

Controlling Trust Access Beyond Age 18

By David O'Connor

Introduction

Before the Finance Act 2006 tax changes, the Accumulation & Maintenance (A&M) Trust was an ideal solution for grandparents or parents wishing to make provision for children. The Trust was a Potentially Exempt Transfer (PET) provided the following conditions were met:

- *The beneficiaries were the grandchildren of a common grandparent*
- *The children had to achieve a vested interest by age 25, although this could be a right to income rather than capital*
- *The Trustees could use Trust funds for the maintenance and education of the beneficiary*

This meant that considerable gifts could be made without an immediate tax charge.

Probably the most attractive feature of the old A&M Trusts was that they prevented the beneficiaries from becoming absolutely entitled to the property at the age of 18, this being considered too young by many parents and grandparents.

Post Finance Act 2006

The preferred option by many seems to be the use of a Discretionary Trust because of the ability to defer the beneficiary's entitlement to the Trust fund to a later date. However this route attracts periodic and exit charges. It also restricts the amount being placed within the Trust to the current Nil Rate Band (NRB) of £325,000 before attracting lifetime Inheritance Tax (IHT) at 20%.

The Alternative

There is now a realistic alternative to the old A&M Trust which offers the following features:

- The initial transfer into the Trust is a PET
- All investment income is accumulated throughout the life of the plan. There is no requirement to pay 'income' out by a certain age
- An 'income' can be paid, which is provided by way of maturing policies
- The Trustees can use Trust funds for the maintenance and education of the beneficiary as they could under an A&M trust
- Finally, the investment vehicle is located offshore, so that the investment accumulation is virtually tax-free.

This arrangement is known as a controlled reversion trust (CRT). It is a concept that aims to allow lump sum payments ('income') for child beneficiaries at a time when they need it whilst allowing the Donor to gift in excess of the IHT NRB without incurring an immediate tax liability.

It allows the Trustees to decide before the beneficiary reaches age 18 at what age they should receive further lump sum payments. This provides the level of control required by the Donor, and the Trustees can ensure the beneficiary receives appropriate amounts at the appropriate age.

The CRT is a Bare Trust and therefore there is no quasi NRB restriction on the amount gifted, no ten-yearly periodic charges and no exit charges.

Obviously the Donor needs to live for seven years for the amount of the PET to be excluded from their estate.

The major benefit of this type of arrangement is that the Trustees can defer entitlement to capital well beyond the beneficiary's 18th birthday.



Specialist investment product

This outcome is achieved within the framework of a Bare Trust by the specialist investment product that the Trustees hold as an asset. The product consists of a series of offshore investment

policies. The policies can be allowed to mature on the pre-determined policy anniversary or be deferred if payments are not actually required for the benefit of the child.

Example

Mr Brown wishes to provide for his only grandson Peter (currently aged 7) to fund his private education, university costs and beyond. He envisages that he can help Peter get on the housing ladder at a later date and give financial assistance when Peter has his own family.

He is aware that if he makes gifts at those particular times there could be an inheritance tax issue, and what if he were to die before then? Mr Brown wants to be happy in the knowledge that he has put plans in place to achieve his objectives in the most IHT efficient manner.

He decides to make a gift of £300,000 into a CRT and selects Peter's parents as Trustees along with himself.

The Trustees purchase the investment policies, which are established to provide maturities over 15 consecutive years commencing when Peter is ten.

Prior to Peter's 18th birthday,

the Trustees can vary the dates of the maturities allowing them to extend the final vesting dates if they feel it is appropriate.

Peter's private education costs are £20,000 a year, therefore the trustees arrange for policies to mature each year from age ten for the next eight years with any investment growth taking care of any inflation in the school fees.

In the final year preceding Peter's 18th birthday, the Trustees have to make the decision as to when they want the remaining policies to mature. The policies could therefore all be deferred to age 25 if Peter chooses not to go to university, or could be arranged to mature in consecutive years from age 25 until they have all matured.

In this example however, the Trustees decide to defer the maturity dates to provide for Peter's continuing education at university, then provide him with lump sums at ages 25 and 30 with the final balance payment at age 35.

The proceeds of any policies maturing after the beneficiary's 18th birthday have to be paid to the beneficiary, but as none of the policies have any surrender rights this makes it impossible for a child beneficiary reaching their 18th birthday to demand the encashment of the remaining policies.

As the likely donor will be either a grandparent or possibly a parent, it is important to note that there is a difference as to who is liable for the potential income tax liabilities on any maturing investment policies.

If the grandparent makes the gift, any potential liability always falls on the child as the Bare Trust beneficiary, who will usually have a personal allowance to offset against any gains.

Alternatively, if the parent makes the gift, any potential liability would fall on the parent until the child's 18th birthday or their earlier marriage.

Conclusion

This is a realistic alternative to using an 18-25 Trust or a Discretionary Trust and offers great flexibility for the Donor to ensure his or her objectives for the future of the beneficiary are met whilst being as tax efficient as possible.

Professional advice should always be taken before entering in to an investment contract.

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