The Loan Trust

Case study

Pete

- 52 years of age
- Married with two adult children
- Senior investment analyst with a leading fund management group
- Keen investor, looking to place a fairly large bonus into an offshore bond

As a local Independent Financial Adviser (IFA), I advised Pete and his wife to start thinking seriously about the effects of Inheritance Tax (IHT). Their jointly-owned property and current assets are already in excess of their Nil Rate Bands (NRBs). The NRB is the amount of a person's estate on which there is no charge to IHT. So the likelihood is that the IHT liability will escalate over time.

Reducing the value of his estate was considered, but at this stage Pete is not prepared to gift assets away to reduce the liability. He still wants access to the capital. However, he does agree that gifting capital could be a future planning option.

As an alternative, I suggested we look at the cost of insuring the present IHT liability, and consider ways of reducing the effects of IHT going forward. We discussed the merits of setting up a Discretionary Loan Trust.

The loan made to the trustees will be interest free and repayable as and when the lender decides. Whilst the outstanding loan stays within the estate for IHT purposes, any growth in the investment over and above the initial loan is for the benefit of the beneficiaries, and is therefore immediately outside of the lender's estate. In addition, if the lender takes the loan repayments to spend, this might have the effect of reducing the value of the estate as well.

Setting up a Discretionary Loan Trust is not a gift for IHT purposes, which means it would not be a Chargeable Lifetime Transfer (CLT). However, as I explained to Pete there may be a periodic charge every 10th anniversary if the value of the trust fund (less any part of the outstanding loan) is over the then NRB (see example). I explained that the size of the loan and the investment returns are important in determining the periodic charge, if any.

Periodic Charge			
Investment	**Year 10**	**Year 20**	**Year 30**
200,000	0%	0.64%	3.28%
500,000	0.98%	3.86%	4.91%

Assumes 5% p.a. withdrawals are taken years 1-20.

Pete sets up a Discretionary Loan Trust, appointing himself, his wife and the two children as trustees. He also appoints the children as default beneficiaries. The trustees use the loan to invest in an offshore bond with Friends Provident International. Pete instructs the trustees to repay the loan using the investment bond's annual 5% tax-deferred allowance. Pete can if he wishes stop the loan repayments at any time.

He may also decide in the future to forgo some or all of the outstanding loan, and gift the capital to the trust for his beneficiaries. The gift, which should be kept within his NRB, will be a CLT and outside of Pete's estate after seven years.

Get in touch

To find out more about how a Loan 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.

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All policyholders will receive the protection of the Life Assurance (Compensation of Policyholders) Regulations 1991 of the Isle of Man, wherever their place of residence.

Investors should be aware that specific investor protection and compensation schemes that may exist in relation to collective investments and deposit accounts are unlikely to apply in the event of failure of such an investment held within insurance contracts.

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

Complaints we cannot settle can be referred to the Financial Services Ombudsman Scheme for the Isle of Man.

Some telephone communications with the Company are recorded and may be randomly monitored.

Legal Interpretation

Each policy is governed by and shall be construed in accordance with the laws of the Isle of Man.

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