

This document is for investment professionals only and should not be relied upon by private investors.

# The Bare Loan Trust

Adviser guide

 Adviser Solutions



# Contents

1 Bare Loan Trust – objectives and suitability	3
2 Bare Loan Trust and inheritance tax planning	3
3 Bare Loan Trust – some practical issues	4
4 Bare Loan Trust provisions in detail	4
5 UK tax implications of the Bare Loan Trust	5
6 Notifying HMRC about a Trust	7
7 Further information	7

**IMPORTANT NOTE:**

Fidelity Adviser Solutions cannot give advice regarding the legal or tax effects of the Trusts, and will not accept responsibility for any loss occurring from their use. Investors are strongly recommended to seek independent legal advice before completing the trust deed to ensure the Trust meets their needs. Once established, trusts may be difficult to unwind and gifting money or assets into certain trusts will mean you cease to have access to the money or assets.

## 1 The Bare Loan Trust – objectives and suitability

The aim of the draft Bare Loan Trust Deed is to facilitate effective lifetime inheritance tax (IHT) planning. Potential users of the Bare Loan Trust could be:

- New investors contemplating investments in unit trusts, OEICs and/or SICAVs on the Fidelity Adviser Solutions platform or as Fidelity funds off the platform (in this guide such investments are referred to as “investment funds”); and/or
- Those investors contemplating investment in one or more of the single premium life assurance investment bonds (here called “Bonds”) offered via Fidelity Adviser Solutions.

By using the Bare Loan Trust with Bonds or investment funds, the investor will be able to achieve a gradual reduction in his or her estate for inheritance tax purposes while retaining access to his or her original capital.

The investor using the Bare Loan Trust is called the Lender. The Lender will be the person who creates the Trust, often also called the Settlor of the Trust.

The Bare Loan Trust anticipates that a potential investor in Bonds and/or investment funds who has these objectives could, instead of investing directly in his or her name, lend a sum of money to Trustees to invest in Bonds and/or investment funds to hold on trust for Beneficiaries indicated in the Trust, subject to the right of the Lender to repayment of his or her loan.

With the moneys lent to them by the Lender, the Trustees will collectively apply for the intended investments. When the intended investment is Bonds, the Trustees will normally make an application for a policy on the lives of the Lender and/or some of the Beneficiaries on a joint, or multiple, lives last survivor basis.

To ensure that the Bare Loan Trust is effective for IHT purposes, the Lender cannot benefit from the Trust assets in any circumstances. Indeed, with the Bare Loan Trust, nobody other than the named Beneficiary(ies) can benefit from the Trust in any circumstances, although the Lender is, of course, entitled to repayment of his or her outstanding loan at any time.

The more specific objectives of the Bare Loan Trust can be summarised as follows:

- To gradually reduce the value of the Lender’s taxable estate and to reduce the IHT liability arising on his or her death;
- To allow the Lender tax efficient access to the amount originally invested through capital (loan) repayments; and
- To ensure that all capital growth on the investment accrues outside the estate of the Lender and passes to the Beneficiaries free of inheritance tax.

The investor for whom a Bare Loan Trust may be appropriate would normally:

- Be of an age where IHT planning is relevant;
- Have a net estate (either alone or with a spouse or registered civil partner) for inheritance tax purposes exceeding their available nil rate IHT allowance;
- Have capital to invest or realisable investments available for reinvestment without capital gains tax liabilities;
- Require access to his or her capital, for example, to periodically supplement his or her income;
- Need to know that he or she can call upon the whole (or the remaining part) of the original capital (the loan) invested at any time should he or she need to; and

- Have identified and be certain of the Beneficiaries whom he or she wishes to benefit.

Full details of the UK tax implications of the Bare Loan Trust can be found in Section 5 of this guide.

As well as being able to secure important tax benefits, the Bare Loan Trust offers important probate avoidance advantages. The asset that is subject to the Bare Loan Trust will not be an asset of the Lender’s estate for probate purposes which means that in the event of the Lender’s death, the Trustees can carry on dealing with the investment without waiting for probate or letters of administration on the investor’s estate. Of course, any outstanding loan will form part of the Lender’s estate for probate purposes.

To ensure that the investment can be dealt with without delay in the event of the Lender’s death, the legal ownership of the investment must be with a person or persons other than the Lender. Therefore, bearing in mind that the Lender will be a Trustee, this benefit will only be secured if there is at least one other Trustee who survives the Lender. Under the Bare Loan Trust the Lender is automatically appointed as one of the Original Trustees and further Trustees are appointed in the Trust Deed. If any of the additional Trustees retires or dies before the Lender, a further Trustee or Trustees should be appointed. The power of appointing Trustees vests in the Lender (whilst alive) and then the Trustees.

If no additional Trustees are appointed, or they have been appointed and retired, died or been removed, so that there is no surviving Trustee at the date of the Lender’s death (the Lender therefore being the sole Trustee immediately before his or her death), the Trust will nevertheless continue to exist and the personal representatives of the deceased Lender will assume the role of Trustee. This means that although the Trust investment will not be part of the Lender’s estate for IHT or probate purposes, securing probate or letters of administration to the Lender’s estate will still be necessary to ascertain the deceased’s personal representatives as they will then act as Trustee under the Bare Loan Trust. Clearly, it is very important that additional Trustees are appointed who are likely to survive the Lender so as to ensure that any delays in being able to deal with the Trust investments are avoided.

The Bare Loan Trust is available only to individual investors i.e. it cannot be effected jointly. This is because a joint Loan Trust can become highly complex and cause adverse inheritance and inheritance tax problems.

The Bare Loan Trust will not be suitable where:

- An investor does not require any access to the funds; or
- An investor does require access to the investment but also requires some control over the ultimate destination of the benefits.

In these cases, although the Bare Loan Trust will not be suitable, a different type of Trust may be. Fidelity Adviser Solutions offers a range of different trust wording for the consideration of professional advisers.

## 2 The Bare Loan Trust and inheritance tax planning

By establishing a trust under which the Lender does not have any beneficial interest, the Lender will, effectively, remove the Trust Fund (after deduction of any loan owing to the Lender) from his or her taxable estate for inheritance tax purposes. The Lender (as a creditor) has full access, at any time, to the amount of the outstanding loan. The amount of any outstanding loan remains in his or her taxable estate but the remainder of the Trust Fund (effectively the accrued investment growth) is outside of the Lender’s estate for inheritance tax purposes and inaccessible to the Lender.

\*References to the income and capital gains taxation of ‘investment funds’ in this guide do not apply to offshore funds which do not hold HMRC reporting fund status. Offshore income and gains arising from such funds are taxed under the income tax regime.

HM Revenue & Customs (HMRC) accepts that the loan itself, even though it is interest-free, does not involve any element of gift, as long as it is repayable on demand.

To ensure that the Lender makes an effective gift for IHT purposes, the Lender must not retain any benefit (actual or prospective) under the Trust. This is the case with the Bare Loan Trust. The Trust is expressed as being irrevocable and the only persons who can benefit are those individuals identified as Beneficiaries in the Trust Deed. The Trust is therefore effective for inheritance tax purposes.

The Lender's right to have his or her loan repaid does not amount to a reservation of benefit. The argument against any gift with reservation arising in connection with the arrangement is also strengthened by the fact that the Lender does not actually make any gift when the Trust is established.

For a detailed consideration of the inheritance tax implications of the Bare Loan Trust see Section 5.

### 3 The Bare Loan Trust – some practical issues

#### Choosing the Trustees

The Lender and at least one other individual (preferably two or three) must be appointed as Original Trustees in the Trust Deed. The Lender has the power to appoint and/or remove other Trustees. Trustees must be aged 18 or over, of sound mind and ready and willing to act as a Trustee.

It is important for the Lender to choose his or her Trustees carefully. Even though the Lender will be one of the Original Trustees and it is expected that he or she will remain as Trustee during his or her lifetime, as the Trust is governed by English law the Trustees must act unanimously. In extreme circumstances of disagreement, the Lender has the power under the Trust to dismiss a Trustee, but only if at least one Trustee remains other than the Lender or the Lender's spouse or registered civil partner.

The Trustees must understand their responsibilities to the Beneficiaries and to the Lender. Therefore, if the Trustees were considering paying a benefit to Beneficiaries, they should take account of the Lender's outstanding loan. At the very least, it would be prudent for them not to deplete the value of the trust fund below the outstanding loan.

#### Making the loan

The Lender and the Trustees execute the Loan Agreement.

A cheque for the amount of the loan should be made payable to the investment provider concerned (e.g. Fidelity) and handed over by the Lender to the Trustees.

On the basis that the Lender provides the Trustees with a cheque payable to, say, Fidelity there will be no need for the Trustees to open a bank account at this stage. This would become necessary if the Lender wished to make the loan in cash or by a cheque payable to the Trustees. In such a case, as it is generally no longer possible to simply endorse cheques, the Trustees would have to pay the cheque into their own bank account and subsequently draw a cheque from that account in favour of Fidelity. It may, however, be necessary for the Trustees to consider opening a bank account in due course should they start receiving investment income, requesting withdrawals from Bonds or selling investment funds.

It is important that the cheque should come from a bank or building society account held in the Lender's sole name, i.e. it should not be drawn on a joint account, for example, held by the Lender and his or her spouse, or registered civil partner, because it is only the Lender who is establishing the arrangement.

#### Loan repayments

Loan repayments may be requested by the Lender from time to time when he or she requires capital and the Trustees will have to make part encashments from the Bonds and/or investment funds to facilitate repayments. Although, in theory it is possible for the Trustees to set up a regular withdrawal facility from a Bond, caution should be applied.

It is important to understand that the loan must operate as an interest free loan that is repayable on demand (in accord with the loan agreement). Where a loan is made that is both interest free and repayable on demand, the making of that loan should not constitute a transfer of value for inheritance tax purposes. Where a loan is made that is either repayable at the end of a fixed term or by instalments over a fixed term, rather than on demand, it is likely to constitute a transfer of value and have adverse inheritance tax consequences.

Where the Lender demands repayment by way of a single sum or irregular ad hoc sums, it can be seen that there is no pattern of repayment to suggest that the loan is repayable by fixed instalments over a term. Where the loan is repaid by way of a specified regular fixed withdrawal (e.g. 5%) from a bond set up in advance, it may be seen that there is a possible argument that the loan is, in reality, a term loan repayable in instalments over 20 years. Ideally, the demand for loan repayments should operate in such a way to avoid any possibility of argument that it is a fixed term loan of whatever nature.

It is, of course, possible that the Lender will request a significant loan repayment during the course of a year, so the ability to access any investments and any consequent tax charges must always be considered.

#### Type of investment

The Trustees can invest in Bonds and/or investment funds.

#### Further investments by the Lender

If the Lender wishes to make further investments, he can do so, provided no gift is made into the Trust. If further sums are to be made available then this should be solely by way of further interest-free loans by the Lender to the Trustees. If the Lender wishes to make outright gifts, these should either be made directly to the donee(s) or to another trust. It is important to maintain the IHT effectiveness of the Bare Loan Trust by making no gifts to it.

#### Writing the loan off

If the Lender decides that he or she no longer needs access to his or her capital, he or she can by Deed write off the loan. This would, however, constitute a gift to the Trust by the Lender. It is important not to mix gifted sums and lent sums in a single trust which is why any loan write-off should only occur in respect of the whole amount outstanding under the loan.

### 4 The Bare Loan Trust provisions in detail

The Bare Loan Trust provides that the Beneficiary(ies) named in the Trust Deed is entitled absolutely to both the income and capital of the Trust. If there is more than one Beneficiary named, they benefit in the shares specified and neither the Beneficiaries nor their entitlements can be changed.

#### Execution of the Deed and Trust declaration

The Trust Deed is executed by the Lender and the named additional Trustees. No gift takes place at this time.

#### The Loan Agreement

Once the Trust is established, the Lender makes an interest-free loan, repayable on demand, to the Trustees. The Lender and the Trustees together execute a formal Loan Agreement to this effect. It is envisaged that the Trustees invest the loan monies in Bonds and/or investment funds and, with this in mind, the Lender should draw the cheque in favour of the appropriate investment provider (e.g. Fidelity). The Bonds and/or investment funds will represent the only assets of the Trust.

From time to time, the Lender may request repayments of his or her loan. The Trustees will encash part of the Bonds and/or investment funds to make the repayment – see section 5 for the tax implications of encashment. The part repayment of the loan to the Lender will be tax-free in the hands of the Lender as a capital repayment (although there may be some income tax implications if the underlying investment is in income-producing investment funds, or if the encashment of Bonds triggers a chargeable event – see Section 5 for full details).

Caution should be applied with loan repayments made on a regular basis and for the same amounts so as to avoid any possibility of an inference that the loan is in fact repayable by instalments and therefore payable within a fixed time frame (which may give rise to adverse IHT implications).

It is important that the loan is expressed to be interest-free and repayable on demand, as loans repayable by instalments have different (less favourable) tax consequences.

### **The investment**

The Original Trustees (of whom the Lender is one) make an application for Bonds and/or investment funds, using the cheque given to them by the Lender. In the case of a Bond (a life assurance policy), the Trustees must indicate on whose lives the policy should be issued. Normally this should be on a joint, or multiple, lives last survivor basis on the lives of the Lender and/or some of the Beneficiaries, with the Trustees as the policyholder.

If the Lender were the sole life assured under the Bond, the Bond would automatically encash on his or her death, and trigger a chargeable event. Effecting the Bond on the lives of two or more persons, as indicated above, will avoid this automatic encashment, assuming the Lender dies first. It could therefore provide greater flexibility as to the time of the final encashment of the Bond and could avoid an encashment at a time that is unsuitable for either investment or tax reasons.

The Trustees can exercise all the powers and options under the policy including taking withdrawals from the Bond. When the Lender requests repayment of the loan, in full or in part, the Trustees will have to encash an appropriate part of the Bond or sell a number of units or shares from the investment funds in order to fund the repayment.

### **The draft Bare Loan Trust**

The following is a summary of the key provisions as they appear in the draft Bare Loan Trust.

#### **Part 2 – Definitions**

In this part of the Trust the terms used throughout the Trust are defined to avoid repetition. The most important definition is that of the Beneficiaries.

The Beneficiaries are those named in the trust deed. To identify them, the Lender inserts their full names. If there is more than one, their respective shares also need to be specified, otherwise they benefit equally. Under the Bare Loan Trust, each Beneficiary becomes absolutely entitled to his or her share of the trust assets. Beneficiaries and/or their respective shares cannot be changed.

#### **Part 3 – Principal trust terms**

In this part the rights of the Beneficiaries are defined, i.e. that they are absolutely entitled to the Trust capital and income. If there is a minor Beneficiary(ies), the Trustees are given powers to use the Trust income (if it arises) and capital for the maintenance, education or benefit of this Beneficiary(ies). When the child reaches the age of full legal capacity, he or she will be able to call for his or her share of the Trust Fund, subject, of course, to the Trustees being satisfied that they retain sufficient funds to repay any outstanding loan.

#### **Part 4 – Administrative powers**

The Trustees also have wide administrative powers to deal with the Trust Fund and to reinvest the proceeds of any investment in any way they

wish. They also have the power to borrow funds, to make payments to parents or guardians of minor Beneficiaries and to delegate certain powers.

#### **Part 5 – Appointment, dismissal, retirement and remuneration of Trustees**

The Trust contains comprehensive provisions applying to the Trustees.

The power to appoint new or additional Trustees is vested in the Lender during his or her lifetime and, after his or her death in the Trustees. The Lender also has power to dismiss any Trustee provided at least one Trustee other than the Lender remains after such dismissal. There is no power to dismiss a Trustee after the death of the Lender and it must be remembered that the Trustees as the Trust is subject to English law must act unanimously.

There are also powers dealing with the retirement of Trustees and corporate Trustees.

#### **Part 6 – Further trust provisions**

These deal mainly with the Trustees' liability in relation to the Trust.

The liability of individual Trustees is limited so that they will not be held liable for any loss to the Trust fund provided they act in good faith. Trustees who are paid for their services are also liable for negligence.

Professional Trustees are permitted by the Trust Deed to charge normal professional fees. The Trustees are permitted to take part in transactions and Trustees' decisions in which they have a personal interest.

#### **Part 7 – Governing Law**

English law governs the validity of this Trust, and its construction, effects and administration.

## **5 The UK tax implications of the Bare Loan Trust**

In what follows, it is assumed that the Lender, the Beneficiaries and the Trustees of the Trust are all UK resident and domiciled. Special rules apply where this is not the case and relevant professional advice should be sought. This section is only intended to provide a brief guide to taxation and precise taxation treatment will depend on types of trust investments and the tax circumstances applicable to an individual trust arrangement.

### **Inheritance tax (IHT)**

#### **Establishment of the Trust**

- Since no gift is made by the Lender when the Trust is established, the creation of the Trust will not give rise to a transfer of value by the Lender for inheritance tax purposes as long as the correct procedures are followed.
- So long as the loan is expressed to be interest-free and repayable on demand, the granting of the loan should have no immediate tax implications for the Lender.
- As the Lender is entitled only to receive loan repayments, and is not a Beneficiary of the Trust, the arrangement is not caught by the IHT "gift with reservation of benefit" provisions. Furthermore, HMRC has confirmed that the income tax pre-owned assets tax (POAT) rules in Schedule 15 Finance Act 2004 should not apply.

#### **Death of a Beneficiary**

- The Beneficiaries are treated as owning the Trust property for IHT purposes.
- On the death of a Beneficiary, the value of that Beneficiary's underlying interest in the Trust property (the Bonds and/or investment funds less the amount of any outstanding loan) will be included in the deceased Beneficiary's estate.
- If the Beneficiary is under the age of 18 (16 in Scotland), unmarried and not in a registered civil partnership, the assets will usually pass to the deceased Beneficiary's parents under the rules of intestacy.

## Death of the Lender

- On the death of the Lender, the amount of the outstanding loan forms part of the Lender's estate for inheritance tax purposes. However, the balance of the value of the Trust Fund (effectively, the investment growth accrued by the Bonds and/or investment funds) will be outside the Lender's estate as this represents the Beneficiaries' entitlement (see above).
- If the Lender is married he or she may, in his or her Will, leave the right to the repayment of any outstanding loan to his or her surviving spouse or registered civil partner. In such a case, no inheritance tax will be due on the outstanding loan entitlement on the Lender's death and loan repayments can continue to him or her.

Under current legislation, no other inheritance tax charges will arise under the Bare Loan Trust. In particular there will be no periodic charges or charges when payments are made to a beneficiary – such charges are only relevant to other types of trust called relevant property settlements. The Bare Loan Trust is not a relevant property settlement.

## Capital gains tax

### Creation of the Trust

There will be no capital gains tax (or income tax) implications at the time the Trust is established, although, of course, a capital gains tax charge may arise if the Lender realises investments to generate the cash used to make the loan.

### Trust capital gains

For capital gains tax purposes the Trust is ignored and the Beneficiaries are treated as outright owners. This means that all capital gains arising when the Trustees sell shares or units in investment funds are assessed on the Beneficiaries, regardless of who the Lender is. The gain will be calculated in the usual way and apportioned in line with the Beneficiaries shares. Each Beneficiary, subject to their own available CGT annual exemption, will be taxed at the tax rate applicable to that individual for taxation on capital gains.

If loan repayments are funded from the proceeds of sale of units or shares in investment funds, there will be the usual CGT implications. The Trustees should, therefore, ensure that potential CGT liabilities are taken into account when realising shares or units in investment funds.

## Income tax – generally

The income tax implications depend on whether the investment held by the Trustees is a Bond or investment funds.

### Chargeable event gains under a Bond

The general rule is that any income tax liability due on a chargeable gain will be assessed on the Beneficiary (irrespective of age) at his or her marginal rate of income tax (after the application of any top-slicing relief), even if the chargeable event arises while the bond is still subject to the Bare Trust.

Exceptions to this general rule can arise where wider so-called 'anti-avoidance' legislation applies so as to treat income arising under a settlement as that of the Lender. HMRC take the view that "income arising under a settlement" includes amounts deemed or treated as income for the purposes of income tax, which includes chargeable event gains from insurance bonds. Therefore, in such circumstances the gain is assessed on the Lender rather than the beneficiary.

One example of this tax treatment is if the Beneficiary is the Lender's child and is aged under 18, unmarried and not in a registered civil partnership. If this is the case, any gain or income from other investments and any other gifts made to the child by the Lender will be assessed for income tax on the Lender at his or her marginal rate if the gross income attributable to that Beneficiary exceeds £100 gross per parental Lender in the tax year.

Another example of where this treatment could apply, although HMRC will not clarify this point, is where the Lender retains an interest under the Trust. Particularly, where the Lender has made a loan to the Trust, and some, or all, of that loan remains outstanding. HMRC take the view that they cannot comment generally about the application of the settlement 'anti-avoidance' rules given that the specific circumstances will determine whether these apply to a particular Bare Trusts and whether chargeable event gains arising for beneficiaries should be attributed to Lenders. Accordingly, this is a matter upon which Lenders should seek individual professional advice where necessary.

### Income arising to the Trustees from investments in investment funds.

Whilst any part of the loan remains outstanding, any income arising to the Trustees will be assessed on the Lender as it arises. (for these purposes, income includes offshore income gains arising on offshore funds).

Even when the loan is completely repaid, if a Beneficiary of the Trust is a child of the Lender, and that Beneficiary is under the age of 18, unmarried and not in a registered civil partnership, then any income from the shares or units in investment funds held in the Trust will be assessed on the Lender. This will be the case if, when added to any other income on gifts made by the Lender to that child, the gross trust income exceeds £100 in a tax year. The £100 limit applies per parent per child.

In all other cases, all trust income will be assessed on the Beneficiary regardless of the amount.

The income tax implications of loan repayments are considered below.

## The income tax implications of loan repayments

### ■ Where the investment is a Bond

Under current legislation, the Trustees can withdraw up to 5% p.a. of the amount invested from the Bond without an immediate tax charge. This withdrawal limit is cumulative and any allowable amount not withdrawn in a year can be carried forward to the next year and so on, subject to total cumulative withdrawals not exceeding 100% of the amount invested in the Bond. Therefore, a convenient level of capital (up to 5% per year of the original investment) can be tax effectively accessed by the Trustees to facilitate loan repayments. Of course, the level of repayment depends entirely on the circumstances and the wishes of the Lender.

Repayments in excess of 5% of the initial capital may be withdrawn by the Trustees each year to finance loan repayments, but this will mean that:

- If such a level of repayment continues, the loan will be repaid quicker and thus the Lender will have no further rights under the Trust; and
- any amounts withdrawn over and above the cumulative unused 5% annual allowances in any policy year will amount to chargeable event gains and will, during the Lender's lifetime, and while he is tax resident in the UK, be assessed on the Lender for income tax purposes under the usual rules governing chargeable events.

### ■ Where the investment is in investment funds

The Lender will be assessed on all trust income whilst any of the loan is outstanding, but the actual loan repayments will not be subject to income tax.

If loan repayments are funded from the proceeds of sale of units or shares, there will be the usual capital gains tax implications as explained on page 6.

## 6 Notifying HMRC about a Trust

### **Income tax and capital gains tax**

HMRC operates an online Trusts Registration Service for Trustees. This has replaced the previous paper based 41G (Trust) form and the ad hoc process for Trustees to notify changes in their circumstances. Also, trustees must ensure and confirm the Trust Register is accurate and up to date, guaranteeing their obligations under Money Laundering Directives are complied with. Any new trusts with a UK tax consequence will be required to use the registration service to obtain a unique taxpayer reference (UTR). The requirement to register online includes those trusts that have already registered with HMRC using the 41G(Trust) form. Trustees must update the register each year that the Trust generates a UK tax consequence.

You should consult the relevant guidance from HMRC for details concerning the requirement to register and report your individual trust as appropriate to the circumstances of that trust.

### **Inheritance Tax**

For Inheritance Tax purposes, gifts to a Bare Trust are treated as 'potentially exempt transfers'. This means that they are usually only subject to Inheritance Tax if the settlor who put the assets into the Trust dies within seven years of doing so. In this case, since the capital and income of a Bare Trust belong absolutely to the beneficiary, the beneficiary is responsible for any Inheritance Tax that may be due. There is no reporting requirement at all unless the PET fails on the death of the transferor within 7 years.

## 7 Further information

This guide should be read in conjunction with the literature available for the relevant Fidelity Adviser Solutions and Fidelity investment contracts to be held within the Bare Loan Trust.

Tax rates and allowances quoted are those for the tax year to 5 April 2024.

**Adviser Solutions**



Issued by Financial Administration Services Limited, authorised and regulated by the Financial Conduct Authority. Fidelity, Fidelity International, the Fidelity International logo and F symbol are trademarks of FIL Limited. Financial advisers and their clients are recommended to seek independent legal advice to ensure the Trust meets their needs.

UKM0824/66246-10/QC/0725

ADV\_TR\_148 [WF:1992936]