Sanlam

Wealth

Discretionary discounted gift trust

AT A GLANCE

A discretionary discount gift trust provides families with the flexibility and control to organise their estates efficiently

Important information: This guide is for use by financial advisers only. It is not intended for onward transmission to a private customer and should not be relied upon by any other person.

The discretionary discounted gift trust facilitates lifetime inheritance tax (IHT) planning for an investor (the 'settlor') when used in conjunction with a Sanlam single premium life insurance bond. It enables the settlor to immediately reduce his or her taxable estate for IHT purposes by the amount of the discount, while retaining an entitlement to fixed payments from the trust for life. If the value of the discounted gift along with any other chargeable transfers made in the previous seven years is lower than the current nil rate band, there should be no immediate IHT consequences. Any growth on the invested amount is immediately outside of the settlor's estate for IHT purposes, and provided that the settlor lives for at least seven years from the date of the gift and makes no further chargeable transfers, there should be no IHT consequences for the gift to the trust.

Definitions

Appointor: the settlor during his lifetime and, after his death, the trustees.

Default beneficiaries: the individual(s) who will benefit from the trust in the unlikely event that the power of appointment is not exercised by the appointer by the end of the trust period (125 years from the time the trust is created).

Discretionary beneficiaries: the beneficiaries listed in part 2 of the trust deed, which includes any spouse/civil partner, former spouse/civil partner, widow or widower, children, brothers and sisters of the settlor.

Settlor: the person who makes the gift to the trust.

Objectives

- The purpose of the discretionary discounted gift trust is to facilitate IHT planning, by allowing the settlor to make a gift to the trust which will be held for the benefit of the named beneficiaries.
- To immediately reduce the value of the settlor's taxable estate for IHT purposes, by the amount of the discount.
- To allow the settlor to receive fixed payments from the trust for life.

The settlor's fund comprises a series of specified payments at pre-specified frequencies (the regular withdrawals). The remainder of the trust fund, known as the beneficiaries' fund, is held for the settlor's intended beneficiaries, and this is the part that is gifted. The settlor in his capacity as the appointor retains considerable legal control over who benefits from the trust fund during his or her lifetime.

The discretionary discounted gift trust may be suitable where:

- The settlor(s) is aged over 60, and wishes to mitigate a potential IHT liability.
- The settlor wishes to retain an entitlement to payments from the trust, but is happy that this is restricted to a series of fixed capital withdrawals.
- The settlor is happy to give up access to the rest of the investment.
- The settlor is in reasonably good health (a medical report will be requested to determine the level of discount). Full underwriting will be carried out for each case as 'evidence' of the level of discount should this be queried by HM Revenue & Customs.
- Single or joint settlors (such as spouses/civil partners) wish to make a gift for IHT purposes.

It is not advisable for each of a married couple (or registered civil partners) to set up separate discretionary discounted gift trust arrangements at the same time, as this may defeat the tax planning purpose of the arrangement.

Questions and answers

Can the settlor benefit from the beneficiaries' fund?
No, but the settlor has the right to capital payments from the trust throughout his or her lifetime. For joint settlors (such as spouses/civil partners), withdrawals continue to the survivor for their lifetime.

How is the value of the settlor's rights to future capital payments determined?
By taking into account the settlor's age, state of health and the amount and frequency of the payments.

Can the settlor, as the appointor, exercise the power of appointment in favour of his/her spouse/civil partner with trust benefits paid to the spouse/civil partner?
Technically yes, but it is not recommended as it may defeat the IHT planning purpose of the trust.

What happens if the settlor no longer needs payments from the trust?
Payments must continue to ensure that the trust is tax effective. The settlor then could gift the cash he receives from the trustees to anyone, including any of the intended beneficiaries.

Are there are any geographical restrictions?
Should the settlor require Scottish law to apply to the trust, appropriate professional advice should be taken. There is some uncertainty over whether a discounted gift trust can be validly constituted under Scottish law.

What happens following the death of the settlor or the death of both settlors?
The value of the trust fund (the bond) is outside of the settlor's estate for IHT purposes. If the settlor does not survive the gift by seven years, the value of the discounted gift will form part of his estate for IHT purposes. If no IHT was due on the original transfer (because the value of the discounted gift was below the nil-rate band and no previous gifts had been made), there should be no further tax due on the gift to the trust. However, the value of the transfer will use up some or all of the nil-rate band, increasing the amount of IHT that is payable on the rest of the estate.

Forms and guides

- *Discretionary discounted gift trust – adviser's guide*
- *Discretionary discounted gift trust – trust deed*
- Medical questionnaire
- Appropriate Sanlam single-premium life insurance bond key features and application form

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