

TECHNICAL SALES BRIEFING



CALCULATING AND REPORTING PERIODIC CHARGES

The following information is based on our interpretation of current law and taxation practice in the Isle of Man and the UK as at February 2025.

- › Many years have now passed since the changes to the relevant property regime in 2006 and trustees will need to be aware of their responsibility in assessing whether a charge to inheritance tax (IHT) is due in respect of policies written subject to discretionary trusts issued post 21 March 2006.
- › This Technical Sales Briefing has been designed to explain the ten yearly periodic charge which could be applicable to such policies. It also clarifies the reporting requirements for trustees and what information they will require and looks at what Utmost International Isle of Man Limited does to support settlors, trustees and advisers in this process.

INTRODUCTION

Prior to 21 March 2006, most of the trusts associated with Utmost International Isle of Man Limited's products were Interest in Possession (IIP) trusts.

At that time, most IIP trusts were flexible power of appointment trusts and, like a discretionary trust, allowed the trustees flexibility regarding the beneficiaries as regards both income and/or capital under the trust. However, unlike a discretionary trust, the IIP trust provided that the value of the trust property was deemed to form part of the estate of the person(s) who held the IIP until the point that interest was appointed away from them, at which time a transfer of value for IHT purposes was made. The creation of this type of trust was also treated as a potentially exempt transfer by the settlor for IHT purposes.

However, the Finance Act 2006 introduced legislation that meant that new IIP trusts issued post 21 March 2006 would be subject to the relevant property regime which had previously only applied to true discretionary trusts.

THE RELEVANT PROPERTY REGIME

The relevant property regime seeks to apply IHT charges to the trust instead of any individual, in the form of potential entry, exit and ten year periodic charges. This is to accommodate the fact that no particular person holds an interest; as the trustees have discretion as to who can receive capital and/or income. Whilst this may appear more complex to some practitioners, it does add simplicity for tax collectors if the trust, rather than individuals, is taxed at certain points. For example, this taxation regime removes the necessity to track changes in beneficial rights for IHT purposes - which was required under the old IIP regime.

With a few limited exceptions, any IIP trust set up post 21 March 2006¹ will be taxed as a discretionary trust and

deemed to be within the relevant property regime and thus will be subject to potential entry, exit and ten year periodic charges under the provisions set out in the 1984 Inheritance Tax Act.

The first periodic charges will potentially become reportable and payable (if applicable) on any discretionary trust established post 21 March 2006. This will include all Utmost International Isle of Man Limited's Estate Planning Bonds (discretionary trust version) and other discretionary gift trusts that have been used in conjunction with our life and capital redemption policies.

It is the ten year periodic charges that this briefing focuses on.

WHEN DOES A TRUST BECOME REPORTABLE?

Under the terms of The Inheritance Tax (Delivery of Accounts)(Excepted Settlements) Regulations 2008, if the value of the trust fund is over 80% of the Nil Rate Band (NRB) (which equates to £260,000 when the NRB is £325,000) then the trust must be reported to HMRC².

This £260,000 threshold is designed to allow HM Revenue & Customs (HMRC) to receive information on trusts where the value of the trust at the time of the ten year anniversary

falls just below the taxable threshold. This in turn enables HMRC to potentially query potential valuation issues with the trustees, which would otherwise be unknown if the reporting threshold was set at the full NRB (£325,000 until tax year 2029/30).

It is important to understand therefore that some trusts may therefore be reportable but no tax will actually be due on that trust as the value of the trust is below the NRB.

UNDER WHAT CONDITIONS WILL A PERIODIC CHARGE ACTUALLY BECOME PAYABLE?

A periodic charge will actually be due if the value of the trust fund exceeds the NRB at the 10 year anniversary date. The excess over the NRB at that time is then taxed at 6%. What follows now is an outline of how this would work in respect of different situations.

¹ Note - the Finance Act 2006 also potentially brought pre 22 March 2006 IIP trusts into the relevant property regime if certain changes were made to these trusts, including changes to the IIP beneficiary. This briefing does not, therefore, deal with this area.

² **Inheritance Tax (Delivery of Accounts)(Excepted Settlements) Regulations 2008 and overseas settlors and trustees**
The Inheritance Tax (Delivery of Accounts)(Excepted Settlement) Regulations 2008 and the 80% reporting threshold only applies where the settlor is domiciled (or long-term resident from 6 April 2025) throughout the life of the settlement and the trustees are UK resident. Where a settlor has taken out a trust and moves to the UK, or has used overseas trustees, the trust is reportable regardless of the actual value. Trust reporting is something that HMRC are looking to review and this has been mentioned in budget commentary, however, at the time this document was updated no further details have emerged.

SIMPLE GIFT TRUSTS

For gift trusts, any client or their adviser will simply need to understand what the value of the bond is at the date of the 10 year anniversary. They will also need to take into account any chargeable lifetime transfers made by the settlor in the period of seven years prior to setting up the gift trust, and any withdrawals that have been taken from the policy and distributed to beneficiaries during the ten year period. Broadly, if the value of the policy plus any withdrawals is above the Nil Rate Band at the time of the anniversary tax will be payable. The tax should be paid by the trustees as they will be able to access withdrawals from the policy.

LOAN TRUSTS

The situation for loan trusts is the same as that for gift trusts except that, in order to calculate the value of the trust property, the trustees need to deduct the value of the outstanding loan at the ten yearly anniversary from the value of the policy. Withdrawals taken from the policy to pay back part of the loan can be ignored. Again, the tax should be paid by the trustees as they will be able to access withdrawals from the policy.

ESTATE PLANNING BOND

If the original settlor is dead at the date of the ten year anniversary then the situation is the same as for gift trusts. Any withdrawals taken from the policy and paid to the settlor during the settlor's lifetime can be ignored but any withdrawals taken by the trustees and distributed to beneficiaries since the settlor's death need to be taken into account in addition to the actual policy value.

If the settlor is still alive at the ten year anniversary then the position is slightly more complicated. Once again, it is necessary to determine the value of the bond at the anniversary date. Any withdrawals taken from the policy can be ignored. However, the value of the trust fund is able to be reduced by taking an Open Market Value of the trust fund and the settlor's right to future withdrawals for the rest of their lifetime. In other words, a revised discount will apply at that time. HMRC have confirmed that a simplistic valuation approach is permissible in these circumstances, meaning that the discount will be based on the addition of 10 years to the settlor's age or rated age at the outset of the policy.

For many clients that hold an Estate Planning Bond, a periodic charge at the ten year anniversary is highly unlikely to be payable for several reasons.

1. Any discretionary discounted gift trust settled since 21 March 2006 is likely to have had a gift value that was equal to, or less than, the NRB at the date of commencement in order to avoid an immediate charge to tax. The NRB has slightly increased since 2006 from £285,000 to £325,000, giving each trust issued prior to 6 April 2009 an extra £40,000 of growth before any periodic tax charge is applied.
2. As stated above, the settlor's rights to future withdrawals need to be valued at the point of the periodic charge, thus reducing the value of the trust for the purposes of reporting and paying tax. There are two parts to this reduction:
 - a) Firstly, any buyer of the beneficiary's rights would need to take into account the fact that he or she would not be able to access the funds until the death of the settlor. Actuarial principles, based on tables provided by HMRC, are used to calculate this future value. This figure is then taken from the full value of the trust fund.
 - b) The second part of the reduction comes from the discount, calculated in much the same way as the original discount was at the outset of the policy. A discount will still apply in this situation even if the addition of 10 years to his or her age next birthday means that the settlor is over 90 at the ten year anniversary. This difference in approach to 'Over 90' ratings is mainly due to the fact the valuation is based on the open market value of the remaining trust fund. The discount here is given against the value arrived at following step (a).
3. Under the Estate Planning Bond, the settlor will usually have taken withdrawals utilising the full 5% annual tax deferred entitlement to maximise the value of their discount. These withdrawals, together with charges on the underlying policy, will have an impact on the net growth meaning it is less likely for the growth under the policy to have exceeded the £325,000 (NRB).



AN EXAMPLE MAY HELP TO DEMONSTRATE THESE POINTS:

- › Sandra invested £450,000 into an Estate Planning Bond on 1 July 2006.
- › She is taking monthly 5% tax deferred withdrawals, which equate to £1,875 per month.
- › At the time of investment, Sandra was aged 80 next birthday. For underwriting purposes, 2 years were added to her age, giving her, for the purposes of calculating the discount, a 'rated age' of 82 next birthday.
- › This resulted in a discount in 2006 of £175,000 and a corresponding gift of £275,000. As the NRB at the date of the commencement of the policy was £285,000 there was no entry charge.

Position at the ten year anniversary on 1 July 2016:

The value of the policy is now £544,610.

Sandra is still alive on 1 July 2016 and her effective age, for the purposes of calculating the value of the relevant property is obtained by adding 10 years to her "rated age" making Sandra 92 next birthday.

Using the Actuarial Assurance Factor, the Open Market Value (OMV) of the policy is £436,534.

The discount applicable to the OMV, for a 92 year old is £101,683 (Note this discount will be calculated using the methodology and actuarial tables currently in force).

Therefore the value of the relevant property is: £436,534 - £101,683 = **£334,851**

Value over the NRB on 1 July 2016 = **£9,851**

Tax to pay @ 6% = **£591**

Effective rate of IHT is: £9,851 @ 20% = £1,970

£1,970 / £334,851 = 0.588381%

0.588381% @ 30% = **0.176514%**

This effective rate of **0.176514%** will be the rate used if any further distributions are made in the next 10 years (although further withdrawals paid to the settlor will not be relevant for these purposes). Here the calculation would utilise the number of complete quarters since the periodic charge was due to give a proportional tax charge.

HOW CAN YOU CALCULATE IF THE TRUSTEES WILL NEED TO REPORT/PAY TAX?

The following table provides an overview of the actions that should be taken by trustees to check the reporting and the taxable position of the trust. These actions are mainly based on the value of the trust fund at the time of the periodic charge:

VALUE OF THE TRUST FUND AT THE TEN YEAR ANNIVERSARY*	ACTION TO TAKE
£0 - £260,000 (80% NRB)	› No requirement to report if a) the settlor has been UK domiciled throughout (or from 6 April 2025 was long-term resident at outset and remains long-term UK resident at the time of the charge) and b) the trustees are UK resident. Otherwise the trust will need reporting regardless of value.
£260,000 - £325,000 (NRB)	› If this is a standard discretionary trust then the trust will be reportable. › If the trust is an Estate Planning Bond then you should contact us to find out whether the discount takes the policy under the reporting threshold.
EXCEEDS £325,000 (NRB)	› If this is a standard discretionary trust then the trust will be reportable and a periodic tax charge will apply. › If the trust is an Estate Planning Bond then you should contact us to find out whether a discount takes the policy out of a tax charge and/or under the reporting threshold.

*Values can be doubled in cases where there were joint settlors assuming they are still alive at the ten year anniversary. For discounted gift schemes such as the Estate Planning Bond, this value will be the value less any relevant discount at this time.

WHEN MUST THE REPORT BE SUBMITTED AND THE TAX BE PAID?

Trustees must report and have paid inheritance tax by the end of the sixth month after the date in which the periodic charge occurred. HMRC will charge interest on payments received after the due date.

WHAT FORMS MUST BE COMPLETED AND WHERE MUST THESE BE SENT?

To report the periodic charge, the HMRC form IHT100 should be used if the value of the trust exceeds 80% of the NRB. If a tax charge is applicable then the additional form IHT100D must also be submitted, which is specifically used to declare and pay the ten year periodic charge.

The forms must be returned to HMRC and more information on the returns can be found on the following link

<https://www.gov.uk/government/publications/inheritance-tax-inheritance-tax-account-iht100>

SETTLOR MUST PAY ANY PERIODIC CHARGE ON THE ESTATE PLANNING BOND DURING THEIR LIFETIME

Under the Estate Planning Bond the settlor only has rights to the fixed withdrawal payments during their lifetime. It is not possible for them to take any additional money from the bond, or indeed place any additional monies into the bond during their lifetime. The reasons for this are discussed in the TSB entitled EPB flexibility. Ultimately, this will mean that whilst the trustees must file the report with HMRC, the settlor will have to pay any tax due.

Where a trust is still in force and the settlor has passed away, the trustees can then take withdrawals or surrender segments to pay any potential periodic charges.

HOW CAN UTMOST INTERNATIONAL ISLE OF MAN LIMITED ASSIST TRUST REPORTING?

PERIODIC CHARGE AND OUR ESTATE PLANNING BOND

If you need to understand an estimation of the value of the applicable discount at the time of the periodic charge, then please e-mail customersupport@utmostwealth.com They will then liaise with our actuarial and technical teams to respond to your query.

OTHER DISCRETIONARY TRUSTS

As we have seen, many factors contribute to the unlikelihood of a periodic charge being payable on an Estate Planning Bond discretionary trust. Conversely, where a discretionary trust is wrapped around a standard investment bond policy there will be no discount and possibly no withdrawals. This could make reporting more likely for trusts that were set up following 21 March 2006.

However, the issue here is relatively straightforward and simply requires the trustees to understand the value of the policy at the time of the periodic charge. All the relevant information is available to trustees and advisers without further calculations being necessary. We do not normally provide any additional guidance or assistance in this area. Useful guidance on the calculation of periodic charges can be obtained by visiting the HMRC Inheritance Tax Manuals which have full details of the operation of the rules. Please use the link here <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm42000>

CONCLUSION

The requirement to report and potentially pay tax on discretionary trusts could create an additional administrative burden on trustees and advisers. However, many Estate Planning Bond policies will be free from reporting and any actual tax liability for the reasons described earlier.

Where necessary Utmost International Isle of Man Limited provides assistance in relation to the Estate Planning Bond (and any DGT Conversion scheme) in order to help trustees to understand their position and take the relevant action.

In all cases, the first step to take should be to obtain a valuation of the policy. Once this has been obtained and assessed against the table contained in this Briefing, the appropriate course of action should be taken.

TECHNICAL SERVICES
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