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**Introduction**

**Trusteds and probate**
When someone dies their legal personal representatives (LPRs) must sort out their estate. They are called executors if there is a valid Will or administrators if there is no valid Will. Before the LPRs can act they must apply for a grant of probate (letters of administration if there is no valid Will). For simplicity, in this guide the term ‘probate’ is used whether there is a valid Will or not.

Depending on how complicated the estate is, the process of obtaining probate may take from a few weeks to several months. Importantly, before probate is granted, any inheritance tax (IHT) liability on the estate must be settled. Until probate is granted the assets in the estate of the deceased cannot be dealt with and, of course, funds are not available for the intended beneficiaries. If the asset is located outside the UK, as is the case with the Zurich International Portfolio Bond (the Plan), separate probate may need to be obtained in the relevant jurisdiction which will also add to the delay and costs.

However, probate is not needed where an asset is held subject to a valid trust.

The exception is a trust under which someone is entitled absolutely to the trust assets or has a general power under the trust to deal with the assets (including for their own benefit). For this reason, if a trust is to avoid probate, that trust must include certain restrictions – see below.

Of course, even if the trust assets are not included in the estate for probate purposes, they will still be included in the estate for IHT purposes if the deceased was one of the trust beneficiaries as will be the case under the PT.

Another issue to remember is that if the settlor was the sole trustee of the trust, although the trust assets are likely to be outside his estate for probate purposes on his death, probate will still be necessary to establish who the new trustees are. It is therefore essential that additional trustees, who are likely to survive the settlor, are appointed.

**Avoiding probate with lifetime trusts**
As part of lifetime planning certain steps can be taken to avoid probate, perhaps on some of the assets, so that the individual retains access during lifetime but so that the assets are available to other beneficiaries on his death without having to wait for probate. This can be achieved by transferring assets to a PT.

Prior to 22 March 2006 it was possible to create a probate trust that was neutral for IHT purposes as the initial transfer into the trust was not treated as a transfer of value for IHT purposes and the value of the trust property simply remained in the estate of the settlor. Unfortunately, the rules changed and from 22 March 2006, a transfer of assets to such a trust would be a chargeable lifetime transfer and the trust subject to the IHT regime involving potential periodic and exit charges as well as possible reporting to HM Revenue & Customs (HMRC). Also, as the settlor can benefit from the trust, the trust property will be treated as subject to the reservation of benefit rules.

Apart from the tax implications arising under the PT, the prospective settlor must be happy that they will no longer have the absolute right to the capital of the trust and must rely on the unanimous decisions of the trustees before they can have access to the funds in the trust. Whilst the settlor will be a trustee, other trustees must exist for an appointment to be made to the settlor.

For all these tax and practical reasons, probate trusts have lost some of their attraction, although, if it is desired to ensure that funds are available to beneficiaries immediately following an investor’s death, they may still be appropriate if the sums involved do not cause the investor to exceed the available nil rate band.

The PT is only available for individual investors. It cannot be used for investments held or to be made in joint names, for example by husband and wife.
1. The main benefits of the Probate Trust (PT) – investor suitability
The PT enables an investor to:

- make a lifetime gift of the Plan whilst retaining flexibility over who will ultimately benefit from the gift;
- retain access to the investment for their own benefit in the future at the discretion of the Trustees; and
- most importantly, avoid probate on the investment on their death (as long as there is a surviving Trustee).

2. Who is the PT not suitable for?
Broadly speaking, where the benefits summarised above are not required or valued by the investor, the PT will not be suitable.

More particularly, the PT is not suitable for persons who:

- do not wish to retain access to the Plan or part of it for their own benefit;

or

- wish to make an outright immediate gift and require no flexibility or control (subsequent to the gift) over its final destination;

or

- wish to make a gift to a trust that is effective for IHT.

3. How does the PT work?

(i) The Plan
The underlying investment of the PT is a Zurich International Portfolio Bond (the Plan) that, depending on the version chosen by the Settlor, will 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 PT, the Settlor 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 some or all of the Beneficiaries on a joint lives last survivor basis so that the Plan can continue until the last Beneficiary dies. Up to ten lives can be included. No life insured is necessary under the capital redemption version.

(ii) The Trust
The investor (who is known as ‘the Settlor’) and additional Trustees appointed by the Settlor execute a Deed of Trust which sets out the terms of the gift. The Trust Deed is called the ‘Discretionary Gift Trust Deed (Settlor included)’.

The Trust operates as follows:

- The Trust Fund is held on discretionary trust. This means that no Beneficiary has a fixed right to any benefit. The Trustees decide who, from the class of discretionary Beneficiaries (which includes the Settlor), should receive what benefit from the Trust and when.

- The Settlor names the Default Beneficiary(ies) at outset. This is/These are the person/people the Settlor would ultimately like to benefit from the Trust after their death. However, the Default Beneficiary(ies) will only benefit if the Trustees make an absolute appointment to them or when the Trust ends after 125 years with no appointment having been made by the Trustees.

- If an appointment is to be made to the Settlor, it must be made by a minimum of two Trustees, one of whom is not the Settlor or the Settlor’s spouse. This provision is needed to ensure that the Trust is an independent structure and holds property that no longer belongs to or is under the control of the Settlor.
4. The inheritance tax effects of the PT

(i) Establishing the Trust
The creation of the Trust by the Settlor (with either a new or existing Plan) will give rise to a chargeable lifetime transfer (CLT) for IHT purposes.

If the gift causes the Settlor’s nil rate band to be exceeded, there will be an immediate 20% IHT charge on the excess over the nil rate band. For these purposes, CLTs made in the previous seven years need to be taken into account but allowing for any available annual exemptions.

If the CLT causes the nil rate band to be exceeded and the Settlor is to pay the IHT, this will mean that the gift needs to be ‘grossed-up’ so that the actual amount of the loss to the estate on which tax is payable takes account of the tax payment.

Example
John transfers his Plan to a PT which results in a CLT of £340,000. He has made no CLTs in the previous seven years and his annual exemptions have been used elsewhere. Either the Trustees can pay IHT of £3,000 (i.e. 20% of £340,000 – £325,000) or John can pay IHT of £3,750 (i.e. 20% of £343,750 – £325,000).

A further tax liability (at 20%) on the gift could arise if the Settlor dies within seven years of making the transfer (see point (v) of this section).

It is not recommended that the Settlor makes a gift in excess of their available nil rate band. This is not only so that no immediate tax liability arises but also to avoid the practical difficulties that this may give rise to. For example, if the Trustees were to pay the tax, they would need cash to do so. This would not be possible if an existing Plan is being gifted. For a new investment, they would need to keep some of the cash gift back in order to fund the tax and so the amount of cash available for investment would be reduced. They would also need to open a bank account which the Settlor’s gift cheque would have to be paid into first, so it would not be possible for the Settlor to simply make a cheque payable to Zurich.

If, on the other hand, the Settlor were to pay the tax, the gift would have to be grossed-up and the grossed-up figure used in all IHT calculations, and this is likely to be more complicated.

For the purpose of this guide, we assume that the initial gift is fully covered by the Settlor’s available nil rate band.

As the Settlor can benefit from the Trust, the gift amounts to a gift with reservation of benefit (GWR) which means that the value of the Plan will remain in the Settlor’s estate for IHT purposes – see point (iv) below for more details on this.

(ii) How is the size of the gift determined?
For new Plans, the investment made will be treated as a transfer of value for IHT purposes and will be a CLT. For existing Plans, the value of the gift will be the value of the Plan (or the initial investment made, if greater, less any part surrenders, less an allowance for any decrease in the value of units since allocation at inception of the Plan).

As mentioned above, it is not recommended that gifts are made if they cause the Settlor’s available nil rate band to be exceeded, as an immediate tax charge at 20% will then arise.

(iii) Does HMRC need to be informed about the PT?
Whether a gift will need to be reported to HMRC depends on the amount of the gift and the nature of the asset gifted. The gift will need to be reported in the following circumstances:

(1) Where the gift is of cash (this includes a new Plan), it causes the donor to exceed the then nil rate band taking account of CLTs made in the previous seven years or,

(2) Where the gift is of an existing Plan, it either causes the donor to exceed 80% of the then nil rate band, taking account of CLTs made in the previous seven years, or the amount gifted exceeds the then nil rate band less CLTs made in the previous seven years.

If the gifts need to be reported to HMRC, Inheritance Tax, the Settlor must do so on forms IHT100, IHT100a and D34.
(iv) What are the implications of the gift being a GWR?
The PT gives rise to a GWR for IHT purposes which means the value of the Trust Fund effectively remains in the Settlor’s taxable estate for IHT purposes as long as he remains a Beneficiary. This will use all or a part of the Settlor’s nil rate band at the date of death and will affect the amount of any transferable nil rate band available to the surviving spouse of the Settlor.

If the Settlor dies within seven years of creating the PT there could be a potential double tax charge by virtue of the Settlor having made a chargeable lifetime transfer to the Trust and because the Settlor has reserved a benefit in the Trust Fund because of his inclusion as a Beneficiary.

However, the IHT legislation provides relief from a potential double charge to IHT. In these circumstances it is necessary to carry out two sets of tax calculations – see point (v) below.

(v) What are the IHT implications of the Settlor dying within seven years of establishing the PT?
If the Settlor dies within seven years of creating the PT, there could be a potential double charge to IHT by virtue of the Settlor having made a chargeable lifetime transfer to the Trust within seven years of death and because the Settlor has reserved a benefit in the Trust.

To deal with this situation, the Inheritance Tax (Double Charges Relief) Regulations 1987 give relief from a double charge. The relief works as follows.

First, it is necessary to calculate the total tax chargeable as a result of the Settlor’s death in two sets of circumstances:

(A) include the gift with reservation in the estate but ignore the original gift, and

(B) include the original gift but ignore the gift with reservation.

The amount of tax payable is the higher of the amounts produced in calculations (A) and (B), as illustrated in the example.

The facts
On 15 March 2003, Dave made a gift of £300,000 (net of annual exemptions) to a discretionary trust under which he is a potential beneficiary. The gift was therefore a gift with reservation (GWR). Also, because the gift was a CLT (and because the nil rate band was £250,000 in 2002/03), IHT of £10,000 was payable at the time.

Dave died on 1 February 2010 without having released his interest in the trust. His estate was valued at £80,000 and the trust fund was then worth £370,000. The nil rate band for 2009/10 was £325,000 and will remain frozen until 2018.

### First calculation (A):
Include the trust fund now worth £370,000 in Dave’s death estate as a GWR and calculate the IHT ignoring the gift.

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Value (£)</th>
</tr>
</thead>
<tbody>
<tr>
<td>15 March 2003</td>
<td>Original gift (ignored)</td>
<td>—</td>
</tr>
<tr>
<td>1 February 2010</td>
<td>Taxable death estate – £450,000</td>
<td>125,000</td>
</tr>
<tr>
<td></td>
<td>(£370,000 trust fund plus £80,000 estate) less</td>
<td></td>
</tr>
<tr>
<td></td>
<td>nil rate band (£325,000)</td>
<td>125,000</td>
</tr>
<tr>
<td></td>
<td>Tax on death estate</td>
<td>50,000</td>
</tr>
<tr>
<td></td>
<td>Less tax already paid on gift</td>
<td>10,000</td>
</tr>
<tr>
<td></td>
<td>Total tax due as a result of Dave’s death</td>
<td>40,000</td>
</tr>
</tbody>
</table>

### Second calculation (B):
Include the gift but ignore the trust fund in the death estate.

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Value (£)</th>
</tr>
</thead>
<tbody>
<tr>
<td>15 March 2003</td>
<td>Original gift – £300,000</td>
<td>Nil†</td>
</tr>
<tr>
<td>1 February 2010</td>
<td>Death estate (ignoring GWR) as top slice of cumulative chargeable transfers of £380,000</td>
<td>80,000</td>
</tr>
<tr>
<td></td>
<td>Tax thereon (£380,000 – £325,000) @ 40%</td>
<td>22,000</td>
</tr>
<tr>
<td></td>
<td>Total tax due as a result of Dave’s death</td>
<td>22,000</td>
</tr>
</tbody>
</table>
Notes to the example

(i) The first calculation gives the higher amount of tax and so this applies.

(ii) If the donor (Dave) dies within seven years of his gift, it is normally necessary to recalculate IHT at the death rates (and apply taper relief if appropriate). In our example, the original gift that Dave made will now be fully covered by the nil rate band. However, the £10,000 tax already paid is not recoverable nor can it be set against the £22,000 IHT due on the free estate.

(vi) What are the IHT implications for the Trust itself?

As this is a discretionary trust, this means that special IHT charging rules apply. These apply despite the GWR provisions applying. Under these rules there may be IHT charges:

• on every ten-year anniversary of the Trust – ‘the Periodic Charge’, and/or
• whenever property leaves the Trust (e.g. when capital is advanced to a Beneficiary) – ‘the Exit Charge’.

The Periodic Charge

Periodic charges at ten-yearly intervals are, broadly speaking, applied to the value of the assets in the Trust.

The effective rate of IHT will be determined based on an assumed transfer by an assumed transferor. This will mean that it will broadly be necessary to take account of:

• the value of the property in the Trust on the ten-year anniversary and any other trust set up on the same day (the assumed transfer) and,
• the Settlor’s cumulative total of CLTs made immediately before the Trust was established plus any sums paid out of the Trust in the ten years prior to the anniversary (the cumulative total of the assumed transferor).

The maximum liability will be 6% of the value of the trust property but frequently it will be much less or nil.

In cases where the Settlor has not made any CLTs in the seven years before the Trust is created, no payments have been made out of the Trust in the previous ten years and there has been no added property, there will be no liability provided the value of the Trust does not exceed the nil rate band applicable at the ten-year anniversary. Any excess over the then nil rate band will suffer IHT at 6%.

Example

Kevin creates a PT in July 2009 for £250,000. Kevin has made no CLTs in the previous seven years. No payments are made out of the Trust in the first ten years.

In July 2019 the Trust Fund is worth, say, £385,000 and the nil rate band is, say, £400,000. No IHT is payable.

Had the value of the Plan (and so the value of the relevant property in the settlement) been £450,000, then IHT of £3,000 would have arisen (£50,000 @ 6%). This equates to a charge at 0.66% on the whole value of the trust property.

If all the Trust Fund is distributed before the tenth anniversary, no tax charge will arise (see next section). If assets remain in the Trust after a distribution (or in the unlikely event of further assets being added to the Trust), the Trustees will need to obtain specialist tax advice.

The Exit Charge

Exit charges will be based on the value of property leaving the Trust.

There will be no exit charges within the first ten years of the PT’s existence if the value of the initial CLT going into the Trust (i.e. the gift) plus the cumulative total of the Settlor’s CLTs in the seven years prior to creating the Trust is below the nil rate band when the Trust is created, assuming no property has been added to the Trust. If an exit charge does arise, it will increase according to the number of quarters that have expired since the Trust was created.
The amount of any exit charge occurring after the first ten years will depend on the rate of tax charged at the previous ten-year anniversary (if any) and the length of time (in quarters) that the property has been in the Trust since the last periodic charge. If there is no periodic charge at the immediately preceding ten-year anniversary then there will be no exit charge in the next ten years.

Example
In July 2025, six years since the first ten-year anniversary, the Trustees of Kevin's Trust pay £50,000 to Kevin. Assuming the rate of IHT paid at the last ten-year anniversary was 0.66%, the IHT charge will be £50,000 x 0.66% x 24/40 = £198.

No IHT charge will arise on property paid out of the Trust if there was no IHT charge at the last ten-year anniversary.

An exit charge will not arise on loans made by the Trustees to the Beneficiaries.

The occasion of a periodic charge and transactions that can give rise to an exit charge, such as capital payments to the Beneficiaries, may also need to be reported to HMRC on forms 100c and 100d (and form D34 where a life insurance bond is involved) if they exceed a certain amount.

5. The Trustees and Beneficiaries
(i) Who can be Trustees of the PT?
The Settlor will automatically be a Trustee. Additional Trustees must 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 is appointed and survives the Settlor if probate is to be avoided following the Settlor’s death. In addition, certain trust powers, including the power of appointment, are exercised by the Trustees jointly and there must be at least two Trustees if any appointment is to be made to the Settlor.

(ii) Who are the Beneficiaries under the Trust?
The trust benefits are held on discretionary trust for such of the Beneficiaries as the Trustees decide. As the Trust is discretionary, no Beneficiary is entitled to anything until the Trustees make an appointment in their favour.

If any income arises to the Trustees from the trust investments (not relevant while the sole trust asset is the Zurich International Portfolio Bond), they can either accumulate it during the Trust Period or distribute it (or some of it) to whichever Beneficiary they decide. However, no Beneficiary will have the right to any income – distributions will be at the discretion of the Trustees.

The Trustees have powers to deal with the trust property, including wide powers to invest, as well as the power to advance capital to any Beneficiary.

Discretionary Beneficiaries are the people to whom the Trustees can appoint benefits and include the following persons:

- The Settlor.
- The Settlor’s spouse/civil partner.
- Children and remoter issue of the Settlor.

(vii) What are the IHT implications of making payments to Beneficiaries other than the Settlor?
The Trustees can appoint benefits to other Beneficiaries if the Settlor no longer needs access to those funds. As the Settlor will be a Trustee, he will be involved in this decision. As with payments to any Beneficiary, there may be an exit charge as explained above. In addition, the Settlor will in effect give up his right of access to those funds which will mean giving up his reserved benefit in that part of the Trust Fund. When the Settlor gives up a reservation of benefit, this is treated as a potentially exempt transfer (PET). Consequently this gift will fall out of account for IHT purposes if the Settlor survives seven years from making this PET.
• Any spouse, widow or widower of the Settlor’s children and remoter issue. For this purpose spouse includes a registered civil partner.

• Any other person whom the Settlor may appoint to the class of potential Beneficiaries.

The Settlor names (as ‘Default Beneficiaries’) the individual or individuals who the Settlor would like to benefit from the Trust Fund if no other appointment is made. However, in order for these people to become entitled to benefits, the Trustees must appoint benefits in their favour. If no appointment is made during the Trust Period, they will become entitled to the Trust Fund at the end of the Trust Period.

6. The investments of the PT
(i) What investments can be held in the PT?
The Trust is only available with a Zurich International Portfolio Bond (the Plan), new or existing, and regardless of whether it is based on the life insurance or capital redemption version.

(ii) What are the income tax implications of the PT?
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.

If the life insurance version is chosen, the death of the last life insured will also be a chargeable event. For a capital redemption policy, the maturity will be a chargeable event.

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. Whether any tax is payable and, if so, how much, will depend on the circumstances.

Chargeable event gains will be taxed on the Settlor if alive and UK resident in the tax year in which they arise. Liability to tax will be at the Settlor’s marginal rate(s). For the purposes of the liability to higher rate or additional rate (income over £150,000) tax only, top-slicing relief will apply so, in general, the gain will be divided by the number of whole years the Plan has been in force.

If the Settlor is not alive in the tax year in which the chargeable event occurs, or is not resident in the UK for tax purposes, the Trustees, if they are UK resident, will be liable for any tax on the gain. The gain will be taxed at the trust rate – currently 45% – except for the gains falling within the £1,000 standard rate tax band available to the Trustees, where the tax charge will be at the rate of 20% only.

If the Trustees are not UK resident, the chargeable event gains will be assessed on any UK ordinarily resident Beneficiaries when, and to the extent that, they receive any benefits from the Trust.

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 PT?
There is no reason why both spouses should not establish their own Trust provided neither is concerned about IHT planning. The PT is for a single Settlor only and not for joint Settlors.

(ii) What are the capital gains tax implications of the PT?
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) Will the POAT apply to the PT?
There will be no income tax charge under the pre-owned assets tax (POAT) rules because the gift is subject to the GWR provisions.

(iv) 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.

(v) Can the Plan be added to at a future date?
Further investments in the Plan are permitted. These would be further CLTs and GWRs for IHT. This is likely to complicate the calculation of periodic and exit charges as well as the tax calculation on the estate and so it is not recommended.
(vi) Can the Trustees encash segments of the Plan and pay the proceeds to the Beneficiaries?
If the Trustees wish to make an advancement of capital to a Beneficiary they can encash a part of or the whole of the Plan and advance cash to the Beneficiary. Alternatively, the Trustees could make an absolute appointment of capital to an adult Beneficiary and assign segments to that Beneficiary in satisfaction of their interest. The Beneficiary must then encash the segments themselves and, in such a case, chargeable event gains will be taxed on that Beneficiary which may produce a lower tax liability than if the Trustees had encashed.
If the payment is to be made to someone other than the Settlor, there may be additional IHT implications – please see section 4(vii) above.

(vii) Why can the appointment of benefits only be made by the Trustees and not the Settlor?
To ensure that the Trust is effective to avoid probate it is essential that it is legally valid. If the Settlor could simply make appointments of benefits in their own favour it could be argued that the whole arrangement is a sham and not a proper trust. In addition, if the Settlor retained a power to appoint benefits amongst Beneficiaries including himself, this would be treated as a ‘general power’ and in such a case the trust assets will be treated as part of the Settlor’s estate for probate purposes.

(x) What are the charges associated with an investment in the PT?
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.

(xii) How do you set up a PT?
The Settlor and the additional Trustees complete the Trust Deed titled ‘Discretionary Gift Trust Deed (Settlor included)’. 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 (January 2015).

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 Settlor’ section of the Trust Deed.
The Zurich International Portfolio Bond is provided by Zurich Life Assurance plc.

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We may record or monitor calls to improve our service.