

Discretionary gift trust

AT A GLANCE

The discretionary gift trust provides individuals with a useful inheritance tax solution by enabling them to make gifts in a tax-efficient way

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 gift trust facilitates lifetime inheritance tax (IHT) planning for an individual when used in conjunction with a Sanlam single premium life insurance bond. It allows an individual or individuals (the settlor/s) to make a lifetime gift for IHT purposes. If the value of the gift along with 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 three of the trust deed, which includes any spouse/civil partner; former spouse/civil partner; widow or widower; children; and brothers or sisters of the settlor.

Settlor: the person creating the trust.

Objectives

- The purpose of the discretionary gift trust is to facilitate lifetime inheritance tax planning for an individual, either by making a gift of an existing policy or by applying for a new policy to be held under the trust.
- As the policy is held subject to the terms of the trust, it is not an asset of the settlor's estate, however, there may be IHT consequences if the settlor dies within seven years of establishing the trust or makes a further chargeable lifetime transfer within that period. The amount of any IHT liability will depend on the value of the chargeable lifetime transfer to the trust as well as the value of any previous and/or subsequent chargeable transfers.

- As appointor, the settlor can retain considerable legal control over who benefits from the trust fund during his lifetime.

When is the discretionary gift trust suitable?

- If the settlor wishes to mitigate his IHT liability and does not require access to the investment.
- If the settlor is not prepared to commit to a gift to any particular named beneficiary, and wishes to retain control over who will ultimately benefit from the trust property.
- If a single settlor or joint settlors wish to make a lifetime gift (for example spouses/civil partners).

Please note that it is not advisable for each of a married couple (or registered civil partners) to set up separate discretionary gift trust arrangements, as this may defeat the tax planning purpose of the trust.

It is recommended that the policy is effected on the lives of two or more people on a last survivor basis. This avoids automatic encashment on death under a 'sole life assured' or 'first death' policy.

Questions and answers

What happens on the settlor's death?

If the settlor is the sole life assured, the bond will automatically encash on his death. It is therefore recommended that the policy is effected on the lives of two or more people, on a last survivor basis. This avoids automatic encashment on death, where there is a sole life assured.

On the death of the settlor, what value is taken for IHT purposes?

If the settlor survives for a period of at least seven years from the date of making the gift and makes no other subsequent chargeable transfers, there should be no IHT consequences of making the gift to the trust.

Is probate required on the settlor's death?

As the trust assets do not form part of the settlor's estate, no grant of probate is required upon the settlor's death in relation to the trust property.

How is the trust established?

The settlor normally applies for a single premium life assurance policy, which is issued to the settlor in his capacity as trustee. The settlor will be required to appoint at least one additional trustee. However, it is also possible for an existing policy to be assigned to the trust.

How many trustees should be appointed?

The settlor and at least one other individual (preferably two) must be appointed as original trustees. The settlor has the power to appoint and remove trustees.

Can the settlor remove a trustee?

Yes, as long as there are at least two trustees remaining after the removal.

Who are the beneficiaries of the trust?

There are two classes of beneficiaries: the default (named) beneficiaries and the discretionary beneficiaries. No beneficiary has any specific rights to the capital or income of the trust unless the trustees exercise their discretion and appoint benefits in their favour.

Can the settlor benefit under the trust?

No, in order that the trust is effective for IHT purposes, the settlor cannot benefit under the trust in any circumstances. However, the settlor can retain considerable legal control over who benefits from the trust fund during his lifetime.

Can the settlor make payments to his spouse/civil partner during his lifetime?

A payment to the settlor's spouse/civil partner during the settlor's lifetime should be approached with caution as it is essential that the settlor does not personally benefit from the trust property. If this were to happen, the gift to the trust would be treated as a 'gift with reservation' which would defeat the tax planning purpose of the trust.

What happens if a gift is made to the trust during the settlor's lifetime which is in excess of the nil rate band?

This will give rise to a lifetime IHT liability (the gift to the trust is a 'chargeable lifetime transfer'), and specialist tax advice should be taken before proceeding.

Can new and existing policies be used?

Yes, the trust can be used in connection with both new and existing Sanlam life assurance policies.

Can the trust be used with a joint policy?

Yes, the trust can be used regardless of whether the policy is owned or applied for by one or two individuals. The person creating the trust is the settlor and where two people own a policy or are affecting a policy that is being placed in trust, they are joint settlors

Is the trust subject to periodic and exit charges?

Yes, as the trust is a discretionary trust, it is potentially subject to an IHT charge on the value of distributions from the trust and on each 10-year anniversary. For more information on how these charges are calculated, please refer to the *Discretionary gift trust - adviser's guide*.

Forms/guides

- *Discretionary gift trust - adviser's guide*
- *Discretionary gift trust - trust deed*
- *Deed of appointment of trustees*

Note: we require a minimum of two trustees from the outset of the trust. This deed must always be completed where there is a single settlor.

- Appropriate Sanlam single premium life insurance bond key features and application form.



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