

a multiple trust solution



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Colin Jelley sets out the Rysaffe principle and demonstrates how multiple trusts can be used to achieve effective trust planning.

The added complexities that the new regime brings does not mean inheritance tax (IHT) planning is no longer viable, it simply means we have to look at the longer term view and fully understand clients' objectives.

The flexibility that can be achieved in the new regime can make the issue of paying tax upfront (where previously there was none) a lot more palatable.

the Rysaffe principle

The Rysaffe case is often referred to within trust planning and relates to Rysaffe Trustee Co (CI) v IRC (2003) where a series of trusts were created on consecutive days. The principle being that by establishing a series of smaller trusts you can reduce the impact of the ten yearly periodic charge and exit charge by establishing a nil rate band (NRB) for each trust.

case background

The Inland Revenue (now HM Revenue & Customs) contended:

'That the making of all the settlements were associated operations and that therefore the Settlor had made one composite settlement by an extended disposition.'

After an initial successful hearing for the Revenue before the special commissioners both the High Court and a unanimous Court of Appeal judgement stated that Section 42 IHTA 1984 was to apply on the basis that the word 'disposition' had its ordinary meaning and was not to be extended to include a disposition by associated operations.

A key statement from the judgement dealing with the associated operations point was as follows:

'All the parcels of shares were property comprised in settlements for the purposes of Section 64. The associated operations provisions had nothing to do with that analysis. There were 10-yearly charges on all of the parcels of shares. It is (I assume) true that in aggregate the five 10-yearly charges would be lower than the single charge which would have applied if there had only been one settlement. But that is not a valid reason for artificially importing the associated operations provisions into the exercise and using them to impose the false hypothesis that there was only one settlement when in fact and in law there were five.'

Additionally, from a planner's point of view it is worth considering the statutory definition of 'related settlements' contained in Section 62 IHTA 1984. Related settlements are treated as a single settlement and so would not each have a separate NRB. In summary, for a trust to be a related settlement, the Settlor must be the same in each case and the trusts must have commenced on the same day.

So, trusts created on different days do not fall within this definition. By creating a series of trusts you can reduce the inheritance tax payable. This is demonstrated in the simple example to the right.

This planning may not be suitable for all your clients. However, when reviewing the needs of clients for immediate and future planning strategies, it can offer a clear tax benefit where the trust is expected to be managed for a significant period. This can be, for example, to cover a wide class of beneficiaries like grandchildren (born and unborn) and help them through their future education needs.

This document is based on Skandia's interpretation of the law and HM Revenue & Customs practice as at 31 October 2006. We believe that interpretation is correct, but cannot guarantee it. Tax relief and the tax treatment of investment funds may change.

example: £300,000 investment into a discretionary trust

Scenario 1:

If £300,000 is made as a one-off payment into the trust and assuming the full NRB is available (and other exemptions have been used elsewhere) the tax liability at entry would be:

£300,000 gifted in to trust

£285,000 (NRB for 2006/07)

£15,000 liable to tax at 20% (half the death IHT rate)

Tax due = £3,000, assuming trustees pay the tax

Scenario 2:

If we now consider creating three trusts each for £100,000 on separate days.

Trust Fund 1: £100,000 gifted in to trust day one

Previous chargeable lifetime transfers (CLTs) = £0

£100,000 + £0 = £100,000 - £285,000 (NRB for 2006/07)

= No tax to pay

Trust Fund 2: £100,000 gifted in to trust day two

Previous CLTs = £100,000

£100,000 + £100,000 = £200,000 - £285,000 (NRB for 2006/07)

= No tax to pay

Trust Fund 3: £100,000 gifted in to trust day three

Previous CLTs = £200,000

£100,000 + £100,000 + £100,000 = £300,000 - £285,000 (NRB for 2006/07)

= £15,000 liable to tax at 20%

Tax due = £3,000 assuming trustees pay the tax

In this example the entry charge is the same for the one trust route as it is for using three trusts. However, the exit charges on Trust Funds 1 and 2 would be different using the multiple strategies when compared with the single trust route. This also applies to the 10-yearly periodic charge.

10-year periodic charge

If we consider that the trust has grown from £300,000 to £600,000 and the NRB is £400,000 in 2016/17 (which is approximately 3% per annum growth in the NRB over what has already been announced) and there have been no other previous CLTs or exit charges, then the 10-year periodic charge is calculated as follows:

Scenario 1:

Current value of Trust Fund	£600,000
Previous CLTs in seven years before creation of Trust	£0
Plus any distributions that give rise to an Exit Charge	£0
Less NRB (2016/17)	<u>-£400,000</u>
Taxable amount	= £200,000
Hypothetical CLT tax at 20% (half the death IHT rate)	= £40,000
Effective Rate	= Hypothetical CLT tax (£40,000) Current value of Trust Fund (£600,000)
	= 7%
	= 2%
of which 30%	= 2%
10-year Anniversary Charge	= Current value of Trust Fund x 30% of Effective Rate
	= £600,000 x 2%
	= £12,000

All numbers are rounded to the nearest whole number.

Compare this to the three trusts used in scenario 2:

Trust 1

Current value of Trust Fund	£200,000
Previous CLTs in the seven years before creation of Trust 1	£0
Plus any distributions that give rise to an Exit Charge	£0
Less NRB (2016/17)	<u>-£400,000</u>
Taxable amount	= £0

Trust 2

Current value of Trust Fund	£200,000
Previous CLTs in the seven years before creation of Trust 2	£100,000
Plus any distributions that give rise to an Exit Charge	£0
Less NRB (2016/17)	<u>-£400,000</u>
Taxable amount	= £0

Trust 3

Current value of Trust Fund	£200,000
Previous CLTs in the seven years before creation of Trust 3	£200,000
Plus any distributions that give rise to an Exit Charge	£0
Less NRB (2016/17)	<u>-£400,000</u>
Taxable amount	= £0

The result is that we have created a series of trusts where the 10-yearly periodic charges are now £0 and any future exits in the following 10 years will also be taxed at this rate. This compares to scenario one where there is tax to pay of £12,000 at the tenth anniversary. There will also be tax on any future distributions of capital in the following 10 years.

key considerations

- Parliament can change legislation.
- You need to take care at the implementation stage to ensure the right trust is set up at the right time.
- Currently, with reporting levels at £10,000, you would need to complete three sets of forms - (IHT100, IHT100a and supplementary forms depending on the assets).
- Significant growth in trust values relative to future increases in the NRB may mean one or more of the trusts suffer 10-yearly periodic charges and consequently exit charges may apply.
- Product pricing may be adversely affected because of smaller investments (allocation rates) or mortality rates (for protection) where they are not on a pro rata basis.
- This type of planning will not suit every investor, but adds a level of planning which may well be suitable for high net worth individuals looking to create long-term IHT strategies.
- It is worth remembering that in both the PET and CLT regime you can, in effect, give away your NRB every seven years without incurring an immediate IHT liability.

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