Settlor-interested trust (SIT)

Purpose

To remove an asset from an individual's IHT estate whilst allowing them to retain the income.

Summary

An individual or a couple settle assets such as an investment portfolio or a second property into a SIT (note, the family home cannot be used). They would continue to be entitled to the income from the asset and, as they would also be trustees, would have complete control over the investment. They could not 'eat into' the capital; however, in practice enough assets should be retained in their estate for this not to be an issue. After seven years, it is outside the IHT estate.

Method

An individual settles assets not exceeding the NRB into an interest in possession (IIP) trust for life, in which he/she is also the income - but not capital - beneficiary and the trustee.

On death, the trust can continue in use for other members of the family or come to an end and the assets go to family members in the same way as if done by will.

Case Study

John and Yoko have the following assets in their estate:

	£
Main residence	1,000,000
Investments	900,000
Rental property	800,000
Total estate	2,700,000

Their IHT exposure is £2.7m less £650k @ 40% = £820k (note the main residence nil rate band will not apply because the estate is too big). This cannot be reduced by making gifts as they want to retain the income from the dividends and rent. John and Yoko decide to use a SIT to reduce this exposure. The investments and the rental property up to the value of £650k can be transferred into a SIT. After seven years, the IHT exposure would be reduced by £260k. Note, the main residence nil rate band would also be available as a consequence thereby reducing the IHT exposure further.

CGT must be considered before transferring the properties, as holdover relief is not available for SITs:

- As one of the rental properties used to be their main home, principal private residence and the letting exemption apply, reducing the gain to nil. It is therefore transferred. Its value is £450k.
- A further £250k of investments are then transferred. By transferring the investments with a small gain or a loss, John and Yoko manage to avoid CGT arising on this transfer.

John and Yoko are the trustees, so they can sell the investments or the rental property as and when they choose and replace them with other assets. They cannot 'eat into' the capital, but this does not matter as there is sufficient capital in the remaining assets, should they require it.

After seven years, the SIT will be outside of their IHT estate.

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