Wealth Management

[Loan]

Gift and Loan Trust

Client Guide

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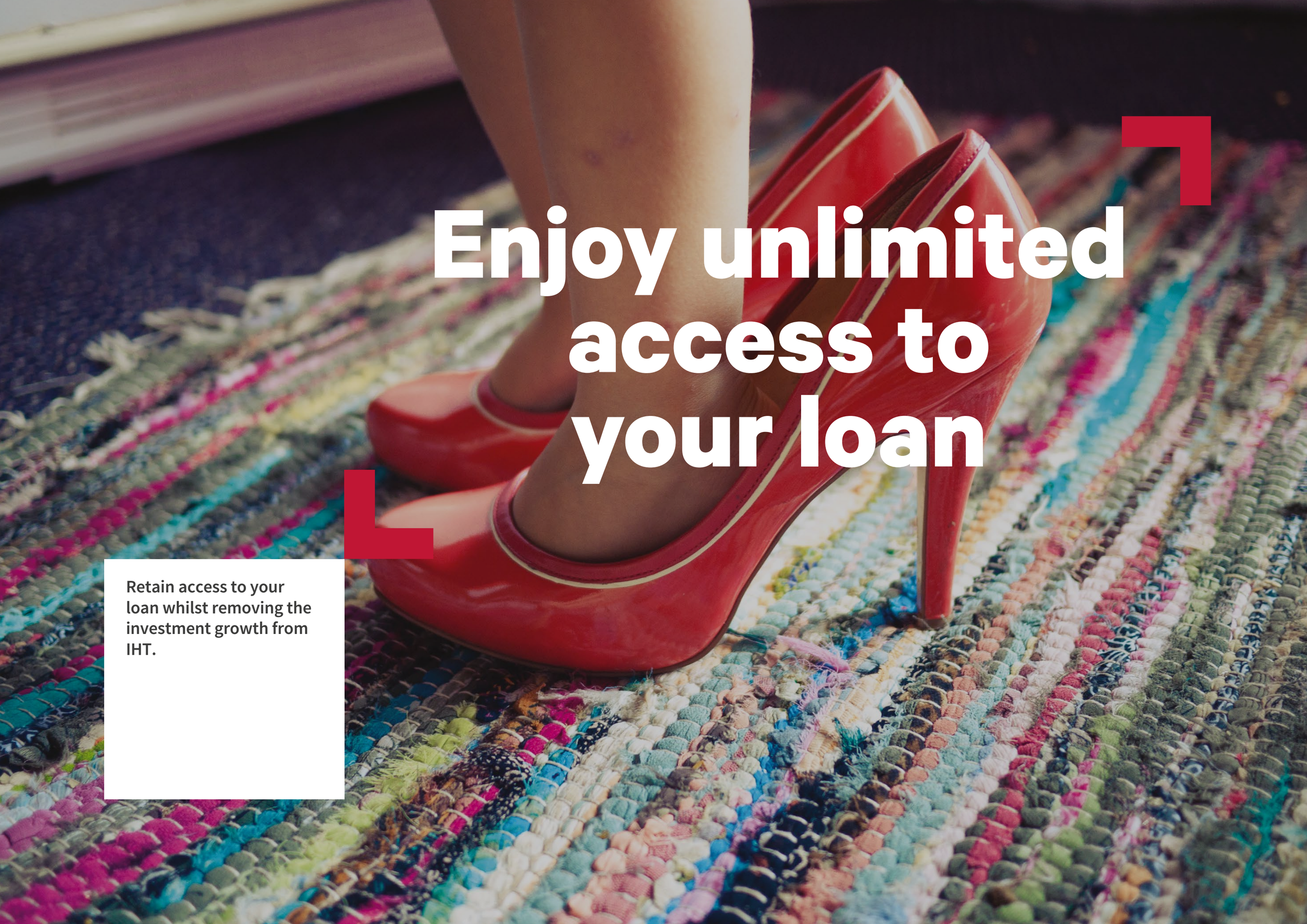


Enjoy unlimited access to your loan

Retain access to your loan whilst removing the investment growth from IHT.

You loan the trustees a lump sum and as it's a loan, you have unlimited access to the outstanding loan.

The Gift and Loan Trust

As we get older and we are more financially secure it is only natural that we consider the future for our children and grandchildren.

However, the situation is brought into sharper focus by the fact that UK inheritance tax (IHT) may well reduce the amount that you are able to leave to your family.

Introduction

IHT is a tax levied against the value of an individual's estate on death and also, in some circumstances, on gifts made during their lifetime.

An individual is only allowed to leave £325,000 (standard nil rate band) to his or her heirs (subject to any available exemptions) without the estate suffering IHT. From 6 April 2017 there is an additional residence nil rate band if a residence is left to a direct descendant. Married couples and registered civil partners can each leave their nil rate band and residence nil rate band to their heirs.

And whilst you could make gifts to help reduce your potential IHT bill, your circumstances may not allow you to do this.

Alternatively you could consider making an interest-free loan, repayable on demand, which can generate IHT-free investment growth.

The benefits of a gift & loan trust include:

- **Regular 'payments' by way of loan repayments**
- **You can recoup any of the outstanding loan at any time**
- **It can be a joint arrangement with you and your spouse or civil partner each making a loan**
- **Choice of bare or discretionary trust arrangements**
- **The beneficiaries can be changed at any time providing the discretionary trust version is used**

Background

In broad terms, what happens is that you (or you and your spouse/civil partner jointly) establish a trust by making a small gift of £10. Then you make a larger interest-free loan to your trustees.

The £10 gift is to ensure that the date on which the trust is established is clearly demonstrated.

The trustees then invest this loan with the aim of generating investment growth.

The investment growth is part of the trust and therefore does not form part of your estate. However, any outstanding loan does form part of your estate and would be subject to IHT.

The loan is repayable on demand and could, if required, be repaid over a period of time. In this way it can produce regular payments in the shape of the loan repayments. It must be appreciated that you cannot receive back more than the full amount of the original loan. For example, if the amount of the loan was £100,000 and a yearly repayment of £5,000 was requested, the payments would last for 20 years only and then cease.

Any part of the outstanding balance of the loan can be reclaimed at any time if there are unforeseen circumstances. This will impact on the amount of future payments available and may give rise to an income tax liability. If there is any of the loan outstanding on your death, the benefit of the loan (and hence the regular payments) can be passed on – for example, to your spouse. This is achieved by the addition of a codicil or clause to your will.

The Canada Life gift & loan trust allows you to carry out IHT planning, whilst still having access to capital.

How it works

The gift & loan trust starts with you making a gift into trust, of just £10. If you are establishing the gift and loan trust with your spouse/civil partner each will be making a gift of £5.

For IHT purposes, the initial gift can be offset against the annual exemption, but failing that it will either be a potentially exempt transfer or a chargeable lifetime transfer depending on the trust arrangement.

For full details of the tax position, please ask your adviser or see the tax notes which are available on request.

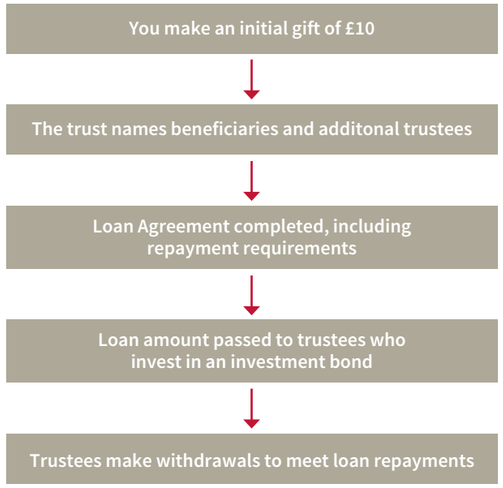
The trust fund is held for the benefit of beneficiaries. Please note beneficiaries can only be changed or other individuals included at a later date if you choose a discretionary trust. Therefore before deciding on which trust to use (bare or discretionary) you should speak to your adviser.

After making the initial gift, you make an interest-free loan to the trustees and they invest that amount in an investment bond. This loan is repayable on demand and any loan repayments are funded by withdrawals from the investment bond.

Procedure

Any outstanding loan is due to you and forms part of your estate for IHT purposes. However, any investment growth on the investment bond owned by the trustees will be outside your estate and free of IHT.

The trust will also have the advantage of avoiding delays on your death, because there is no need to obtain a grant of representation, provided that there is a surviving trustee.

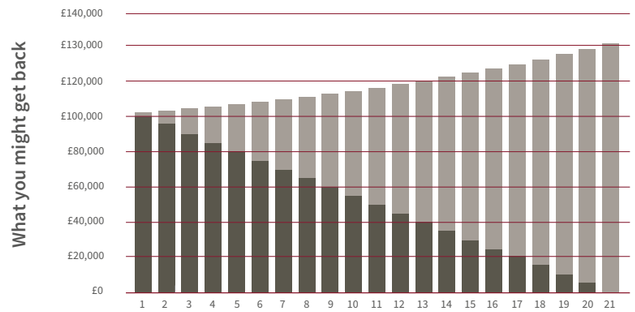


Example

The gift & loan trust is an ideal vehicle for IHT mitigation. If you take regular loan repayments, you are effectively converting assets subject to IHT into assets free of IHT.

The chart shows the effect of this. It assumes that your trustees repay 5% of the loan each year and that the trust investments grow by 6% each year. This means that the loan is repaid in full over 20 years and the growth in the investments will then fall outside your estate, so the parts of the bars coloured light grey in the chart are not subject to IHT.

Gift and loan – 5% withdrawals



Assumptions:
Select Account
Canlife Managed (0-35% Shares) Fund
£10 gift + £100,000 loan
Loan repayed by annual 5% withdrawals
6% growth a year*

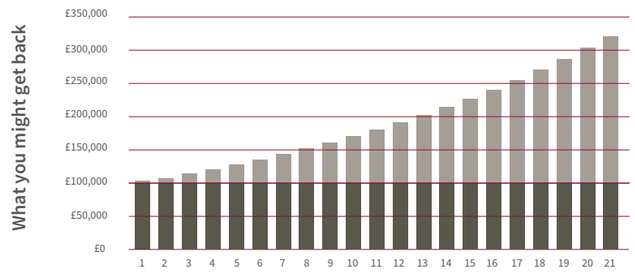
Loan outstanding
Outside estate

Alternatively, you may decide to not take any loan repayments or defer them to a later date. In that case, the growth free from IHT is maximised as shown in the chart.

The fundamental objectives of the gift and loan trust are:

- To reduce the potential IHT liability on your estate
- To allow you to retain control over who benefits from the trust fund
- To provide you with access to your original capital

Gift and loan – no withdrawals



Assumptions:
Select Account
Canlife Managed (0-35% Shares) Fund
£10 gift + £100,000 loan
No loan repayments
6% growth a year*

Loan outstanding
Outside estate

* The 6% growth is being used as an example and is not guaranteed. Please note that past performance is not a guide for the future. The value of units can fall as well as rise and currency fluctuations may also affect performance.

Questions and answers

What happens when I die?

If the investment bond has been written on your sole life in the event of your death the death benefit will be paid to the trustees.

However, if the investment bond has been written with other lives assured it will remain in force until the last life assured dies (joint life last death). In this situation the trustees may need to surrender the bond to repay the loan if the appropriate provision has not been included in your will. Otherwise, the loan repayments can continue to be made to your surviving spouse/civil partner or the will beneficiary.

Where can the trustees invest the loan amount?

Under our UK and international investment bonds there is a wide choice of funds available to the trustees, covering different geographical and economic sectors of the global economy.

They will have access to funds run by many of the leading established fund managers, plus specialist multi manager and multi asset portfolios. There are funds which cater for all investors from cash funds through to specialised funds. Please speak to your adviser for more information of the funds available.

Why is there a trust?

To reduce your potential IHT liability, it is important to legally separate your initial gift from the rest of your assets. This is achieved by using a trust.

The trustees, who are appointed by you, are then responsible for investing the loan you make and also administering the trust on behalf of the beneficiaries. You are automatically the first trustee but you must appoint at least one additional trustee for the arrangement to be effective.

What happens if my investment falls in value and I want my loan repaid?

The loan agreement only allows for you to receive the current value of your investment, at most. What this means is that in most cases, if the value of the investments in the trust fund is lower than the balance of outstanding loan at any time, the trustees' liability to repay the loan to you will be limited to the value of the trust fund.

The trustees will have no personal liability to repay the difference between the value of the trust fund and the balance of outstanding loan.

However, where this applies, please note that the whole of the balance of the outstanding loan (not the limited amount) will be potentially assessable to IHT in your estate.

How can I use the gift & loan trust to minimise my inheritance tax liability?

The gift & loan trust allows you to make potential IHT savings whilst still having access to your capital. At the outset, the initial gift is £10 and then you decide on the subsequent interest-free loan to the trustees. Any investment growth will not form part of your estate, it is only the outstanding loan amount that will form part of your estate for IHT purposes.

Please note that, in the view of HMRC, a limited recourse loan agreement (as described above) has no impact on the potential IHT liability on the outstanding balance of the loan at the death of the Lender.

As a result, unless the outstanding balance is exempt (for example, because it is inherited by the lender's widow(er)), IHT would be chargeable on the full outstanding loan.

Will I need to have a medical?

No medical evidence is required under this type of arrangement.

Taking a 'payment': when do I decide how much I want to receive?

You inform the trustees on how you want the loan repaid – if you choose regular amounts (yearly, quarterly or monthly), this could provide you with tax-efficient payments.

You can choose the level of loan repayments you want to receive when you start the investment bond. However, you can change this or decide to take the outstanding balance of the loan at any time.

Please note that the total of all payments you receive from the investment bond can never exceed the amount of the loan you originally made.

Will I pay tax when I take a payment?

You are currently entitled to receive 5% of the investment, for each policy year for 20 years and defer any income tax payable. Where the full 5% entitlement is not taken in any policy year, the unused amount is carried forward for use in future years.

For example, should you select a yearly withdrawal of 4% of your original investment, you are entitled to take withdrawals free of income tax for 25 years.

If the withdrawals including any ongoing adviser charges agreed by the trustees, in any year exceed 5% of the investment made, the excess will generate a chargeable gain.

There may also be a chargeable gain on the full surrender of any investment bond.

Where there is a chargeable gain, this must be included on your tax return and you may be liable to income tax. You should speak to your adviser regarding this.

What are the other advantages or disadvantages of the arrangement?

One advantage is that under the discretionary version, the trustees can change the beneficiaries at any time.

However, it should also be remembered that you can only receive 'payments' in the form of loan repayments. Once the loan is fully repaid no more payments can be made.

Also, if you die in the early years of the arrangement, very little in the way of IHT mitigation will normally have been achieved.

Past performance is not a guide for the future. The value of any investment is not guaranteed, as it is directly linked to the value of assets held by the selected investment fund(s) and can fall as well as rise. If the investment bond is surrendered, the surrender value may be less than the original investment. Currency fluctuations can also affect performance.

This document is based on Canada Life's understandings of applicable legislation, law and current HM Revenue & Customs practice as at November 2023. It is provided solely for general consideration. The information regarding taxation is based on our understanding of current legislation, which may be altered and depends upon the individual financial circumstances of the investor. We recommend that investors take their own professional tax advice.

About Canada Life

Canada Life

The Canada Life Assurance Company provides insurance and wealth management products and services through domestic operations in the UK, and international operations in the Republic of Ireland, the Isle of Man, Germany and, of course, Canada, as well as branch and subsidiary operations in other countries.

Canada Life is a subsidiary of The Great-West Life Assurance Company.

Strength and stability

We understand that you want to invest in a company that is strong, safe and secure. As part of the Great-West Lifeco group we are a constituent of the Financial Times Global 500 world's largest companies.

We have a strong platform for continued growth as a world-class financial services provider.

You can read more about **our company** and **who we are** on our website.

Ratings are another reflection of our financial strength; Great-West and its subsidiaries have received strong scores from the major ratings agencies. View our latest ratings and awards **here**

For more information about Canada Life, please speak to your adviser.

A gift and loan trust allows you regular or ad hoc access to your outstanding loan.

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