Zurich International Portfolio Bond

Bare Gift Trust adviser guide

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The growing scope of inheritance tax

Inheritance tax (IHT) can significantly diminish the amount passing to a person’s beneficiaries on death. On a person’s death, IHT applies at a flat rate of 40% on the excess over the nil rate band. This is £325,000 for the 2012/13 tax year and will remain frozen until 6 April 2015.

For some married couples (including civil partners) the introduction of the transferable nil rate band by the Finance Act 2008 has helped to reduce the potential IHT bill on their estates. This is because any percentage of the nil rate band not used on the death of the first of such a couple to die can be utilised on the survivor’s subsequent death. Whilst this is a welcome relief, many married couples will find that the value of their combined estates may well still exceed the threshold above which IHT is payable. For example, based on a nil rate band of £325,000, on the death of a surviving spouse with a taxable estate of £1 million an IHT charge of £140,000 would still arise even though two full nil rate bands may be available.

Using lifetime gifts to reduce IHT

One very effective way to avoid IHT is to make lifetime gifts. Lifetime gifts that are potentially exempt transfers (PETs) give rise to no IHT when made. However, following the new rules introduced by the Finance Act 2006, the scope for making PETs has been severely restricted so that only outright gifts to other individuals or gifts to bare (or absolute) trusts and trusts for the disabled qualify as PETs.

For a gift to be effective for IHT, the donor cannot retain any access to the property gifted or the income from it as otherwise the gift with reservation (GWR) rules will apply. These rules, which apply when a donor makes a gift and continues to enjoy a benefit from the asset gifted without paying for that benefit, mean the value of the gifted asset continues to form part of the donor’s taxable estate for IHT purposes and so no IHT saving results.

As well as the GWR rules, the changes to the taxation of gifts introduced in 2006 also need to be considered. Under provisions in the Finance Act 2006 all trusts created during a settlor’s (donor’s) lifetime (other than bare trusts and trusts for the disabled) are now treated in the same way as discretionary trusts for IHT purposes.

This means:

- gifts that cause a person to exceed their available nil rate band (taking into account chargeable lifetime transfers (CLTs) made in the previous seven years) will give rise to an immediate 20% IHT charge on the excess over the nil rate band;
- there can be a periodic charge every ten years, generally equal to a maximum of 6% of the excess of the value of the trust fund over the available nil rate band at that time;
- capital leaving the trust could be subject to an IHT charge of up to 6%.

In addition, IHT calculations will need to be carried out and tax returns may need to be made to HM Revenue & Customs (HMRC).

A bare trust such as the BGT, is not a settlement for IHT purposes. Therefore, provided a donor is prepared to forego all flexibility over who eventually benefits from the trust fund on their death, PET treatment of the initial gift and avoidance of the periodic and exit charges to IHT is still possible.

Introduction

In this guide the term ‘spouse’ includes registered civil partner. Tax rules apply to registered civil partners in the same way as they apply to married couples.
1. The main benefits of the Bare Gift Trust (BGT) – investor suitability

The BGT enables an investor to:

- make a tax efficient investment into an Investment Bond held in trust for the benefit of a named Beneficiary or named Beneficiaries (as appropriate) which gives rise to a lifetime gift which is a PET, i.e. without an immediate IHT liability arising regardless of the size of the gift;
- avoid any risk of periodic or exit charges in connection with the Trust;
- avoid any IHT implications on survival of the gift by seven years; and
- ensure that investment growth accrues outside of their estate during their life and (where appropriate) the life of their spouse from outset.

2. Who is the BGT not suitable for?

Broadly speaking, where the benefits summarised above are not required or valued by the investor, the BGT will not be suitable.

More particularly, the BGT is not suitable for persons who are not prepared to forego the flexibility over who benefits from the Trust Fund.

It also will not be suitable for persons who cannot afford to give up access to the investment held subject to the BGT.
3. How does the BGT work?

(i) The Zurich International Portfolio Bond (the Plan)

The underlying investment of the BGT is a Plan that, depending on the version chosen, may be a whole of life insurance policy or a capital redemption policy. An investment in a non-income producing asset, such as a life insurance policy or capital redemption policy, means that trust administration is minimised and the investor is substantially sheltered from any personal income tax during the Plan’s existence.

Under the BGT the Donor can transfer a new or existing Plan to the Trust.

If the life insurance version is chosen, the Plan should be effected on the lives of the Beneficiary(ies) and, if more than one, on a joint lives last survivor basis so that the Plan can continue until the last Beneficiary dies.

(ii) The Trust

The Donor and additional Trustees appointed by the Donor execute a Deed of Trust which sets out the terms of the gift. The Donor transfers the Plan to the Trustees. Legal ownership of the Plan then vests in the Trustees.

The Trust Fund is held on bare trust for the named Beneficiary(ies). This means that neither the Beneficiary(ies) nor their share(s) can be changed.

4. The inheritance tax effects of the BGT

(i) Establishing the Trust

The creation of the Trust will give rise to a transfer of value by the Donor for IHT purposes based on the value of the gift. If there are joint Donors each will be treated as making 50% of the total investment for the purposes of calculating the gift.

As the Trust is one that vests an absolute entitlement in the Beneficiary(ies), this transfer will be a PET except to the extent that it is exempt (e.g. where the value transferred falls within the available annual exemption which is currently £3,000). It is also possible to use any unused annual exemption carried forward from the previous year so that a maximum of £6,000 per Donor could be exempt if no gifts were made in the previous tax year.

This means that there will be no IHT charge when the transfer is made and the possibility of a charge will only arise should the Donor die within seven years of making the gift – see overleaf.

(ii) Does HMRC need to be informed about the BGT?

As the gift is a PET, there is no need to inform HMRC about it when the BGT is established.
(iii) What are the IHT implications of the Donor dying within seven years of establishing the BGT?
If the Donor does not survive the gift by seven years, the PET will become chargeable. Even then, a liability would only arise on the gift if the Donor’s available nil rate band was exceeded.

Any tax liability that does arise on the gift would benefit from taper relief if more than three years had elapsed from the date of transfer. Broadly speaking, where a PET becomes chargeable, this relief reduces the IHT due by 20% for each full year after three years, until after seven years there is no tax liability.

It is important to note that, regardless of this relief, the full value of any PET (at the time it was made) that becomes chargeable, by virtue of the Donor’s death within seven years of making the PET, will have to be taken into account when assessing the IHT liability on the estate of the Donor.

(iv) What are the IHT implications for the Trust itself?
As this is a bare trust, the special IHT charging rules that apply to other types of trust do not apply here.

The value of the Plan is treated as part of the estate of the Beneficiary(ies) and so the only IHT implications to arise do so if the Beneficiary were to die.

5. The Trustees and Beneficiaries
(i) Who can be Trustees of the BGT?
The Donor will automatically be the first Trustee and will usually remain a Trustee. Additional Trustees should be appointed and this is contemplated in the Trust Deed at outset. Anyone over 18 years old and of sound mind may be appointed. It may be appropriate to appoint a professional adviser, such as a solicitor or accountant, as a Trustee, although such a person is likely to charge a fee for acting as Trustee. It is essential that at least one additional Trustee survives the Donor if probate is to be avoided following the Donor’s death.

(ii) Who are the Beneficiaries under the Trust?
The Trust Fund is held on bare trust for the named Beneficiary or Beneficiaries. As the Trust is a bare trust, neither the Beneficiaries nor their shares if there is more than one Beneficiary can be changed.
6. The investments of the BGT
(i) What investments can be held in the BGT?
The BGT is provided for use with the Zurich International Portfolio Bond (the Plan), new or existing, and regardless of whether it is based on a life insurance or capital redemption version.

(ii) What are the income tax implications of the BGT?
An income tax chargeable event gain can arise in the event of the Plan being encashed or a part surrender of more than the cumulative 5% tax deferred annual allowances being taken.

As the Plan is an offshore investment plan, there is no UK tax deemed to have been paid on any gain, with the result that the full amount of the gain is subject to UK income tax. This is different from the income tax treatment of gains within a UK-based plan, where basic rate tax is deemed to have been paid within the plan, and gains are only taxed when they take the taxpayer into the higher rate or additional rate of tax. Whether any tax is payable and, if so, how much, will depend on the circumstances.

Any gains are taxed on the Beneficiaries, regardless of the age of the Beneficiary, unless the Donor is the parent of the Beneficiary and the Beneficiary a minor who is not married and not in a civil partnership. If the Donor is the parent of such a minor Beneficiary, any chargeable gains are assessed on the Donor.

Before April 2007 the assessment would be on the Beneficiary only if the Beneficiary was at least 18 years of age. A person who is assessed to tax on the gain may, if it is available, use any unused personal allowance to set against the gain.

The above rules apply regardless of whether the Plan is based on the life insurance or capital redemption version.

7. Other important questions
(i) Should spouses each set up their own individual BGT?
There is no objection to this, as neither spouse would be a Beneficiary of the other’s Trust. However, they could also effect one (joint life) Plan subject to a joint Donor Trust. You will need to advise your client(s) on the most appropriate choice based on their circumstances.

(ii) What are the capital gains tax implications of the BGT?
A life insurance or capital redemption bond, such as the Zurich International Portfolio Bond, does not produce gains that are subject to capital gains tax.

(iii) Is stamp duty payable?
With effect from 1 December 2003, stamp duty on documents was abolished which means that a declaration of trust no longer needs stamping.

(iv) Can the Plan be added to at a future date?
Further investments into the Plan are permitted. They will be held subject to the same Trust.

(v) Can the Trustees encash segments of the Plan and pay the proceeds to the Beneficiaries?
The Trustees can encash segments, take part withdrawals or assign segments to the Beneficiary. If the Beneficiary is a minor, payments would normally be made to the Beneficiary’s parent or guardian but must be used for the benefit of the Beneficiary. An assignment of a policy or a segment can only be made to a Beneficiary who is over 18 years of age.

(vi) Can an investor get their money back after making the investment?
Yes, they can. When we issue the Plan documents, we’ll send your client details of how to cancel their Plan. They will have 30 days from receiving these documents to do this.

If they decide to cancel, we’ll give them their money back. However, what they get back may not be the amount they invested – they may get back less.
The amount they will get back will be the lower of the amount they invested and the value of their transaction account after we have sold the assets that they have already invested in.

They can also cancel before they receive their Plan documents by calling us, or you notifying us on their behalf.

If they invest in assets that are not priced daily, there may be a delay in paying the cancellation value until all trades have been completed.

Please refer to the Plan’s Terms and Conditions for full details.

(vii) Is there any income tax on final encashment of the Plan?
Chargeable event gains arising on full encashment of the Plan can be taxable. The full implications were described in the answer to the above question ‘What are the income tax implications of the BGT?’ in section 6(ii).

(viii) What are the charges associated with an investment in the BGT?
You should look at Zurich Life Assurance plc’s literature on the International Portfolio Bond in order to determine the charges made on such an investment.

(ix) How do you set up a BGT?
The Donor and the additional Trustees complete the BGT Deed. Completion instructions are included in the Trust Deed.
Creating a trust is an important matter and has lasting legal and tax consequences. This guide is for your general information only and cannot cover every situation. If you are in any doubt about the purpose or effect of this Trust, you should consult your own legal advisers.

The Trust, once created, is irrevocable and the Plan and its benefits must be held according to the terms of the Trust. The Trustees will be in control of the operation of the Trust, which means that they may need to set up a Trustee bank account. Any benefits arising because of the exercise of options available under the Plan will also be held subject to the Trust.

Taxation law is subject to change. Such changes cannot be foreseen. The information in this guide is based on our understanding of current law and HMRC practice (November 2012). Although every care has been taken in the preparation of this guide and the draft Trust Deed, neither Zurich Life Assurance plc nor any of its officers, employees or agents accept responsibility for the operation of the Trust.

Your attention is drawn to the ‘Important information for the Donor’ section of the Trust Deed.
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