Integritas Financial Planners Ltd
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FLEXIBLE REVERSIONARY TRUST

What is it?

A flexible reversionary trust allows a person to make a gift into a discretionary trust with the aim of reducing their potential inheritance tax (IHT) liability, while still keeping the option of receiving yearly payments from the trust, if required.

The arrangement consists of a series of maturing life assurance policies which are set up at the outset to mature at future anniversary dates, so that funds can be released to the investor (settlor) each year, if required. The trustees can defer these maturity dates if the settlor doesn't need funds from the trust at that time.

After seven years, the gift is outside the settlor's estate, which means there's no inheritance tax to pay on it. Any investment growth is outside of the estate from day one.

A flexible reversionary trust arrangement usually consists of the following:

- A series of offshore single premium life assurance policies with varying maturity dates
- A bespoke trust arrangement which gives the settlor access to the proceeds from each of the maturing policies, if required
- Usually single settlor only (i.e. one person is making the gift into the trust)
- The settlor is usually automatically a life assured on the policies – and additional lives assured can also be included to ensure that the plan doesn't automatically come to an end on the settlor's death (and avoids triggering a chargeable event at what might be an inopportune time)
- Usually not possible to add further investments after the arrangement is set up
- During the settlor's lifetime, each time a policy reaches its maturity date, the maturity proceeds are available to the settlor, via the trustees, but if the settlor doesn't wish to receive the maturity proceeds they can choose to defer the payment to a future anniversary date
- The trust beneficiaries are entitled to any other remaining policy benefits, for example any policy death benefits payable, the early surrender of any of the policies that haven't matured, or the maturity proceeds of any of the policies that mature after the settlor's death
- The trust beneficiaries are chosen by the settlor at the outset and must be a person or people or an identifiable group but the settlor can't be a beneficiary

The mechanics of setting up a flexible reversionary trust vary from provider to provider. Some arrangements provide for the bond or policies to be placed directly into a trust which sets out the rights of the settlor and those of the beneficiaries. Others put the policies into bare trust for the settlor and then assign the equitable rights under the policies to a trust which sets out the respective rights of the settlor and beneficiaries.

In either case, provided the settlor's retained rights are carved out from the property that is gifted then the arrangement will not be a gift with reservation. In addition, the settlor's retained rights do not give rise to a charge under the pre-owned assets tax legislation.

Income tax

On the settlor's death, if the settlor is the only life assured, or the last surviving life assured, the arrangement will come to an end and the death benefit will be paid to the trustees for the benefit of the trust beneficiaries. There will be chargeable events on any remaining policies with the income tax assessed on the settlor as if they had owned the policies personally and payment of any tax due will be dealt with by the personal representatives as part of the administration of the estate, but can be reclaimed from the trustees.

If there are remaining lives assured, the policies don't come to an end so there is no automatic chargeable event. The trustees can decide whether to surrender some or all the policies or leave some or all of the policies to reach their maturity dates, when they will be paid to the beneficiaries. If the trustees choose to encash any policies in the tax year in which the settlor died, the income tax assessment falls on the settlor (as above), but if in a later tax year, the trustee tax rate applies. The arrangement can continue until the death of the last life assured, at which point the death benefit is payable to the trustees for the benefit of the beneficiaries. Any chargeable gains are assessed on the trustees.

Inheritance tax (IHT)

The gift into trust is a Chargeable Lifetime Transfer (CLT) for IHT purposes. If the CLT, plus the total of any previous CLTs made by the settlor in the past seven years, exceeds the Nil Rate Band (currently £325,000), there will be an immediate liability to IHT on the excess, at the lifetime rate of 20%.

Any growth on the plan is immediately outside of the settlor's estate for IHT purposes.

If the settlor lives for at least seven years, the gift to the trust will drop out of their estate and will not be subject to IHT on their death. If they die within seven years, some IHT may be payable, and the extent will depend on how soon they die after making the gift and the amount of the gift. The trust may be subject to potential future IHT charges, in the form of periodic and exit charges. Periodic charges are assessed every 10 years and exit charges may arise whenever capital is paid out from the trust to the beneficiaries (but not from maturing policies paid to the settlor).

Why use a flexible reversionary trust arrangement?

Flexible reversionary trusts are similar to discounted gift trusts (DGT) in that each involves the settlor transferring a bond or a series of endowment policies into trust and retaining the right to certain benefits. However, the DGT is less flexible as the settlor's 'income' rights are defined at outset and can't easily be changed without inheritance tax consequences whereas the flexible reversionary trust arrangement gives the settlor the option of whether to take or defer each maturity payment. The DGT also requires underwriting but does usually offer an immediate reduction to the settlor's estate by way of the 'discount' element which isn't a feature of the flexible reversionary trust arrangement.

When comparing to a loan trust, the flexible reversionary trust offers greater inheritance tax benefits as the amount placed in trust is outside the settlor's estate after seven years whereas with a loan trust the amount placed in the trust is only a loan and remains part of the settlor's estate – only the growth on the loan is outside the settlor's estate. But of course the loan amount remains fully accessible to the settlor.

So with a flexible reversionary trust, the amount gifted (the CLT) is the full amount placed in the trust. With a DGT the CLT (assuming a discretionary trust is used) would be the amount gifted less the discount. With a loan trust there is no gift so no CLT or PET is made.

Advantages of flexible reversionary trust arrangements

- Whole gift is outside the settlor's estate after seven years
- Growth is immediately outside the settlor's estate
- Benefits can be paid to the settlor at each maturity, but only if required, so more flexible than a DGT
- Benefits can be paid to beneficiaries at any time (a DGT is usually more restrictive in this respect as providing the settlor's defined income is a priority)
- Assets within the trust won't form part of beneficiaries' estates
- Policies can be appointed
- Trustees have control over who benefits from the trust
- No underwriting required

Disadvantages of flexible reversionary trust arrangements

- Benefits will be exhausted should all the maturities be taken
- Any growth on the policy maturities or surrenders may be subject to an income tax charge
- Gift is limited to the available nil rate band if 20% IHT is to be avoided at outset
- Potential for periodic or exit charges depending on values
- Should the settlor die within seven years, the value of the gift is liable to IHT on death – no discount
- No 5% allowance available to the settlor during settlor's lifetime
- Need liquid assets to make the investment
- Life expectancy of at least seven years

Trust Registration Service (TRS)

The TRS is a government register of the beneficial ownership of trusts. From 6 October 2020 the scope of the TRS was extended. The new rules are to ensure that the UK has an anti-money laundering and counter terrorist financing regime that is; up to date, effective, and proportionate. The rules will improve transparency about the ownership of assets held in trust.

The Flexible Reversionary Interest Trust will need to be registered on the TRS. The deadline for registration is 90 days from trust creation.

Where the investment within the trust is an offshore bond effected in Ireland, the trust also needs to be registered on the Irish Central Register of Beneficial Ownership of Trusts (CRBOT) although this isn't possible at time of writing while the Irish Revenue simplify the process for non-resident trustees (the current position is shown within the 'CRBOT FAQs and troubleshooting for UK trustees and advisors' document).

The trustees can designate a 'lead trustee' to register the trust or an 'agent'. The 'agent' would need to be a business which operates as an accountancy service provider.

Risk considerations

There are a number of risk considerations that need to be taken into account, and it's important that you are aware of these:

- Past performance is no guarantee of future returns
- If growth is low, charges may eat into the capital invested
- The price of units and the income from them can fall as well as rise
- The value of this investment is not guaranteed and on encashment the settlor/trustees/beneficiaries may not get back the full amount invested
- A surrender penalty may apply if you encash this investment in the early years
- If withdrawals are made at a rate which exceeds the net growth of the fund, capital will be eroded
- Where regular maturity amounts are taken, if these amounts aren't spent they will simply accumulate in the settlor's estate, negating the IHT benefits of the scheme
- Similarly, if the maturity amounts are taken and not spent, but gifted away, they will be subject to the usual gifting rules (to the extent that they are not covered by an exemption) and remain part of the settlor's estate for seven years
- The arrangement involves the absolute transfer of capital to the trust - apart from the 'income' available by choosing to take the maturity values, the settlor has no access to the capital once the plan is in force
- There may be occasions when an individual fund or funds may have a higher risk rating than the settlor's/trustees' overall stated attitude to risk. If this is the case, then the overall risk rating applied to all of the combined funds being recommended is still designed to meet the stated risk tolerance.

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