



Estate Management Bond

Technical Guide

For consideration by professional advisers only. Not for distribution to the general public.

1. What is the Estate Management Bond?

The Estate Management Bond (EMB) is a flexible estate planning solution designed for clients looking to maximise and protect family wealth for future generations whilst ensuring they maintain ongoing access to wealth should their circumstances change.

2. How does it Work?

The EMB is set up using a UK discretionary interest-in-possession settlement, allowing the client, as settlor of the settlement, to make a gift to a wide class of beneficiaries designed to operate within the Nil Rate Band (i.e. that part of an estate which is not subject to inheritance tax (IHT) – currently £325,000 2019/2020). The gift consists of the premium payable which is applied to a series of non-surrenderable cluster endowment policies. At outset the settlor must select the term of each individual policy, so they mature at predetermined sequential dates, to coincide with future income requirements, and revert back to the settlor of the trust should the trustees not elect to extend policy maturity date or dates.

The bond is established and immediately then assigned into a settlement and the benefit of the bond and operation of the investment of the assets within the bond will fall to chosen trustees of that settlement. The trustees have the ability to defer a reversion of benefits to the settlor by extending the maturity date

of a policy they consider is no longer required, or not required at that time.

The bond is written on the settlor's life and following their death, the trustees may distribute the settlements assets to the beneficiaries in a tax efficient manner. Whilst the bond ends on death of the settlor the trustees can, if they deem it appropriate, continue with the settlement in place and invest the settlement fund elsewhere.

3. Who can be the trustees?

There must be a minimum of two individual trustees, or one corporate trustee, at all times and the settlor and their spouse are excluded from being trustees as this is considered to be the most prudent approach to try and ensure the gift is not considered a gift with reservation.

4. What is the role of the trustee?

The trustees are the legal owners of the assets held subject to the settlement (in this case the bond and its proceeds and any additions to the settlement fund). The trustees' role will be determined by the terms of the settlement. The trustees owe a duty of care to the beneficiaries when investing settlement property, and must act fairly and reasonably, considering the interest of all beneficiaries or potential beneficiaries.

In relation to the investment of the settlement fund, the trustees must review this and consider the suitability of investments and the need for diversification. Trustees are also required to obtain and consider proper/professional advice on investment matters.

In simple terms, the trustees' job is to hold and manage the settlement fund in the best interests of the beneficiaries. This includes making the appropriate investment decisions and, when the time comes, making distributions from the settlement fund in accordance with the terms of the settlement deed. It is important for the trustees to realise that IOMA Life will require the approval/signatures of all of the trustees for all transactions relating to the Bond.

5. Can a trustee be changed?

The statutory power to appoint new and additional trustees will apply to the EMB settlement in accordance with the Trustee Act 1925.

By virtue of Section 36 of Part III of the Trustee Act 1925, where a trustee is dead, or remains out of the United Kingdom for more than twelve months, or wishes to be discharged from all or any of the settlements or powers reposed in or conferred on him, or refuses or is unfit to act as trustee, or is incapable of acting as trustee, or is under 18, then, subject to the restrictions imposed by the Act on the number of trustees, any persons nominated in the settlement to appoint trustees, or if there are none or no one is willing to act as trustee, then the continuing trustee(s) (or their personal representatives) may, in writing, appoint one or more other persons (whether or not being the persons exercising the power) to be a trustee or trustees in the place of said trustee.

IOMA Life has prepared draft deeds of appointment available for use by all relevant parties including the appointor, any continuing trustees, and retiring trustees and any additional trustees. Trustees should, however, note that IOMA Life is unable to provide legal advice which should be taken by all parties prior to entering into any legal agreements.

6. Can the beneficiaries be varied?

The EMB uses a discretionary settlement. Trustees can make payments to a wide range of potential beneficiaries, excluding the settlor and any spouse or civil partner of the settlor, during the settlor's lifetime. Trustees may add any other person in their absolute discretion by way of a deed at any time before the end of the perpetuity period/end of the life of the settlement provided they are eligible to act as trustee, and the additional beneficiary is not one of the trustees. The widow/widower of the settlor may also be included in the class of beneficiaries, after the demise of the settlor.

7. What happens in the event of the settlor's death?

As the sole life assured, the policies will terminate on the death of the settlor and this would be deemed a 'chargeable event' for the purpose of UK chargeable event legislation (see point 17(1) below).

The final payment from the bond, which includes an additional death payment of £100, will then be paid to the trustees who can, if appropriate, decide to make distributions to beneficiaries or to reinvest and keep assets within the protection of the trust.

8. What are the inheritance tax implications?

The gift into a discretionary settlement will be a Chargeable Lifetime Transfer (CLT) for IHT purposes and providing the settlor survives 7 years from making the gift, the CLT should become fully exempt from IHT.

A CLT will trigger an immediate charge to IHT if it, together with any other chargeable transfers made by the same person within the previous 7 years, exceeds the current Nil Rate Band. It is taxable at the lifetime IHT rate of 20% (half of the 40% death rate).

If the settlor dies within that 7 years period, the value of the chargeable transfer at the date of the gift is offset against any available Nil Rate Band at the date of death and any excess is chargeable to IHT, payable by

the trustees but with allowances for any IHT paid when the gift was made.

A CLT may also incur other settlement transfer charges if, for example money is distributed to beneficiaries from a settlement and also every 10th anniversary of the settlement if the value of the settlement assets exceeds the Nil Rate Band at the time. However, such gifts during the settlor's lifetime are not available under the EMB discretionary settlement as per Clause 3(a). Such gifts are only allowable after the 'Relevant Date'.

Any capital growth from the underlying settlement fund would fall out of the settlor's estate with effect from the date any such growth is applied to the fund.

9. Will the gift be classed as a gift with reservation of benefit?

The gift is not considered a gift with reservation of benefit under Section 102 of Finance Act 1986 since the reversionary interest of the settlor in the policies is property which is retained by the settlor and is not comprised in the gift. A deemed carve-out for IHT purposes.

This is the effect of the carve-out theory which has long been endorsed within UK case law and by HMRC in relation to gift with reservation issues concerning IHT plans involving reversionary interests for settlors under settlements. This has been endorsed in cases such as the *Ingram v IRC* (2000) 1 AC 293, HL.

10. Does Pre-Owned Assets Tax (POAT) apply (per Schedule 15, Finance Act 2004)?

Carved out reversions are deemed to be held in a bare trust for the settlor and do not therefore form part of any gifted property. This view concurs with HMRC's treatment of reversions under the Pre-Owned Asset Tax regime and HMRC has confirmed that the settlor's interest in such a bare trust will not be subject to the POAT charge.

11. Why are deferrals not treated as making a new gift?

The settlor makes a gift in the form of the premium payable and applied to a series of single premium policies into the settlement but retains the maturity rights of the policies which are clearly defined [as being in favour of the settlor]. This series of sequential reversionary interests constitute a bare trust for the settlor and are separate and distinct rights from the death benefit which is settled under the gift.

As such, HMRC have confirmed that these reversionary interests cannot be attributed with a substantive value at any particular time, given that the power to extend a maturity date lies with the trustees of which the settlor (and spouse) are excluded from being one. Deferrals will therefore not give rise to a chargeable transfer as they have no value.

12. Why are reversions not assessable for any potential exit and 10 year anniversary tax charges?

HMRC have confirmed reversions to the settlor do not give rise to an exit charge under Section 65(1)(a) of IHTA 1984. Also, those distributions will not be taken into account for the purposes of calculating the ten year charge under Section 64 (as it is considered that the distributions are derived from the reversions carved out from the gift and retained by the settlor, rather than from the property settled into the bond).

The rationale for this view is based on the fact the reversionary interest of the settlor is a bare trust and does not constitute 'relevant property' pursuant to Section 58 of Chapter III Part III of the Inheritance Act 1984.

13. What are the capital gains tax implications?

As the EMB is invested in a series of cluster single premium offshore life policies issued in accordance with Isle of Man law by IOMA Life, there will be no

liability to UK capital gains tax whilst assets are held within the bond.

14. What are the income tax implications?

On the maturity reversion to the settlor, of each policy, benefits are payable to the settlor. Any gain realised on the maturity of a policy will be subject to UK income tax at the settlor's highest marginal rate. The deferral of a maturity date does not trigger an income tax liability.

15. Are there any other tax implications?

The underlying investments comprising the bond usually roll up tax free, with the exception of any withholding taxes which may be imposed by certain jurisdictions. Investors should therefore always take their own financial and taxation advice prior to purchasing an EMB. Switching between investments within the bond does not give rise to any tax liabilities.

16. How are Adviser Charges paid?

Any initial Adviser Charge will be paid prior to the premium being applied at commencement. Any ongoing Adviser Charge will be calculated at the end of each calendar quarter and paid shortly afterwards.

The ongoing Adviser Charge will be deemed a withdrawal from the bond and will affect the level of the tax deferred allowance. The terms and conditions of the bond have been carefully drafted to allow for a small withdrawal facility, available to the trustees, to pay for professional fees such as an Adviser Charge. The maximum ongoing Adviser Charge has been limited to 1% per annum of the value of the bond at the time the charge is calculated.

17. What chargeable event reporting requirements will IOMA Life have to do in relation to the bond?

Where IOMA Life is aware of a policyholder being resident in the UK, we will have to report chargeable events where a gain or excess has arisen. A gain arises

from a policy of life insurance when a chargeable event occurs (see Section 462(1) of IT(TOI)A 2005). The chargeable gain is calculated in accordance with Section 491 of IT(TOI)A 2005. A chargeable event may occur in the following main circumstances:-

1. Death of the life assured

The death of the life assured is a chargeable event within Section 484(1)(b) of IT(TOI)A 2005. The total allowable deductions will be the policy(ies) premium and there will be no past gains. What is critical is the 'total benefit value' of the policy.

The 'total benefit value' of the policy is calculated in accordance with Section 492 of IT(TOI)A 2005 and, assuming that there are no loans in connection with EMB, will be the value of the policy in accordance with Section 493 of IT(TOI)A 2005. Under Section 493(7) of IT(TOI)A 2005, in the case of a chargeable event within Section 484(1)(b), the value of the policy is its surrender value immediately before the death.

The policies comprised in an EMB are non-surrenderable single premium policies. Nothing is paid by IOMA Life for the surrender of a policy immediately before the death of the life assured because there is no surrender facility and surrender will not be permitted in any circumstances.

A policy has no value for the purpose of Section 484 because there is no surrender value, and accordingly there is no gain in respect of the death of the life assured.

2. Maturity of the policy

A maturity of a policy is a chargeable event in accordance with Section 484(1)(c) of IT(TOI)A 2005. Any gain realised on the maturity of a policy will be subject to UK income tax at the settlor's highest marginal rate. The gain is calculated by taking the value of the matured policy, plus any withdrawals* and deducting the original premium, plus any chargeable excesses*.

* see above 'Adviser Charges' and point 3 below.

3. Partial surrenders in excess of the cumulative 5% rules

In accordance with Section 498(1)(a) of IT(TOI)A 2005, and as calculated in Section 507(5), a chargeable excess will occur where an amount in excess of 5% per annum of the premiums paid is withdrawn, or the cumulative 5% allowance if not previously withdrawn, in any one policy year.

The EMB is structured to provide potential payments to the settlor by way of maturing policies (see point 2 above 'Maturity of the policy'). Under the terms and conditions of the EMB the bond does provide a small withdrawal facility (1.5% per annum) which is available solely for the trustees to pay professional fees, including Adviser Charges. Adviser Charges are deemed partial surrenders for the purposes of Section 498(1)(a) of IT(TOI)A 2005.

4. Total policy surrender

Taking the full benefits from a policy by way of a total surrender, in accordance with Section 484(1)(a) IT(TOI)A 2005 and as calculated in Section 541 ICTA 1988, is a reportable chargeable event if a gain arises under these calculations.

The EMB is a non-surrenderable policy and as such this point does not apply.

5. Assignment for money or money's worth

Similar to point 4 above 'total policy surrender' (Section 484(1)(a)), taking the benefits from a policy by assigning for money or money's worth, where a gain arises, will be a reportable chargeable event.

With the exception of the assignment into the settlement immediately following establishment of the EMB (the gift), the EMB is non-assignable.

However, the settlor may make a gift contingently of any policy reversions in order to shift any income tax liability onto the recipient person. Such gifted value will be a new PET upon the settlor.

Important Note

Investors should note that there is no surrender option under the EMB and IOMA Life will not permit any request for a contractual or non-contractual surrender in any circumstances.

18. Are there any other reporting requirements?

Under the Foreign Account Tax Compliance Act (FATCA) IOMA Life have to report a policy to the US IRS, via the Isle of Man Government, where any US persons are connected with the policy. FATCA is intended to detect and deter the evasion of US tax by US persons who hold money outside the US. FATCA creates greater transparency by strengthening information reporting and compliance by imposing rules around the processes of documenting, reporting and withholding on a payee. These rules not only impact the financial services sector, but also affect many entities outside of the traditional financial services sector with operations both in and outside of the United States.

Following the implementation of the Common Reporting Standards (CRS) (see below), IOMA Life will be required to report any persons connected with the policy to a jurisdiction in which they have a domicile, residence or tax connection. CRS is the reporting standard approved and developed by the Organisation of Economic Co-operation and Development (OECD) in 2014 and requires jurisdictions to obtain relevant information from their financial institutions and automatically exchange that information with other jurisdictions on an annual basis. It sets out the financial account information to be exchanged, the financial institutions are required to report, the different types of accounts and taxpayers covered as well as common due diligence procedures to be followed.

CRS is based upon tax residence and not citizenship, as is the case with FATCA.

19. Is there a requirement to disclose the EMB for the purpose of the Disclosure of Tax Avoidance Scheme (DOTAS) rules?

The IHT hallmark was introduced with effect from 6 April 2011 and was designed only to detect a specific type of IHT avoidance involving the use of trusts. Arrangements which are the same, or substantially the same, as arrangements which were made available before that date did not need to be disclosed under the hallmark. EMB was considered a hallmarked scheme since the concept has been in use for over 20 years before the hallmark was introduced.

The Government announced a package of measures to strengthen the DOTAS regime at the March 2015 budget. This included its intention to strengthen the descriptions (hallmarks) of schemes which must be disclosed and to expand the scope of the IHT hallmark.

The Government remains committed to updating the IHT provisions in DOTAS to ensure that the regime operates more effectively but recognises concerns that the draft was drawn too widely. The Government consulted again on a revised IHT hallmark in 2016.

In relation to discounted gift trusts (DGT), HMRC acknowledged in their summary of responses, dated February 2016, to their Technical Consultation:

“With regard to DGT-style arrangements with maturity dates which can be deferred by the trustees, the settlor makes a gift which is not discounted. In the Governments view the settlor is in a similar position to someone who has made a lifetime gift of the property. The Government confirms that it is not intended to catch these arrangements and will further consider whether clarification or amendment to the hallmark is required”.

The Government released a revised IHT hallmark Consultation on 20 April 2016. Flexible Reversionary Trusts, such as EMB, are now included in the ‘Excepted Arrangements’ in the Schedule.

“Flexible reversionary trusts. The transferor (“S”) establishes a settlement or bare trust of which S

cannot be a beneficiary. S assigns to the settlement one or more contracts of life assurance or capital redemption policies. S retains specified rights to future payments, if S is alive at the date the payment falls due (the “retained rights”). The payments may be fixed cash sums, the maturity proceeds of an individual policy or specified benefits under a policy. The retained rights can be defeated or varied by the trustees before the payments fall due”.

The revised IHT DOTAS rules came into force on 1st April 2018.

Under the revised rules, the wording had been changed to ensure that the new hallmark is appropriately targeted to catch IHT avoidance schemes but not the straightforward use of reliefs and exemptions or ordinary tax planning arrangements.

The new hallmark also ensures that established retail products, which accord with established practice that HMRC has previously accepted, do not have to be disclosed if they were first made available before 1st April 2018.

20. Is the EMB subject to the General Anti-Abuse Rule (GAAR) provisions?

The concept of the EMB, commonly referred to by the financial services industry as a flexible reversionary trust, has been used by the financial services industry for over 20 years. The EMB has not been designed as a tax avoidance structure and its objective is instead to provide for IHT mitigation.

Carve out arrangements, where the taxpayer has carefully defined what he has given away by way of gift, accord with established practice and so are not considered within the scope of GAAR.

21. Who advised IOMA Life about the EMB?

IOMA Life has obtained Counsel’s opinion from an experienced UK Counsel specialising in trust law and who has worked closely with the originators of the EMB concept for over 20 years.

22. Order of Gifting

In situations where CLTs are made, as well as PETs, then gifts into settlements of 'Relevant Property' should precede any PETs. Please see Uni-Tech Due Diligence pack for further details.

Important Notes

The content of this document is based on IOMA Life's understanding of the taxation of offshore bonds and settlements in the UK at the date of this document. IOMA Life is, however, unable to provide clients with taxation advice and we would always recommend seeking independent tax advice for an individual's circumstance.

The concept of the EMB structure originates from the early 1990's and has been tried and tested for nearly three decades with input from HMRC when thought necessary.

IOMA Life has successfully been offering its award winning estate planning solutions for over a decade.

Disclaimer

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IOMA Life is authorised and regulated in the Isle of Man by the Isle of Man Financial Services Authority. Holders of policies issued by IOMA Life will not be protected by the United Kingdom Financial Services Compensation Scheme if the company should become unable to meet its liabilities to them. However, holders of policies will be protected under the Isle of Man Life Assurance (Compensation of Policyholders) Regulations of 1991.

Investors should note that the value of investments and any income from them can go down as well as up and investors may not get back the amount originally invested. Past performance is not a guide to future performance. Any returns are subject to counterparty risk.

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