This document is intended for clients of financial advisers. It covers a complex subject and we recommend that you seek advice from your adviser.

The Bare Loan Trust

Investor guide

Fidelity INTERNATIONAL

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IMPORTANT NOTE:
Fidelity 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 What is the Bare Loan Trust?

A trust is a legal relationship which exists when an asset is held by a person or persons (called the Trustees(s)) for the benefit of another person or persons (called the Beneficiary(ies)). The Trustees have the control and legal ownership of the asset but must use it for the benefit of the Beneficiaries.

Based on this principle, the Bare Loan Trust can provide a way of holding an investment, be it a single premium life assurance investment bond ("Bond") and/or holding of shares or units in unit trusts, OEICs and/or SICAVs ("investment funds"*) for the benefit of another individual or individuals. Please note that the value of investments and the income from them can go down as well as up. Some investments, such as Individual Savings Accounts (ISAs) and personal pension plans cannot be held in a trust such as the Bare Loan Trust.

The Bare Loan Trust is an inheritance tax (IHT) planning arrangement which is made up of three parts:

- A Trust;
- A loan; and
- An investment in Bonds and/or investment funds.

It is well known that potential inheritance tax liabilities may be reduced by making lifetime gifts of assets. It is equally well known, however, that not many individuals can realistically give up all access to their assets, in which case effective inheritance tax planning becomes more difficult.

The Bare Loan Trust has been designed for investors who wish to carry out some inheritance tax planning but who cannot afford to give up all access to the assets intended to be used in this planning. They would, however, be prepared to give up access to any future investment growth on these assets.

Under the Bare Loan Trust, an individual lends a sum of money to the Trustees of the Trust, which he or she has established with the specific purpose of receiving such a loan, and the Trustees use the loan to invest in Bonds and/or investment funds. These are the trust assets held by the Trustees for the Beneficiaries. The Lender (who created the Trust, often also called the Settlor of the Trust) retains the right to have his or her loan repaid to him or her at any time, in full or in part. A series of regular loan repayments could therefore be used to create an additional stream of cash payments which could be used to supplement income. Although it is important that regular repayments are not made in a way that it could be argued the loan is one repayable by instalments over a fixed term.

As there is no initial gift, there is no immediate reduction in the Lender's estate for inheritance tax purposes (as the outstanding loan remains repayable to the Lender's estate) but, as the investments held in the Trust grow in value, all of the investment growth will be outside the Lender's estate for inheritance tax purposes and is held for the Beneficiaries of the Trust. The Lender can request the repayment of the whole outstanding loan or a part of it at any time and as repayments are made by the Trustees, and spent by the Lender, the Lender's taxable estate will also reduce for inheritance tax purposes. Thus the Bare Loan Trust is able to freeze the potential inheritance tax liability payable on a portion of the Lender's estate whilst also enabling a gradual reduction in the potential inheritance tax liability to take place.

In the trust deed the Lender names one or more individuals as the Beneficiary(ies) and the proportions in which they are to benefit. The Beneficiaries are absolutely entitled to the trust assets (less any amount representing the outstanding loan), which means that their entitlement cannot be taken away or changed in any way. It is therefore crucial that the Lender is certain about who he or she wants to benefit as he or she will not be able to change his or her mind about this.

2 Why should you use the Bare Loan Trust?

You should consider using the Bare Loan Trust if you:

- Wish Bonds and/or investment funds to be held in trust for your beneficiaries, but you but do not wish to make a gift of your investment;
- Have, or expect to have, total assets in excess of your available nil rate IHT allowance and are concerned about future inheritance tax liabilities;
- Need to retain access to the capital you intend to invest for your own benefit but can afford to give up access to the investment growth; and
- Are certain who is to benefit from the Trust, i.e. you do not wish to retain any flexibility over the choice of your Beneficiaries or the amount that each will receive.

3 When should the Bare Loan Trust not be used?

The Bare Loan Trust should not be used if you:

- Are not interested in inheritance tax planning; or
- Can afford to make a gift of the capital used in the planning without retaining any access; or
- Wish to retain total control and access to the whole investment not just the original capital; or
- Wish to retain some flexibility or control over the final destination of your funds.

In such cases, Fidelity Adviser Solutions offers a range of other trust wordings that may better suit your circumstances. Please ask your financial adviser for further details.

4 How is the Bare Loan Trust established?

The Bare Loan Trust is based on three elements:

- First, a trust is established by the investor specifically with the intention of making a loan to the Trustees. There is no need for a gift to be made and it is accepted that, under English law, a valid trust can be created in this way.

  The Bare Loan Trust is suitable only for a single Lender, i.e. it cannot be set up jointly. This is because a joint Loan Trust can become highly complex and cause adverse inheritance and inheritance tax problems. The Trust is established by the Lender and the additional Trustees completing the Trust Deed. The Lender is one of the Original Trustees together with the additional Trustees.
- Once the Trust is established, the Lender makes a loan to the Original Trustees of the capital that he or she wishes to pass to the Loan Trust. The loan is made on an interest-free basis, repayable on demand and is formally documented using the Loan Agreement. The intention is that the Trustees will invest the loan moneys into Bonds and/or investment funds. To avoid the need for the Trustees to open a bank account to accept the loan moneys, the Loan Agreement requests that the Lender provides the Trustees with his or her cheque made payable directly to the investment provider e.g. Fidelity.
- If the intended investment is a Bond, the Trustees will make an application for the policy on the joint or multiple lives of the Lender and/or some of the Beneficiaries.

  If investing in investment funds, the Trustees purchase the shares or units in the selected fund(s).

*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. Further details are available from your financial adviser.

The draft Bare Loan Trust deed provides for a maximum of four Trustees (including the Lender).

Once the investment is purchased by the Trustees, any subsequent dealings with the investment will be between the Trustees (as the legal owners) and the relevant investment company.

5 Key provisions of the Bare Loan Trust

- The Beneficiaries named in the Trust are entitled to the benefits absolutely.

  This means that a Beneficiary aged 18 or over (16 in Scotland) can demand that the Trustees pay over his or her share of the benefits, although it should be noted that the Beneficiaries have no right to demand payment of any part of the Trust Fund that represents any outstanding loan due to the Lender.
- 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 Lender names, as Beneficiary(ies), the individual or individuals who are to benefit from the Trust Fund and, if more than one, the shares in which they are to benefit. For tax purposes, each of these Beneficiaries is treated as owning the relevant share of the Trust property.
- If there is more than one Beneficiary, the Lender must decide the shares in which they are to benefit, otherwise they will benefit equally.
- The value of the Trust Fund available for the Beneficiaries will increase as the value of the investment grows.
- The Lender remains entitled to have his or her loan repaid at any time and the amount of the outstanding loan remains in his or her estate for inheritance tax purposes.
- To be effective for inheritance tax purposes, the loan must be repayable on demand and interest-free. From time to time the Lender may request part repayments of his or her loan which will be made by the Trustees after making withdrawals of capital from the Bonds or investment funds held in the Trust. The Lender would normally spend these loan repayments so as to reduce the value of his or her taxable estate at that time.

6 The law of the Trust

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

7 The Trustees

- The Lender is automatically appointed as one of the original Trustees. At least one additional Trustee must be appointed at outset. The additional Trustees execute the Trust Deed with the Lender.
- No more than 4 Trustees (including the Lender) should be appointed at outset.
- The Lender can appoint further Trustees later on and the Lender may also dismiss a Trustee provided at least one Trustee, other than the Lender, and/or the Lender's spouse, remains.
- Trustees must be aged 18 or over, of sound mind and ready and willing to act as a Trustee.
- The Trustees must act unanimously.
- Unresolved disagreements may be referred to the courts, so it is important to choose your Trustees carefully.
- 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.

8 The tax implications of the Bare Loan Trust

In all cases, it is assumed that the Lender and the Trustees are UK resident – special rules apply where this is not so, and relevant professional advice should be sought. The following is an outline of the key provisions: 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

As no gift is made when the Trust is established, there are no inheritance tax implications.

The loan made to the Trustees also has no inheritance tax implications, provided it is interest-free and repayable on demand (as is the case when using the standard Bare Loan Trust draft documentation).

Death of a Beneficiary

- The Beneficiaries are treated as owning the Trust property for inheritance tax purposes.
- On the death of a Beneficiary the value of the 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 there is more than one Beneficiary then the value included will be the value of his or her share.
- 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 intestacy rules.

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 settlements. The Bare Loan Trust is not a settlement.

Capital gains tax (CGT)

Creation of the Trust

There are no CGT implications on the creation of the Trust as no assets are transferred to the Trust at outset. Instead cash is used to make a loan to Trustees. A liability could arise if investments are sold to generate the cash used to make the loan.

Trust gains

For capital gains tax purposes the Trust is ignored and the Beneficiaries are treated as outright owners of the assets in proportion to their entitlements under the Trust. 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

The income tax implications depend on whether the asset held by the Trust 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.

- **Loan repayments**
  Loan repayments may be funded by the Trustees making encashments from the Bond. The Trustees are entitled to withdraw up to 5% of the original investment each year (on a cumulative basis, subject to such withdrawals not exceeding the amount paid into the Bond) without incurring any immediate tax liability. As long as the repayments are kept within these 5% allowances there will be no immediate tax implications for the Lender or Trustees. Otherwise the rules for charging tax on the chargeable event gains will apply as explained above. Further details on the taxation of Bonds are available from your financial adviser.

- **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).

After the loan has been repaid, the income will be assessed on the Beneficiary(ies). However, should a Beneficiary be the Lender’s minor unmarried child, who is not in a registered civil partnership, then any income from shares or units in investment funds held in the Trust will be assessed on the Lender if it together with any other income on gifts made by the Lender to that child, exceeds £100 gross in a tax year. The £100 limit applies per parent per child.

9 Notifying HMRC about a bare 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’ (PETs). This means that they are usually only subject to Inheritance Tax if the Lender 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.

10 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.

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