the case, special rules apply and in such circumstances professional advice should be taken.

**Settlor entitlement**

The occasion of the settlor becoming entitled to policies within a policy fund at an entitlement date will not give rise to a chargeable event for income tax purposes. The settlor will then have the choice to either cash in the policies, keep them in force or assign them to another individual.

**Chargeable event gains on cashing in the bond**

The person on whom chargeable event gains will be assessed depends on when the chargeable event arises. The position is as follows:

- **During the settlor’s lifetime or in the tax year in which the settlor’s death occurs**
  For income tax purposes, any chargeable event gains arising under the bond will be assessed on the settlor.

- **After the end of the tax year in which the settlor’s death occurs**
  Following the settlor’s death, the policies in the remaining policy funds will be held on the discretionary trusts. If the trustees then decide to cash in the policies, and the trustees are UK resident, any chargeable event gains arising in a tax year after that in which the settlor died will be assessed on those trustees at the 45% rate applicable to trusts. To the extent that chargeable event gains fall within the £1,000 standard rate tax band, there will be a 20% income tax charge.

  If the trustees are non-UK resident, chargeable event gains will count as trust income for later attribution to payments made to UK resident beneficiaries.

- **Transfer of policies to a beneficiary before cashing in**
  It may be that after the settlor’s death the trustees will consider cashing in the bond and releasing the proceeds to a beneficiary.

  However, as an alternative to cashing in the bond prior to making a payment to a beneficiary after the settlor’s death, the trustees could make an absolute appointment of benefits in favour of an adult beneficiary. They could then assign the bond to the beneficiary. That assignment would not give rise to a chargeable event. Any chargeable event gain arising on any subsequent cashing in by the beneficiary would then be assessed to tax on that beneficiary which may yield a lower tax liability than if the trustees cashed in the policies. The beneficiaries may be entitled to claim top slicing relief.

**Income tax generally on payments to beneficiaries**

As long as payments to beneficiaries are made and documented as an advancement of capital and do not acquire the character of income, there should be no income tax implications. The exception to this would be where the trustees made a withdrawal which exceeded the bond’s 5% annual tax deferred allowance. This would result in a chargeable excess.

It should be noted that a change of trustee and the death of a trustee have no tax implications.

**Capital gains tax**

No capital gains tax should arise in relation to a bond held subject to the Flexible Future Benefit Trust.

If assets are share exchanged into the bond prior to it being assigned into the trust, then this may give rise to a capital gains tax charge.
Frequently asked questions

1. Who is the settlor?
The policyholder who assigns the policy into trust.

2. How is the trust set up?
The settlor applies for our single premium bond, and assigns it into trust. Within the trust, the settlor completes a schedule allocating segments to a series of policy funds with chosen entitlement dates.

3. Can spouses set up the trust jointly?
No. The trust can only have one settlor.

4. Can spouses set up their own trust?
It is possible as long as the beneficiary of each trust is not the other spouse.

5. Can spouses set up a trust for the benefit of each other?
This is not recommended as HMRC could regard it as an ‘Associated Operation’ and treat both arrangements as one. This could be treated as a gift with reservation and subject to IHT.

6. Can the settlor’s spouse be a potential beneficiary?
Under current IHT rules, the inclusion of the settlor’s spouse as one of the potential beneficiaries does not constitute a gift with reservation of benefit for IHT purposes. This means that the trustees can make an appointment of benefits to the spouse and pay benefits to him/her.

However, extreme care must be exercised if any benefits are actually paid to the settlor’s spouse during the lifetime of the settlor. If benefits are appointed to the spouse during the settlor’s lifetime, it is absolutely essential that no part of the funds be used for the direct or indirect benefit of the settlor, as this could be treated as a gift with reservation.

7. Who should be the beneficiaries?
The trust contains a wide class of potential beneficiaries from which the trustees can choose.

8. Can beneficiaries be changed?
The trust is a discretionary trust, which means the trustees have full discretion over who they appoint as beneficiaries.

9. Whom should the settlor appoint as trustees?
The settlor must name the trustees when they execute the trust deed. The appointed persons must be aged 18 or over and of sound mind, and must have the confidence of the settlor. It is essential that at least two trustees are appointed, with a maximum of four. This should include at least one person who is neither the settlor nor the settlor’s spouse.

10. Can new trustees be appointed?
The settlor has the power to appoint and dismiss trustees, provided at least two remain. Any additional trustee(s) (up to a maximum of four) will assume joint responsibility.

11. Should an additional trustee/s be appointed?
The settlor is automatically a trustee (unless the appropriate deletion is made within the trust deed) and it is important that additional trustees are appointed at outset.

In order to avoid the need for a grant of representation when the settlor dies, the legal ownership of the bond must be with a person or persons other than the settlor on his or her death. This is achieved by ensuring that there is always at least one trustee in addition to the settlor.

However, this benefit will only be secured if there is at least one trustee who survives the settlor because otherwise probate will be necessary to determine the trustees. If any of the additional trustees retires or dies before the settlor, a replacement trustee or trustees should be appointed.

It is important for the settlor to choose the trustees wisely to avoid future disagreements disrupting the administration of the trust. In extreme circumstances where the trustees disagree, the settlor has the power under the Flexible Future Benefit Trust to dismiss a trustee, provided at least, two trustees remain, one of whom is someone other than the settlor or his/her spouse.

The primary duty of the trustees during the settlor’s lifetime is to hold the policies within the policy funds for their benefit should they survive to an entitlement date.

As legal owners of the bond, the trustees can take withdrawals from the bond. However, given the settlor’s future reversionary interest, this would not be recommended unless cash was needed to, for example, meet a tax liability of the trust or pay for professional fees incurred by the trustees.
12 Can beneficiaries be appointed as trustees?
Yes, so long as they are aged 18 or over and of sound mind. However, care should be exercised in advance, as the beneficiary would then have a say in how the trust is administered.

13 What is the role of the trustees?
The trustees are responsible for administering the trust fund in accordance with the terms of the trust deed.

14 Who should be lives assured under the bond?
In order to establish the Flexible Future Benefit Trust, the settlor needs to first effect a Friends Provident International Capital Redemption bond or whole of life single premium bond. If the whole of life version is chosen, lives assured will need to be selected.

If a whole of life version is required, we recommend that the bond is issued on a number of lives on a joint lives last survivor basis to ensure greater control over timing of final cashing in of the bond. As the bond would automatically cash in when the last life assured dies, ideally the lives assured should be young. The lives assured could include two or more of the potential beneficiaries under the trust. To ensure that there is no possibility of paragraph 7 Schedule 20 Finance Act 1986 applying (which could cause a gift with reservation), the settlor and the settlor’s spouse should NOT be lives assured under the bond.

15 What is the maximum number of lives assured permitted under the policy?
We will permit up to ten lives assured on a last survivor basis which will normally enable some of the potential beneficiaries to be included.

16 Can further premiums be paid to the bond held in the Flexible Future Benefit Trust?
The settlor can pay further premiums into the bond from time to time. Such premiums will increase the value of all of the policies held in different policy funds. If the conditions for claiming the normal expenditure out of income exemption are met, additional premiums will be exempt transfers. To the extent that conditions are not met, additional premiums will be chargeable lifetime transfers.

17 Can the trust be wound up?
The trust is irrevocable and so cannot simply be wound up by the settlor with him recovering all the trust assets.

18 What if the settlor wishes to cancel the bond under their cancellation rights?
We will cancel the policy and pay the proceeds back to the settlor. The trust will be treated as void as it has no assets.

19 Can an existing policy be assigned to the Flexible Future Benefit Trust?
No. The Flexible Future Benefit Trust is available for new investments only.

20 Can the trustees cash in the bond and reinvest the proceeds in other investments?
If the settlor consents to the cashing in of the policies in a policy fund, the trustees can reinvest the proceeds in any investment that is authorised by the trust. As the settlor will usually be a trustee, they will be a party to this decision whilst alive. If the settlor survives to the entitlement date(s) they will then be entitled to the investments within that policy fund, unless the trustees appoint the benefits to the beneficiaries.

21 Can the trustees appoint the benefits to the beneficiaries before the settlor dies?
Yes, the trustees have the power to defeat the settlor’s reversionary interest in the policy funds and make distributions to the beneficiaries during the settlor’s lifetime.

22 How does a Capital Redemption bond differ from a whole of life assurance bond?
A Capital Redemption bond does not have lives assured and has a term of 99 years with a guaranteed maturity value. For UK tax purposes, a Capital Redemption bond in trust is treated in the same way as a whole of life assurance bond.

23 What are the settlor’s options regarding payments on entitlement dates?
Under the trust the settlor is entitled to a series of reversionary interests in different policy funds. Each policy fund comprises a number of selected policies. This means that when the settlor survives to the stated entitlement date(s), they have the following options:

- To cash in the policies for their own benefit.
- To keep the policies which they have become absolutely entitled to in force.
- To assign the policies to another individual.
- To defer their entitlement to the policy fund.

Friends Provident International Flexible Future Benefit Trust
24 Can the settlor defer entitlement date(s)?
Yes. The settlor can defer the entitlement date of a policy fund by informing the trustees prior to the entitlement date. Such a deferral will not give rise to a chargeable lifetime transfer for IHT purposes at that time.

25 What if, after setting up the bond, the settlor decides that they do not need to receive the benefits on an approaching entitlement date?
It is possible that the settlor may, at a later date, decide that they do not need the policy funds at a future entitlement date(s). In such circumstances, the settlor can.
- Defer entitlement.
- Gift the policies after the entitlement date.

26 Can the settlor take withdrawals from the policies that have reverted to them?
No.

27 What happens on the settlor’s death?
On the death of the settlor more than seven years after the trust was established, there will be no IHT consequences and the settlor’s entitlement under the trust will terminate. On death, no value is included in the settlor’s estate in respect of policy funds that have not yet reached the entitlement date.

On the settlor’s death, the benefits of the bond will continue to be held on discretionary trust for the benefit of the potential beneficiaries. If the trustees wish to make a payment to potential beneficiary(ies) they can make an absolute appointment to them and either cash in policies and pay cash to them or (if they are at least 18) assign policies to the beneficiary(ies). Alternatively the bond can be kept in force subject to the trust for later payment to the beneficiary(ies).

If the bond is cashed in on the death of the settlor, this will give rise to a chargeable event for income tax purposes. For the taxation consequences of this, see Chargeable event gains on cashing in of the bond on page 8.

Get in touch
To find out more about how the Flexible Future Benefit Trust could benefit your clients, please call us on +44 1624 821153, or email us at: alt@fpiom.com.
About Friends Provident International

We are a leading financial services provider, with a reputation for trust, commitment and integrity, offering financial solutions to customers throughout their lives.

Friends Provident International has over 35 years of international experience in offshore savings and investments.

Important notes

The information given in this document is based on Friends Provident International Limited’s understanding of UK and Isle of Man tax law and HM Revenue & Customs practice as at June 2015, which may change in the future. Individuals are advised to seek professional independent advice and no liability can be accepted for the personal tax consequences of this Trust or for the effect of future tax and legislative changes.

We do not condone tax evasion and our products and services may not be used for evading your tax liabilities.

Any references to ‘we’, ‘us’ and ‘our’, refer to Friends Provident International. Friends Provident International is a business name for Friends Provident International Limited.