CROFTON BRADFIELD
TAX

Loan Trust

Overview

A loan trust involves the settlor lending funds to a discretionary trust rather than gifting them. Future growth accrues outside the estate while the original loan remains repayable.

How the Trust Works

Unlike a conventional gift into trust, Mr Smith does not give away the £500,000, but instead, he lends the money to the trustees.

Mr Smith decides the amount of repayment, he can defer repayment, take a small repayment or insist that the loan is repayable on demand

The trustees invest the funds, and any future growth belongs to the trust rather than Mr Smith personally. The structure therefore separates:

- The original capital (loan)
- Future investment growth

The loan remains part of Mr Smith's estate for inheritance tax purposes, whilst the future growth may accrue outside his estate. In this way he can therefore access investment benefits via loan repayments made to him, however, this will clearly be limited to the amount of the initial loan.

IHT Treatment

Any loan amounts that remain unrepaid will be in the settlor’s estate. However, the growth in the trust over the initial loan will fall outside the estate.

Typical Uses:

- Clients unwilling to lose access to capital
- Investment bond planning
- Gradual estate reduction

Suitable For:

- Older clients needing access to capital
- Conservative planners
- Clients with surplus growth rather than surplus capital

- **Usually Unsuitable For**
- Clients seeking immediate substantial IHT reduction
- Clients with short life expectancy

Advantages:

- Retained access to capital
- Simple conceptually
- No gift reservation issue where structured correctly
- Useful with investment bonds

Disadvantages:

- Original loan capital remains potentially taxable in the settlor's estate
- Investment risk remains
- Requires careful administration
- Key Professional Advice Issues
- Proper loan documentation
- Repayment strategy
- Investment suitability
- Income tax implications
- Bond taxation considerations

Case Study – Loan Trust

Scenario
Mr Smith is aged 72 and has an estate worth approximately £2.5 million.

He is concerned about inheritance tax but is reluctant to make outright gifts because he wishes to retain access to capital should he need it in the future.

After taking advice, he establishes a Loan Trust and lends £500,000 to the trustees, who invest the funds in a diversified investment portfolio.

The discretionary beneficiaries are his grown-up children and grandchildren.

CROFTON BRADFIELD TAX

Inheritance Tax Position
At the outset:

Item	Amount
Loan Advanced	£500,000
Value Remaining in Estate	£500,000
Immediate Reduction in Estate	£NIL

- Unlike a normal settlement into a discretionary trust, there should be no Inheritance Tax charges as there will be no chargeable lifetime transfer on settlement.

The planning objective is to remove future growth from the estate rather than the original capital which in any event is in the form of a loan from the settlor.

Growth Outside the Estate
If we assume the investment portfolio grows from £500,000 to £900,000 over 15 years:

Item	Amount
Original Loan	£500,000
Investment Growth	£400,000
Fund Value	£900,000

The original £500,000 loan remains repayable to Mr Smith, but the £400,000 growth belongs to the trust. The potential inheritance tax saving is £160,000 (being £400,000 × 40%) when compared to the settlor retaining the growth in his estate.

Access to Capital
A significant advantage of a Loan Trust is that the settlor retains access to the original capital. Additionally, there are no exit charges on loan repayments to Mr Smith.

For example:

Item	Amount
Original Loan	£500,000
Loan Repaid During Lifetime	£150,000
Remaining Loan Balance	£350,000

The trustees may repay the loan at any time which provides flexibility for unforeseen expenditure, care costs or changing circumstances.

Taxation of the Trust

Income Tax
Income generated by the trust investments is generally taxable on the trustees.

Where annual trust income exceeds £500 then tax is due on the whole amount not just on the excess over £500 and is subject to the special trust rates.

For the 2026/27 tax year:

Type of Income	Tax Rate
Interest Income	45%
Rental Income	45%
Dividend Income	39.35%

If we assume annual non-dividend investment income of £20,000.

Item	Amount
Investment Income	£20,000
Income Tax @ 45%	£9,000
Net Income Retained	£11,000

Where income is distributed to beneficiaries, they may be entitled to reclaim some of the tax suffered depending upon their personal circumstances.

Capital Gains Tax
The trustees are liable for Capital Gains Tax on gains arising within the trust.

If we assume the trustees dispose of investments producing a gain of £100,000:

Item	Amount
Gain	£100,000
Less Annual Exemption	(£1,500)
Taxable Gain	£98,500

Therefore, the potential CGT liability that arises is £23,640 (being £98,500 × 24%).

Ten-Year Periodic Charges
Most Loan Trusts are established using discretionary trust provisions and therefore fall within the Relevant Property Regime.

If we assume the trust fund is worth £900,000 at the ten-year anniversary and no other chargeable lifetime transfers were made in the 7 years prior to the settlement:

Item	Amount
Trust Value	£900,000
Less Outstanding Loan	(£500,000)
Net Trust Value	£400,000

Only the trust's net value is generally relevant when considering periodic charge exposure:

Item	Amount
Net Trust Value	£400,000
Nil Rate Band	£325,000
Excess	£75,000

Therefore, the potential maximum periodic charge is £4,500 (being £75,000 × 6%).

Actual charges will depend on the detailed inheritance tax calculations at the time.

Exit Charges
If capital is distributed from the trust, an exit charge may arise.

The amount depends upon:

- The value distributed.
- The trust's effective inheritance tax rate.
- The time elapsed since the previous ten-year anniversary.

Exit charges are often modest where trust growth has been relatively limited.

CROFTON BRADFIELD TAX

Long-Term Outcome
Mr Smith retains access to the original loan capital throughout his lifetime, whilst the £400,000 growth used in this example has accrued outside his estate and may pass to future generations through the trust structure.

The potential inheritance tax saving is therefore £160,000 when compared to retaining the growth in his estate, whilst preserving access to capital should it be needed.

A Loan Trust is often attractive to clients who are uncomfortable making outright gifts but still wish to undertake inheritance tax planning.

Unlike a normal discretionary trust, the original capital (being the loan) remains accessible and remains within the settlor's estate. The planning benefit arises from removing future investment growth from the estate whilst retaining flexibility through the outstanding loan.

It is particularly suitable for older clients, cautious investors and individuals who may require access to capital in the future but still wish to begin reducing their inheritance tax exposure.