CROFTON BRADFIELD
TAX

Lifetime Inheritance Tax Planning Using Trusts

This document is intended as a reference guide for lifetime inheritance tax (IHT) planning using Trusts and is therefore intended for information purposes only.

Overview of Trusts Used in Lifetime IHT Planning

The principal trusts commonly used in UK lifetime inheritance tax planning include:

Trust Type	Typical IHT Treatment	Common Use
Bare Trust / Absolute Trust	Potentially Exempt Transfer (PET)	Simple gifting, children/grandchildren planning
Discretionary Trust	Chargeable Lifetime Transfer (CLT)	Flexible family wealth planning
Interest in Possession (Life Interest) Trust	Usually, CLT during lifetime	Asset protection and income rights
Flexible Life Interest Trust	Hybrid structure	Spousal/family flexibility
Loan Trust	Growth outside estate	Retaining access to original capital
Discounted Gift Trust	Partial immediate IHT discount	Income retention with gifting
Gift and Loan Trust Combination	Hybrid planning	Flexible access and growth planning
Disabled Person's Trust	Favourable/special regime	Vulnerable beneficiaries
Pilot Trusts	Relevant property regime	Multi-trust planning and succession
Family Investment Company with Trust Ownership	Corporate/trust hybrid	Succession and control planning
Business Property Relief (BPR) Trust Planning	Relief-based planning	Trading business/family company succession
Charitable Trust	Exempt transfers	Philanthropic and tax planning

Many of the above trusts fall within the “relevant property regime”, which may create:

- Entry charges
- Ten-year (periodic) charges
- Exit charges

The taxation and suitability of each trust depend heavily on:

- The settlor's objectives
- Access requirements
- Family dynamics
- Asset type
- Residence and domicile status
- Existing trusts and prior gifts
- Income tax and capital gains tax implications
- Commercial and anti-avoidance considerations

Most discretionary trusts and many lifetime settlements fall within the relevant property regime.

Client Suitability Matrix

Client Objective	Potential Trust Consideration
Simple gifting to children	Bare Trust
Flexible family planning	Discretionary Trust
Protect spouse, but preserve capital for children	Life Interest Trust
Retain some access to capital	Loan Trust / Discounted Gift Trust
Protect vulnerable beneficiary	Disabled Person's Trust
Business succession	BPR Planning Trust
Long-term dynastic planning	Discretionary / Flexible Trust
Philanthropy	Charitable Trust

This matrix is illustrative only and does not constitute advice.

Key Concepts Before Considering Trust Planning

What Is a Trust?

A trust is a legal arrangement whereby one party (the settlor) transfers assets to trustees to hold for the benefit of beneficiaries.

The trustees become the legal owners of the assets and must administer them in accordance with:

- The trust deed
- Trustee legislation

- Fiduciary duties
- Tax law
- The interests of beneficiaries

Main Parties

Party	Role
Settlor	Creates the trust and transfers assets into it
Trustees	Manage and administer trust assets
Beneficiaries	Individuals or classes who may benefit
Protector (optional)	Supervisory or veto role in some trusts

Key Tax Considerations
Trusts may involve:

- Inheritance Tax (IHT)
- Capital Gains Tax (CGT)
- Income Tax
- Stamp Duty Land Tax (SDLT)
- Trust Registration Service (TRS) reporting obligations

Therefore, obtaining professional advice is essential.

The following pages provide an overview of each type of trust.

Bare Trust / Absolute Trust – Overview

Overview
A bare trust is the simplest trust structure. The beneficiary is absolutely entitled to the trust assets and income.

How It Works
The trustees hold the assets absolutely for a named beneficiary, who has an immediate and fixed entitlement to both the income and capital. The trustees have little or no discretion over how the trust assets are applied and are effectively custodians until the beneficiary is legally entitled to take control of the assets outright.

IHT Treatment
Lifetime transfers into a bare trust are generally treated as Potentially Exempt Transfers (PETs). If the settlor survives seven years from the date of the gift, the value transferred will usually fall outside the settlor's estate for inheritance tax purposes. Bare trusts are generally outside the relevant property regime and therefore do not usually suffer ten-year periodic charges or exit charges.

For tax purposes, the beneficiary is generally treated as owning the assets outright, and so typical uses include:

- Gifts for children or grandchildren
- Junior investment planning
- Simple succession arrangements
- Holding assets until a beneficiary reaches adulthood
- Suitable For
- Clients comfortable making outright gifts
- Parents/grandparents planning for minors
- Smaller estates with simple objectives
- Clients not requiring ongoing control

Usually Unsuitable For:

- Asset protection planning
- Complex family situations
- Beneficiaries with financial immaturity
- Divorce protection concerns
- Long-term dynastic planning

- How It Works
- The settlor transfers assets to trustees to hold absolutely for the beneficiary. The beneficiary normally becomes absolutely entitled at age 18 in England and Wales (16 in Scotland).

Advantages:

- Simple and inexpensive
- Straightforward administration
- PET treatment rather than CLT treatment
- No ten-year or exit charges
- Beneficiary taxed personally

Disadvantages:

- Loss of control
- Beneficiary entitlement becomes absolute
- Poor asset protection
- Limited flexibility
- Assets become part of beneficiary's estate
- Key Professional Advice Issues
- Settlor-interested anti-avoidance rules
- Minor children income rules
- CGT hold-over relief considerations
- Timing of gifts
- Interaction with nil-rate band planning

Discretionary Trust

Overview
A discretionary trust gives trustees discretion over which beneficiaries benefit, when they benefit and how much they receive. No beneficiary has an automatic entitlement to benefit.

How It Works
The trustees exercise discretion in accordance with the trust deed and any letter of wishes, with beneficiaries typically forming a class rather than having fixed entitlements.

IHT Treatment
Lifetime transfers are usually Chargeable Lifetime Transfers (CLTs). Potential charges include 20% immediate IHT entry charge above available nil-rate band, ten-year periodic charges and exit charges.

Charge Type	Typical Maximum Rate
Entry Charge	20% lifetime rate
Ten-Year Charge	Up to 6%
Exit Charge	Proportionate rate

Most discretionary trusts fall within the relevant property regime.

Typical Uses:
- Family wealth protection
- Multi-generational planning
- Asset protection
- Bloodline planning
- Vulnerable family situations
- Future-proofing uncertain family circumstances
- Suitable For
- High-net-worth families
- Clients wanting flexibility
- Asset protection planning
- Business owners
- Clients concerned about divorce or bankruptcy risks
- Usually Unsuitable For
- Clients needing certainty of income rights
- Small estates where compliance costs outweigh benefits
- Clients unwilling to relinquish control

Advantages:

- High flexibility
- Strong asset protection potential
- Assets generally outside beneficiaries’ estates
- Useful for future uncertainty
- Effective long-term succession planning

Disadvantages

- Complex taxation
- Higher compliance burden
- Trust tax rates can be punitive
- Potential periodic and exit charges
- Trustee administration obligations
- Key Professional Advice Issues
- Relevant property regime calculations
- Nil-rate band usage
- CGT hold-over relief
- Reservation of benefit rules
- Pre-owned asset tax rules
- Trust Registration Service obligations
- Trustee fiduciary duties
- Letter of wishes drafting

Interest in Possession (Life Interest) Trust

Overview

A beneficiary (the life tenant) has a right to trust income during their lifetime. Capital passes to other beneficiaries after the life tenant’s death.

How It Works

The life tenant receives income. Capital beneficiaries inherit later. Trustees manage underlying capital.

IHT Treatment

Treatment depends heavily on date trust created, whether lifetime or will trust, whether qualifying interest applies and whether immediate post-death interest rules apply. Many lifetime-created interest in possession trusts now fall within the relevant property regime unless qualifying exceptions apply.

Typical Uses:

- Second marriage planning
- Spousal protection
- Asset preservation for children
- Family home planning
- Succession planning for investment portfolios

Suitable For:

- Clients wanting certainty of income entitlement
- Blended families
- Asset preservation between generations
- Will-based planning

Usually Unsuitable For:

- Clients wanting maximum flexibility
- Situations requiring broad trustee discretion
- Highly tax-sensitive lifetime planning without specialist advice

Advantages:

- Certainty of income
- Useful for remarriage situations
- Asset protection for capital beneficiaries
- Structured succession planning

Disadvantages:

- Reduced flexibility
- Potential tax complexity
- Potential conflict between income and capital beneficiaries
- Trustee investment balancing issues

Key Professional Advice Issues:

- Distinguishing qualifying and non-qualifying interests
- Reservation of benefit concerns
- CGT uplift considerations
- Income entitlement drafting
- Care fees implications

Flexible Life Interest Trust

Overview
A flexible life interest trust combines a life interest structure with trustee discretionary powers. It is often used to create flexibility for future tax planning.

How It Works
The trustees hold assets for a class of beneficiaries, with one beneficiary usually having an initial right to income while the trustees retain discretionary powers over capital. The trustees may exercise powers in accordance with the trust deed and any accompanying letter of wishes, allowing future flexibility depending on family and tax circumstances.

IHT Treatment
The inheritance tax treatment depends heavily on the drafting and structure of the trust. Some arrangements may qualify for spouse exemption where there is a qualifying interest in possession. However, many lifetime-created flexible life interest trusts fall within the relevant property regime and may therefore be subject to entry charges, ten-year periodic charges and exit charges.

Typical Uses:
- Spousal planning
- Nil-rate band planning
- Post-death tax planning
- Flexible family succession planning

Suitable For:
- Families seeking adaptability
- Will planning with post-death flexibility
- High-value estates
- Usually Unsuitable For
- Clients wanting simplicity
- Low-value estates

Advantages:
- Significant flexibility
- Potential tax efficiencies
- Allows changing family circumstances to be accommodated

Disadvantages:

- Highly technical drafting required
- Greater professional costs
- Significant trustee responsibility
- Key Professional Advice Issues
- Tax elections
- Appointment powers
- Interaction with post-death planning opportunities
- Anti-avoidance provisions

Loan Trust

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

How It Works
The settlor lends money to trustees. The loan remains repayable on demand. Investment growth belongs to the trust.

IHT Treatment
Outstanding loan remains in settlor's estate. Growth outside the loan may 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 capital remains taxable
- Investment risk remains
- Requires careful administration
- Key Professional Advice Issues
- Proper loan documentation
- Repayment strategy
- Investment suitability
- Income tax implications
- Bond taxation considerations

Discounted Gift Trust

Overview

A discounted gift trust seeks to achieve an immediate IHT reduction or "discount" while allowing the settlor retained withdrawals. These arrangements are typically insurance-based.

How It Works

The settlor gifts capital into trust but retains rights to fixed withdrawals. Actuarial calculations produce a "discount" for IHT purposes.

Typical Uses:

- Older clients seeking partial access
- Investment bond planning
- Long-term estate reduction
- Suitable For
- Clients with reduced life expectancy assumptions acceptable to providers
- Clients wanting regular withdrawals
- Clients comfortable with investment products

Usually Unsuitable For:

- Clients needing full capital flexibility
- Clients uncomfortable with investment risk
- Clients with poor health where underwriting may affect viability

Advantages:

- Potential immediate IHT reduction
- Retained withdrawals
- Investment growth outside estate

Disadvantages:

- Complex actuarial assumptions
- Limited flexibility
- Product-based charges
- Potential investment risk
- HMRC scrutiny risk if poorly structured

Key Professional Advice Issues

- Suitability assessment
- Medical underwriting assumptions
- Product risk disclosure
- Reservation of benefit analysis
- Investment advice permissions

Gift and Loan Trust Combination

Overview

A hybrid arrangement combining an outright gift element with a repayable loan element.

How It Works

The settlor makes a combination of an outright gift and a repayable loan to the trustees. The loan remains repayable to the settlor on demand, while future growth on the invested trust assets accrues for the benefit of the trust beneficiaries outside the settlor's estate.

IHT Treatment

The gifted element is normally treated as either a Potentially Exempt Transfer (PET) or a Chargeable Lifetime Transfer (CLT), depending on the underlying trust structure. The outstanding loan balance remains within the settlor's estate for inheritance tax purposes, although future growth attributable to the trust investments may fall outside the estate. Relevant property regime charges may apply depending on the trust type used.

Typical Uses:

- Balancing estate reduction with access requirements
- Flexible investment planning
- Suitable For
- Wealthy retirees
- Clients wanting partial capital access

Usually Unsuitable For:

- Clients seeking simple structures
- Clients with limited assets

Advantages:

- Flexible balance of access and gifting
- Potentially enhanced IHT efficiency

Disadvantages:

- Complexity
- Multiple tax considerations
- Administrative burden
- Key Professional Advice Issues
- Correct drafting
- Loan documentation
- Segregation of gifted and loaned funds
- Tax reporting

Disabled Person's Trust

Overview

A disabled person's trust is a specialist trust benefiting a qualifying vulnerable beneficiary.

How It Works

The trustees hold and administer assets for the benefit of a qualifying disabled or vulnerable beneficiary. The trustees control distributions and investments in accordance with the trust deed, with the objective of protecting the beneficiary while often preserving entitlement to means-tested state benefits.

IHT Treatment

Qualifying disabled person's trusts may benefit from favourable inheritance tax treatment and can, in certain circumstances, fall outside the standard relevant property regime. Where the statutory qualifying conditions are satisfied, the trust may avoid ten-year periodic charges and exit charges that would otherwise apply to discretionary trusts.

Typical Uses:

- Long-term care planning
- Vulnerable beneficiaries
- Protection of means-tested benefits

Suitable For:

- Families with disabled or vulnerable beneficiaries
- Long-term support planning

Usually Unsuitable For:

- General family planning
- Situations where qualifying conditions are not met

Advantages:

- Favourable tax treatment
- Asset protection
- Controlled support structure
- Potential protection of state benefits

Disadvantages:

- Strict qualification rules
- Administrative complexity
- Ongoing compliance monitoring
- Key Professional Advice Issues
- Vulnerable beneficiary definitions
- Benefit entitlement interactions
- Trustee selection
- Specialist drafting

CROFTON BRADFIELD

TAX

Business Property Relief (BPR) Trust Planning

Overview

Trust planning involving qualifying business assets capable of attracting Business Property Relief.

How It Works

Qualifying business assets are transferred into trust and held by trustees for the benefit of family members or future generations. These trusts are commonly used in connection with family business succession planning, shareholder protection and long-term asset protection strategies.

IHT Treatment

Where the transferred assets qualify for Business Property Relief, relief may be available at either 100% or 50%, significantly reducing or eliminating the inheritance tax exposure on the transfer. Qualification depends on the nature of the business activities, ownership period requirements and the continued availability of BPR. If the business ceases to qualify, the relief may be lost.

Typical Uses:

- Family business succession
- AIM portfolio planning
- Trading company succession

Suitable For:

- Business owners
- Entrepreneurial families
- Clients with qualifying BPR assets

Usually Unsuitable For:

- Investment businesses
- Non-qualifying companies

Advantages:

- Potential 100% or 50% IHT relief
- Succession planning flexibility
- Asset protection opportunities

Disadvantages:

- Relief can be lost
- Trading tests can change
- Legislative risk
- Significant technical complexity
- Key Professional Advice Issues
- BPR qualification testing
- Excepted assets
- Investment versus trading analysis
- Shareholder agreement interaction
- Cross-option planning

Charitable Trusts

Overview
Trusts established wholly for charitable purposes.

How It Works
Assets are transferred to trustees who administer the trust exclusively for charitable purposes in accordance with the trust deed and charity law requirements. The trustees must ensure that the trust operates for recognised charitable objectives and satisfies the public benefit requirement.

IHT Treatment
Transfers into qualifying charitable trusts are generally exempt from inheritance tax. Assets left to charity on death are also exempt from IHT and may reduce the overall inheritance tax rate applicable to the estate where charitable giving thresholds are met. Charitable trusts may additionally benefit from income tax and capital gains tax reliefs.

Typical Uses:

- Philanthropy
- Legacy planning
- Family charitable foundations
- Suitable For
- Charitably motivated clients
- High-value estates
- Long-term family philanthropy

Usually Unsuitable For:

- Clients primarily seeking family wealth retention

Advantages:

- IHT exemptions
- Potential income tax and CGT reliefs
- Legacy and governance opportunities

Disadvantages:

- Regulatory obligations
- Charity Commission compliance
- Irrevocable charitable commitment
- Key Professional Advice Issues
- Charitable status requirements
- Governance obligations
- Public benefit test
- Trustee responsibilities

Key Tax Considerations – Lifetime Trust Planning

Reservation of Benefit Rules
If a settlor continues to benefit from gifted assets, the assets may remain within their estate for IHT purposes. Examples include continuing to occupy gifted property rent-free, accessing trust capital improperly, or retaining excessive control.

Relevant Property Regime
Many lifetime trusts fall within the relevant property regime. Potential charges include entry charges, ten-year periodic charges and exit charges. HMRC guidance confirms the operation of entry, periodic and exit charges for relevant property trusts.

Capital Gains Tax
Trust planning frequently involves CGT considerations including hold-over relief, rebasing, principal private residence issues, trust CGT rates and interaction with investment products.

Income Tax
Trust income tax rates can be significantly higher than personal tax rates. Discretionary trusts and accumulation trusts are generally taxed at trust rates.

CROFTON BRADFIELD

TAX

Trust Registration Service (TRS)

Most UK express trusts require registration with HMRC's Trust Registration Service, with compliance failures leading potentially to penalties.

Why Specialist Advice Is Paramount
Trust planning is highly technical and often involves the interaction of:

- Tax law
- Equity and trust law
- Anti-avoidance legislation
- Financial services regulation
- Succession law
- Property law
- Family law

Incorrect Planning Can Be Extremely Costly
Poorly implemented trust arrangements may result in:

- Failed IHT mitigation
- Double taxation
- Unexpected CGT liabilities
- Reservation of benefit issues
- Income tax complications
- HMRC penalties
- Litigation between beneficiaries and trustees
- Professional negligence claims
- Anti-Avoidance Legislation Is Extensive
- Numerous anti-avoidance provisions may apply, including:
- Gift with reservation rules
- Pre-owned asset tax
- Settlements legislation
- Targeted anti-avoidance provisions
- General Anti-Abuse Rule (GAAR)

Trusts Must Be Tailored to the Client
No single trust is universally suitable. Advice should always consider:

- Family dynamics
- Health
- Asset profile
- Liquidity needs
- Business interests
- Residence and domicile
- Existing planning arrangements
- Risk appetite
- Succession objectives

Trustees Have Serious Legal Responsibilities
Trustees have fiduciary duties and may be personally liable for:

- Breach of trust
- Improper investment decisions
- Tax failures
- Administrative failures
- Conflicts of interest

Ongoing Reviews Are Essential
Trusts should be reviewed regularly due to:

- Legislative changes
- Family circumstances
- Tax changes
- Asset changes
- Trustee changes
- Beneficiary needs

Summary
Trusts remain one of the most powerful and flexible tools available in UK inheritance tax planning.

However, they are also among the most technically demanding planning areas within private client taxation.

The effectiveness of any trust arrangement depends on:

- Correct structuring
- Proper legal drafting
- Accurate tax analysis
- Appropriate trustee selection
- Ongoing administration and review
- No trust should be established without advice from suitably qualified legal, tax and, where appropriate, regulated financial professionals.
- The correct trust can provide:
- Intergenerational wealth protection
- Tax efficiency
- Succession planning flexibility
- Asset protection
- Family governance benefits

The wrong trust - or the right trust implemented incorrectly - can create substantial tax liabilities and long-term family complications.

Disclaimer

This document is for information purposes only and does not constitute legal, tax, investment or financial advice.

Tax legislation and HMRC practice may change.

Specific advice should always be obtained before implementing any trust or inheritance tax planning arrangement.