LOAN TRUST

A TECHNICAL FAQ FOR FINANCIAL ADVISERS

A WEALTH *of* DIFFERENCE

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You should pay particular attention to the sections marked with this icon.

BEFORE YOU BEGIN

The following information does not constitute legal or tax advice and we recommend that investors, and their advisers, always seek independent tax and legal advice. This document should be considered along with Your Guide to the Loan Trust (client guide), the relevant Product Guide, Key Features document and applicable disclosure documents.

The information in this guide is limited to the loan trusts provided by Utmost. It is based on our interpretation of current law and taxation practice in the UK, Ireland and the Isle of Man as at **1 February 2025**, which could change in the future and is dependent on individual circumstances.

A BRIEF OUTLINE OF HOW THE LOAN TRUST WORKS

1. A trust is established with the promise of a loan being made to the trust by the settlor (the trust deed).

2. The settlor makes a loan of cash to the trust - this loan is interest free and repayable on demand by the settlor to the trustees (the loan agreement).

3. The trustees use the loan to purchase a unit-linked life assurance policy or capital redemption policy (the bond).

4. The trustees repay the loan through 'ad hoc' or regular withdrawals using the 5% annual tax-deferred entitlement available under a bond (the loan repayments).

Further details on how the loan trust works can be found in the client guide; **Your Guide to the Loan Trust**.

PLANNING POINT

As the bond is taken out by the trustees, any investment growth is immediately outside the settlor's estate for UK inheritance tax (IHT) purposes. It is important that the loan repayments are taken by the settlor and spent in order to remove the loan from their estate over time and provide more flexibility in terms of the future distribution of benefits.

As the trust property is comprised of a unit-linked bond, there is a possibility that at any point in time the amount of the outstanding loan may be greater than the value of the bond. However, our current trust deeds are designed to protect the trustees from becoming personally liable to repay any shortfall. This is explained in detail in the following section.

ARE THE TRUSTEES PERSONALLY LIABLE FOR REPAYING THE LOAN?

'CAPPING' THE TRUSTEES' LIABILITY

Our current Loan Trusts contain a clause in the Loan Agreement that limits the trustees' liability to repay the loan. The trustees are personally liable to repay the loan only up to the value of the trust fund. Therefore, if the value of the trust fund falls below the value of any outstanding loan the trustees will not be personally liable for any shortfall.

If the trustees have made any distributions to beneficiaries these amounts will still be treated as part of the trust fund when calculating any outstanding liability. This is included in the clause as it prevents the trustees from distributing trust property to the beneficiaries in order to avoid their liability to repay the loan.

This clause was added after receiving a legal opinion from Queen's Counsel.

AN EXAMPLE OF HOW THIS CLAUSE WORKS

A Loan Trust is established with a loan of £100,000. The trust fund (the bond) decreases in value to £80,000. The trustees have made no loan repayments to the settlor, nor have they made any distributions to beneficiaries.

If the settlor requests that the loan is repaid in full at this point then the trustees will only be liable to repay £80,000.

If the settlor dies before the loan is repaid in full, the debt owed to the deceased settlor's estate is limited in the same way, for the purposes of calculating any IHT liability. In the above example, £80,000 would need to be included in the settlor's estate.

NOTES ON OLDER TRUST DEEDS

Please note that some example Loan Trust deeds, previously provided by the Utmost Group of Companies, did not contain this clause. Therefore, if the settlor of one of these trusts were to demand the full repayment of the loan at any time, the trustees would personally need to make good any 'shortfall' if the value of the trust fund has fallen below the amount of the outstanding loan. In the example provided opposite, this shortfall would be £20,000.

To check if the Loan Trust document includes this clause you would need to review the relevant section of the Loan Agreement. Example clauses are given below:

"The Trustees are personally liable for any sum payable under this Loan Agreement only to the extent of the value of the Trust Fund when the payment falls due."

"The total liability of the Original Trustee to the Settlor, his successors and his assignees under or in connection with the Loan shall not at any time exceed the net value of the Trust Fund at that time."

If, after reviewing the deed, you are still unsure as to whether the clause is included, please contact our Customer Support team for guidance.

We have taken every care in preparing the trust deeds, but we cannot take any responsibility for the legal/tax consequences of using them. It is strongly advised that your client consults their own professional advisers and seeks taxation advice in their country of domicile and/or residence.

UPON DEATH OF THE SETTLOR (LENDER) CAN THE EXECUTORS 'POSTPONE' REPAYMENT OF THE LOAN?

When the Settlor dies, the amount of the outstanding loan will form part of their estate for IHT purposes. The executors of the deceased's estate would normally have a legal duty to call in any debts owed to the deceased's estate and they may, therefore, request that the trustees of the Loan Trust repay the outstanding amount of the loan.

The executors can postpone the actual cash repayment of the loan in order to leave the bond in force*. The trustees and the executors may wish to do this for a number of reasons, for example:

- If calling in the loan immediately would result in a chargeable event under the bond that causes a large income tax liability
- If early surrender charges are still applicable to the bond
- If the underlying assets of the bond (for example structured/cash deposits) cannot be accessed immediately without invoking 'early breakage' clauses or charges
- If poor market conditions exist at the time of the Settlor's death. In this case the trustees and executors may wish to postpone surrender of, or withdrawal from, the bond in the hope that the unit value of the linked investments improves in the future.

*If the bond was established on a life assurance basis and the Settlor is the only/last life assured then the bond is automatically surrendered upon death of the Settlor.

However, the decision to postpone calling in the loan will also depend on a number of other factors which might include:

- The nature of the other assets in the Settlor's estate, and the total estate value
- The **beneficiaries of the Settlor's estate**, their immediate needs, and whether they are different from, or identical to, the **potential beneficiaries of the Loan Trust**. (Note, the potential beneficiaries under the Loan Trusts provided by Utmost include those persons named in the Settlor's will)
- The relationship between the Settlor and the trustees, and between the executors and the trustees
- Whether or not a will was executed and, assuming that it was, what provisions, if any, were included in respect of the outstanding loan

These matters are discussed in more detail over the next two pages.

As explained above, it is possible for the executors to allow the trustees to leave the loan outstanding and keep the bond in force. It is sometimes suggested that, if the loan is left outstanding, the executors could request that the bond (or individual segments) is assigned to the desired beneficiaries at a later date. The aim of this is to 'shift' the tax charge on subsequent surrenders to the beneficiaries, to increase tax efficiency (assuming that the beneficiaries have lower individual rates of income tax than the trust rate of income tax). However, in our view, it is possible that HM Revenue & Customs (HMRC) would view any assignment of the bond in these circumstances as being for 'consideration', which may generate a chargeable event at the trust rate of tax (which is 45% for the 2024/25 tax year), making this type of planning ineffective.

THE COMPOSITION OF THE ESTATE AND THE TOTAL ESTATE VALUE

IHT is potentially payable on any estate where the value of the total estate, plus any previous lifetime transfers within seven years of death, exceeds the nil rate band.

The nil rate band is set to remain at the current rate of £325,000 until at least **5 April 2030**. There is also an IHT residence nil rate band that applies if a main residence is left to direct descendants following a person's death. This is in addition to the standard IHT nil rate band of £325,000. The residence nil rate band is currently £175,000 and, like the standard nil rate band, is set to remain at this level until at least 5 April 2030. It is tapered away for estates valued over £2 million. And, like the 'standard' nil rate band, any unused amount is transferable to a spouse or civil partner.

In some circumstances where IHT is due on an estate, the executors may not be able to pay the IHT until they are able to sell certain assets. A person's home is a good example of an asset where IHT may be payable on the death of the owner, but might not be able to be paid immediately. This is because the executors need to value the house and sell it first. Only once they receive the sale proceeds can they pay any IHT due. Of course, this may take considerable time and much will depend on market conditions. HMRC therefore allow payment to be made in instalments to help alleviate the need for the estate to borrow money to pay the IHT due.

Conversely, money held in the deceased's bank account, or in an insurance bond which will pay out on his or her death, is deemed immediately accessible by HMRC. Payment of IHT in respect of such assets would need to be made following the death of the account-holder/policyholder, usually within 6 months of death.

EXAMPLE

Daphne dies on 1 December 2024 with an estate which is comprised of her house, valued at £300,000, and an outstanding loan, under a loan trust, of £50,000. For this example it is assumed that the value of the bond exceeds the loan amount. The estate's IHT liability is £350,000 - £325,000 @ 40% = £10,000. As there are no other liquid assets in the estate, the executors would need to call in the outstanding loan, or part of it, to pay the £10,000 IHT due.

An alternative might be to borrow to pay the IHT liability. However, this option would need to be considered against surrendering the bond held under the loan trust, surrendering individual bond segments or taking withdrawals from the bond to cover the tax due.

THE BENEFICIARIES OF THE ESTATE, THEIR NEEDS, AND WHETHER THEY ARE INCLUDED AS POTENTIAL BENEFICIARIES OF THE LOAN TRUST

The beneficiaries of the Loan Trust will often be the same as the beneficiaries of the Settlor's estate, assuming that the Settlor has made a valid will.

Provided that there is enough money in the estate to pay any IHT due, the executors may, in these circumstances and subject to the approval of the beneficiaries, decide to postpone the actual repayment of the loan.

EXAMPLE

Marie dies on 1 December 2024 with an estate which is comprised of a house valued at £350,000, together with £50,000 in an instant access bank account. She also has an outstanding loan of £30,000 under a Loan Trust. The IHT liability on her entire estate would be £430,000 - £325,000 @ 40% = £42,000. In this example there is enough money in the bank account to cover the total amount of IHT due. In this situation it may be acceptable to the beneficiaries for the executors to postpone the repayment of the loan if this is desirable.

It should be kept in mind that it will not be possible for the executors of Marie's estate to complete the administration of her estate whilst the loan remains outstanding.

It is also important to remember that Marie's executors will still have to account for the £30,000 debt to the estate for the purposes of calculating the IHT. It is simply the repayment of the actual loan that has been deferred.

THE INTERACTION BETWEEN THE DECEASED'S WILL (OR THE INTESTACY PROVISIONS) AND THE LOAN TRUST

If a UK resident dies without a will, their property will be passed on according to a prescribed series of rules called the 'rules of intestacy'. These rules are complex and will depend on many factors, including the total estate value, the marital status of the deceased and whether there are children and other blood relatives.

For example, the rules for a married person (including a registered civil partner) with children, who dies domiciled in England and Wales without a valid will are as follows:

- assets less than £270,000 - Everything goes to the spouse or civil partner
- assets more than £270,000 - Everything up to £270,000 goes to the spouse or civil partner. Half of the remaining assets also go to the spouse or civil partner, with the other half passing to the children.

The full rules are too complex to go into specific detail in this document but more information on the rules of intestacy in England and Wales can be obtained by following the links below:

https://www.gov.uk/inherits-someone-dies-without-will

http://www.hmrc.gov.uk/manuals/ihtmanual/IHTM12000.htm

It is clear from these rules that what a surviving spouse or civil partner will receive is dependent on both the size of the estate and whether or not there are children. Any outstanding loan under a Loan Trust will form part of the deceased's estate on death and will therefore also be covered by the intestacy rules.

PLANNING POINT

Leaving any outstanding loan to a spouse or registered civil partner under the terms of a will ensures that:

- no IHT will arise on the Settlor's death when the loan passes over to the spouse or civil partner (assuming that person is a UK domiciled individual)
- the spouse or civil partner can then decide freely what to do with the outstanding loan.

ACCOUNTING FOR THE OUTSTANDING LOAN IN THE SETTLOR'S WILL

Even where the Settlor has an existing will in place, care should be taken when considering investment in a Loan Trust. The terms of the will may simply leave all the residuary estate to a particular person.

It is important to make sure that the will is written clearly and takes into account the outstanding loan under the Loan Trust. If the will was written before the Loan Trust was effected, the will might need to be amended. The following example shows how failing to account for the loan in the will can cause problems:

EXAMPLE

John is married to Helen and they have one son, Freddy. John has drawn up his will as shown in the table below:

ASSET	LEFT TO
Share in private residence and chattels	Helen
Building Society Account (valued at £100,000)	Helen
Residuary estate (currently a small amount in an ISA)	Freddy

Shortly after John has drawn up his will, he uses the £100,000 in his building society savings account to establish a loan trust. John dies and Helen assumes, having knowledge of the contents of John's will, that she has a right to his entire estate other than the ISA which is being left to Freddy.

However, the outstanding loan now forms part of the residuary estate on John's death and, as such, will pass to Freddy under the terms of the will. Whilst a deed of variation could be used to rectify this position, the deed has to be drawn up within two years of John's death. Perhaps more importantly, as Freddy is the beneficiary under the will he must agree to the variation. Failing this, Freddy will benefit from the remaining outstanding loan as well as the ISA account, which was not what John had originally planned. There is also no scope for postponing the repayment of the loan on John's death if Freddy is not in agreement.

It is important that, when considering use of a Loan Trust, interaction with any existing will is considered to make sure that any outstanding loan passes in accordance with the Settlor's wishes.

CAN THE TRUSTEES BE RELEASED FROM THEIR OBLIGATION TO REPAY ANY OUTSTANDING LOAN?

DURING THE SETTLOR'S LIFETIME

It is possible for the Settlor to release the trustees from their obligation to repay the loan during their lifetime. If the Settlor does waive the loan, the amount waived will constitute a chargeable lifetime transfer by the Settlor for IHT purposes. This chargeable lifetime transfer will be deemed to have occurred on the date that the Settlor waived the loan.

This release of a debt, for no consideration, must be done by an appropriate deed (Pinnel's Case, 1602 WL 4 (QB); 77 E.R 237). For our Loan Trusts, the **Loan Waiver Deed** provided by Utmost can be used to achieve this.

VIA A WILL

It should also be possible for the Settlor to include a provision in their will to waive any outstanding loan to the trust on their death. This would constitute a gift to the trust on the Settlor's death and may have implications for the trust, in terms of future 10 year anniversary and exit charges for IHT purposes. Nevertheless, it may facilitate the management of the potential income tax liabilities on future chargeable event gains by the assignment of the bond (or individual segments) to beneficiaries. Anyone wishing to do this would need to weigh up these points. They would also need to make sure they had sufficient other liquid assets in the estate to pay any outstanding IHT.

If, after the Settlor's death, the loan is released by a beneficiary of the estate, the amount waived would be considered a gift to the trust (chargeable transfer, if the trust is a Discretionary Trust) by the beneficiary. In effect, they are giving up their right to the loan repayment through the will and gifting this into the trust. This gift will be aggregated with any other transfers made by that person. As any beneficiary of the will is also a potential beneficiary of the trust under our loan trust deeds, such release is likely to be considered as a 'gift with reservation of benefit' by HMRC assuming those beneficiaries were UK domiciled or long-term UK resident (post 6 April 2025). This is because they may benefit in future (as a potential beneficiary under the trust) from the gift they have made. For these reasons this is not recommended as a tax planning strategy.

IS A JOINT LOAN TRUST AVAILABLE?

There are two ways for a people who are married or in a civil partnership to effect joint loan trusts in conjunction with an Utmost bond:

1. Each individual can take out their own loan trust arrangement

Or

2. The joint Loan Trust can be used.

Utmost's joint loan trust is written on a joint a tenancy basis. On first death the property will automatically pass to the surviving spouse or civil partner. Whilst half the amount of the loan will still form part of the deceased's estate for IHT purposes, providing the surviving spouse is UK domiciled the spousal exemption will apply meaning no IHT will apply on first death.

On the face of it, a joint Settlor Loan Trust would appear to be an effective option in some cases. There would be a lower cost, as only one bond would be required.

In addition, there is a reduced administrative burden of only having one trust when considering administrational matters, such as the requirement to register any UK trust under HMRC's Trust Registration Service.

However, it is worth noting that the operation of a joint Settlor Loan Trust could also be more complex for the trustees. The loan repayments would need to be clearly identified between both joint Settlors and joint accounts should be used so there can be no challenge that the loan has only been repaid to one party. There could also be administration issues should the parties subsequently divorce, especially if it can be shown that repayments have only been made to one of the settlors.

Other matters may also mean that creating two separate loan trusts is preferable and we have detailed some considerations in the table below:

FEATURE / ISSUE	USING JOINT LOAN TRUST	USING SEPARATE TRUSTS FOR EACH SPOUSE / CIVIL PARTNER
Costs	Only one bond is required which can lead to lower overall charges when compared to using two trusts which requires two bonds.	Two bonds are required – one for each trust – leading to potential higher total product costs.
Can Spouse Benefit? Can widow or widower access trust fund (growth) following death?	No the spouse or widow/widower cannot benefit as they are also a settlor - they are therefore excluded to avoid gift with reservation issues. On death the widow/widower would not be able to access any growth.	Where two loan trusts are used the spouse should be removed from at least one trust to avoid any challenge of gift with reservation through reciprocal arrangements. It is normally preferable for the spouse/civil partner who is more likely to die first to be the Settlor of the trust with the spouse/civil partner included as a potential beneficiary. Note, when setting up trusts for married couples,with care the spouse can also be included as a potential beneficiary without this necessarily creating a gift with reservation of benefit. However, care should be taken here as, if they share any benefit on distribution it may be said that the settlor has not been entirely excluded and thus the gift with reservation rules could apply. HMRC cover this point in their manual IHTM14338. The deed will also allow the widow/widower to benefit.
What happens to outstanding loan on the death of Settlor?	On first death it will pass automatically to the spouse usually free of IHT due to the spousal exemption. On second death it will then form part of the survivor's estate.	Depends on the contents of the will – loan will usually fall into residue and will pass in accordance to the will or intestacy. Using separate trusts can allow for more flexibility in planning in respect of the loan on first death, especially where assets may wish to be passed down to children from previous marriages etc.
Payments	Payments should be made to a joint bank account to avoid any challenges of who has been repaid.	Payments can be made to either a joint bank account (with their spouse or civil partner) or to a sole account.

WHY ARE IN-SPECIE PREMIUMS NOT PERMITTED UNDER OUR LOAN TRUSTS?

For other products and arrangements Utmost will, under some circumstances, accept payment of a premium by 'in-specie' transfer of assets, provided certain conditions are met. However, in-specie transfers are not permitted under the Loan Trust.

The Loan Trust is effective because the Settlor lends a cash sum to the Trustees and forgoes the interest on this sum. The Trustees then invest this loan and, as they are only liable to repay the amount of the loan, any growth on the investments made in their name is outside the Settlor's estate.

If the Loan Trust was established with a loan of assets, from an in-specie transfer, the loan would effectively be of an asset (or assets) and not cash. If an asset is lent, then that asset must be paid back and therefore any growth will also be repaid. For any growth in a lent asset to be outside the Settlor's estate it must be somehow separated from the original value of that asset.

It could be suggested that any growth in the value of the asset is forgone by wording the loan agreement to state the loan is the 'cash value' of the asset at the time it was transferred. However, it is not clear whether HMRC would accept such a wording, as this does not negate the fact that there was still an asset lent at a value (not cash) and the Settlor would not receive the asset back including appreciation, they would simply receive value.

For these reasons, in-specie transfers of assets under the Utmost Loan Trust are not permitted.

OTHER FREQUENTLY ASKED QUESTIONS

CAN THE SETTLOR TOP UP THE LOAN TRUST?

Yes, it is possible for the Settlor to top up the Loan Trust. However, it may be preferable to keep the amounts in separate bonds. The Settlor cannot benefit further from the trust fund once both of their loans have been repaid, due to the IHT gift with reservation provisions. The Trustees would have to keep accurate records to be able to establish the remaining loan entitlements.

Whichever method is chosen, a new loan agreement is required for the second loan and any subsequent loans. The Settlor would not need to set up a separate trust unless they wanted to create a new Loan Trust.

CAN THE LOAN TRUST BE SET UP WITH THE SETTLOR AS SOLE TRUSTEE?

A person cannot legally make a loan to themselves. A loan is a contract and a person cannot contract with his or her self; a contract needs two parties.

The judgment of Rye v Rye (1962) discusses a similar point. For these reasons we insist that at least one other trustee should be appointed from outset.

IS THERE AN ABSOLUTE (BARE) TRUST VERSION AVAILABLE?

Utmost offers an Absolute Trust version of the Loan Trust. Using an Absolute Trust removes the various complicated tax charges associated with Discretionary Trusts. However, there are many disadvantages of using such a trust:

- once a beneficiary reaches 18 years of age they can request their share of the trust fund (the growth at that time). If the trustees made a distribution then this could create a shortfall irrespective of any clause to cap the trustees' liability. As explained on page 6, the cap of any loan to the value of the bond must include previous distributions
- the beneficiaries are fixed and cannot be changed to take into account changes in family circumstances
- if a beneficiary should die before the Settlor, the value of the trust fund (growth) would form part of the beneficiary's estate for IHT purposes
- any chargeable event gain under the bond will ordinarily be assessed on the beneficiary if they are over 18 years of age. Similarly, any chargeable event gains will also be assessed on minor beneficiaries (those under age 18) providing the Settlor is not the parent of the beneficiary and if the gain exceeds £100. These are referred to as the 'parental settlement rules'. This point could be considered advantageous, especially as most children will generally be non-taxpayers, however, this point could also create problems. If the trustees created a chargeable event, perhaps when repaying the settlor's loan, then this gain would fall on the absolute beneficiary who may not have any money to pay the tax on it.

Taking these points into consideration, great care would need to be taken if this trust were to be used.

CAN THE LOAN BE REPAID BY ASSIGNING BOND SEGMENTS?

We are often asked if the trustees can assign bond segments to the Settlor in order to repay the loan without creating a chargeable event (as a chargeable event may occur if the segments were surrendered, or if a large withdrawal was taken from the bond). However, this option will generally not alleviate tax for the following reasons:

- under the loan agreement the Settlor only has rights to receive his original capital back. The Settlor is not a beneficiary of the trust. In our view, the assignment of the bond (or segments) to the Settlor in order to repay the loan would effectively give rise to an assignment for consideration and thus potentially create chargeable events (if the bond has increased in value)
- each segment under the bond must be considered separately as they are individual policies in their own right, if any segment has increased in value then there will be a chargeable event if the policy is assigned for consideration. The fact the trustees may be treating this as a return of the Settlor's capital is irrelevant.

Assignment of the bond segments may be possible if the value of the bond has decreased. Here the segments could be assigned to the Settlor for consideration and there would not be any chargeable gains. However, if there is no gain on the bond there may be no reason to assign the segments as they could be surrendered without any chargeable gain in any case.

CAN PAYMENTS BE MADE TO BENEFICIARIES BEFORE THE LOAN IS REPAID?

Yes, this is possible but in practice this is not something that the trustees should generally agree to. Remember that the trustees are liable to repay the outstanding loan on demand by the Settlor.

Whilst, under our new drafts, the liability of the trustees to repay the loan is capped to the value of the trust fund (the bond) at any time, any previous distributions to beneficiaries must be included in this value. A trustee may therefore create a personal liability if they decide to distribute monies to beneficiaries before the loan has been repaid to the Settlor in full.

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