

the knowled^e

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Colin Jelley
Head of Tax and Financial Planning
UK Business Unit

transitional serial interests

– manaⁿ inⁿ pre 22 March 2006 trusts

The Finance Act 2006 introduced a transitional period to ensure trustees and their advisers had an opportunity to review and, where appropriate, amend existing trusts.

In his second article relating to the transitional period, **Colin Jelley** takes a further look at the concept of Transitional Serial Interests (TSI) and the considerations that need to be addressed when advising on existing life policies under pre 22 March 2006 trusts.

In last month's *informer* I introduced the concept of a General TSI. This is where changes are made to the beneficiary having an interest under a pre 22 March 2006 Interest in Possession (IIP) trust during the transitional period (which runs from 22 March 2006 to 5 April 2008), meaning the trust will not, subject to certain rules, become relevant property.

After 5 April 2008 there will be two additional types of TSI available: Spouse or Civil Partner* TSI and Life Policy TSI. There are certain criteria that must be satisfied for these to be available, as explained in the panel on the opposite page.

*As defined by the Civil Partnership Act 2004.

need for advice

The life policy TSI adds a clear need for advice by trustees when reviewing the trust and its underlying assets. Life policies, including both protection policies and single premium life bonds (but not capital redemption bonds), also benefit from special provisions under the Finance Act 2006.

New money added to a pre 22 March 2006 trust would normally be brought into the relevant property regime, whereas a pre 22 March 2006 life policy under trust can be topped up or premiums increased as long as these options are within policy terms that existed prior to 22 March 2006.

Other allowable variations include term extensions and increases in sums assured. All such premiums paid by the Settlor will be treated, where not exempt, as potentially exempt transfers (PETs) for IHT purposes. These special provisions do not apply to Capital Redemption contracts.

existinⁿ life policies under trust

This does not mean you must never surrender an existing life policy held by a pre 22 March 2006 trust. Instead consideration must be given to the tax value of the TSI relative to the commercial value of having a different policy.

Consider a life bond where the investment philosophy of the trustees cannot be met by the existing product and they wish to move to a product with greater flexibility and wider investment opportunities. Ignoring charges and any chargeable event created by encashing the bond, what value does the TSI offer? Encashing the bond and reinvesting the proceeds will not bring the trust into the relevant

property regime, but as the new product will not be a pre 22 March 2006 life policy the TSI treatment would be lost if the beneficiary were to die.

When advising in these circumstances, consideration would need to be given to the current and future values of the trust fund, as well as the IHT position of the beneficiary. Clearly each case will need to be determined on its own

merits – the trustees must choose between the loss of TSI treatment and the loss of investment opportunity.

While of course the 'tax planning tail should not wag the financial planning dog', advice in this area is key for trustees. Advisers also need to ensure that they have addressed this issue in any report or recommendation. ■

This article is based on Skandia's interpretation of the law and HM Revenue & Customs practice as at 31 October 2007. We believe this interpretation to be correct but cannot guarantee it. Tax relief and the tax treatment of investment funds may change.

when is TSI relevant?

Note that anyone offering advice to trustees must consider whether a TSI is relevant when considering a change to the IIP beneficiary or change to the underlying investment. Please note that for the purposes of this article we have assumed no other exemptions apply and we are only addressing the inheritance tax (IHT) considerations.

In each instance there are certain criteria that must be satisfied, as follows:

General TSI (pre 6 April 2008)

The trust commenced before 22 March 2006 and immediately before this date there was an IIP beneficiary 'A'. Beneficiary A's interest came to an end on or after 22 March 2006 but before 6 April 2008 and 'B' became beneficially entitled to the current interest at that time.

Spouse or Civil Partner* TSI (post 5 April 2008)

The trust commenced before 22 March 2006 and immediately

before this date there was an IIP beneficiary 'C'. C's interest came to an end on or after 6 April 2008, on his/her death. Immediately before C died, 'D' was the spouse or civil partner* of C. D became beneficially entitled to the interest on C's death.

Life Policy TSI (post 5 April 2008)

- a. The trust commenced before 22 March 2006 and immediately before this date there was an IIP beneficiary 'E' and the property in the trust included rights under a life policy.
 - b. The interest came to an end on or after 6 April 2008 on the death of the person beneficially entitled to it, and 'F' became beneficially entitled to the present interest.
- or

The present interest arose on the death of the person previously entitled to it, and is an IIP that is a General TSI.

- c. The rights under the life policy in the trust are the same rights which were in the trust before 22 March 2006 (the same life policy).

Any change failing to meet these criteria will bring the trust into the relevant property regime. The change will be treated as a chargeable transfer made by the beneficiary whose interest is being reduced.

The trust would then be subject to a potential entry tax charge as well as ongoing ten-yearly periodic and exit charges, as per a Discretionary Trust. Obviously, depending on the size of the trust and the individual circumstances of the beneficiaries involved, there may be no tax due and the trust may benefit by removing the asset from the individual's estate for IHT purposes.

*As defined by the Civil Partnership Act 2004.

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