

Absolute gift trust

Adviser's guide

Adviser's guide to the absolute gift trust

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 on by any other person.

In this document, the term 'spouse' includes a registered civil partner under the Civil Partnership Act 2004 and 'married' also refers to a person who is in a registered civil partnership.

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Section 1: Objectives and suitability

The aim of the specimen Sanlam absolute gift trust deed is to facilitate effective lifetime inheritance tax (IHT) planning. Potential users of the Sanlam absolute gift trust could be:

- new investors contemplating an investment in a new Sanlam onshore bond; and/or
- those already holding an investment in a bond.

The investor using the Sanlam absolute gift trust is called the donor. By using the Sanlam absolute gift trust with cash intended for an investment in a new bond or with an existing bond, the donor will be making an outright gift for IHT purposes.

Where an investor creates a Sanlam absolute gift trust in respect of a new bond, the premium to the bond will usually be a potentially exempt transfer (PET) for IHT purposes to the extent that it exceeds the donor's available IHT annual (£3,000) exemption.

When an existing bond is made subject to trust, the value of the gift will be the market value of the bond (or, if greater, the premiums paid to date less the value of any part surrenders and an allowance for any decrease in the value of units since allocation at inception of the bond). This will usually be a PET to the extent that it exceeds the donor's available annual exemption.

To ensure that the Sanlam absolute gift trust is effective for IHT purposes, the donor cannot benefit from the trust assets in any circumstances. Indeed, with the Sanlam absolute gift trust, the only person(s) who can benefit is/are the beneficiary(ies) named in the trust.

Details of the UK tax implications of the Sanlam absolute gift trust can be found in section 5 of this guide.

As well as being able to secure important tax benefits, the Sanlam absolute gift trust offers important probate avoidance advantages. The bond (or investments representing it) that is subject to the Sanlam absolute gift trust will not be an asset of the donor's estate for probate purposes which means that, on the death of the investor, the trustees can carry on dealing with the

investment without waiting for probate or letters of administration to be obtained in respect of the donor's estate.

To ensure that the need for probate or letters of administration in the event of the donor's death is avoided, the legal ownership of the bond must be with a person or persons other than the donor on his or her death. Therefore, this benefit will only be secured if there is at least one trustee who survives the donor. Under the Sanlam absolute gift trust, the donor(s) is automatically the original trustee(s). Additional trustees are appointed by the donor using a separate deed of appointment. A minimum of two trustees (including the donor) is recommended at all times.

If any of the additional trustee(s) retires, is removed as a trustee, or dies before the donor, a further trustee should be appointed.

The power of appointing trustees vests in the donor (whilst alive) and thereafter in the trustees. If no additional trustees are appointed, or if they have been appointed and retired, died or been removed, so that there is no surviving trustee on the death of the donor, the trust will nevertheless continue to exist.

The personal representatives of the deceased donor will then assume the role of Trustee under the Sanlam absolute gift trust. This means that, although the trust investment will not be part of the donor's estate for IHT or probate purposes, securing probate or letters of administration in respect of the donor's estate will still be necessary to ensure that the personal representatives can act as trustee under the trust. Clearly then, it is very important that additional trustees are appointed who are likely to survive the donor, so as to ensure that any delays in being able to deal with the trust investments are avoided.

Provided the legal and tax implications of the Sanlam absolute gift trust are acceptable to the donor, the Sanlam absolute gift trust can be used regardless of whether the gift is to be made by one donor or two jointly. For example, when cash for a new bond investment is coming from a couple's joint account or an existing bond is jointly owned.

Section 2: Inheritance tax planning

Following the reform of the taxation of trusts in March 2006, lifetime inheritance tax planning has been made considerably more difficult. Until 21 March 2006, most lifetime gifts to trusts were treated as potentially exempt transfers (PETs) for IHT purposes; now most lifetime gifts to trusts are treated as chargeable lifetime transfers. As far as gifts into trust are concerned, only gifts into absolute trusts or into trusts for the disabled are still treated as PETs. The Sanlam absolute gift trust therefore offers one of the few remaining opportunities to secure the PET treatment on a gift.

To ensure that the donor makes an effective gift for IHT purposes, the donor must not retain any benefit (actual or prospective) under the trust. This is the case with the Sanlam absolute gift trust, as the donor is specifically excluded. The trust is expressed as being irrevocable and the only persons who can benefit are those individuals named as beneficiaries by the donor in the trust deed. There is, therefore, no doubt about the IHT effectiveness of this trust.

The Sanlam absolute gift trust is not suitable where:

- an investor requires some beneficial access to the investment; or
- an investor does not require access to the investment but nevertheless requires some control over the ultimate destination of the benefits.

In these cases, although the Sanlam absolute gift trust will not be suitable, a different type of trust may be. Other specimen trust wordings are available from Sanlam Investments and Pensions.

For a detailed consideration of the IHT implications of the Sanlam absolute gift trust, please see section 5.

Section 3: Income tax planning

Normally when chargeable event gains arise on a life assurance policy held in trust, they will be taxed on the settlor of the trust if they are alive and UK resident, failing that they will be taxed on the trustees. However, in the case of an absolute trust, Her Majesty's Revenue & Customs (HMRC) takes the view that any chargeable event gains should be taxed on the beneficiary who is absolutely entitled.

The exception to this is in cases where the beneficiary is a minor child (not married or in a civil partnership) of the settlor (donor) when, if chargeable event gains cause relevant income to exceed £100, they will be fully taxed on the settlor (donor). In considering whether the £100 relevant income figure has been breached, account needs to be made of all gross income arising in a tax year on all gifts made by the parent for that child.

This interpretation by HMRC gives rise to some useful planning opportunities. In particular, if a grandparent invests in a Sanlam Offshore Bond subject to a Sanlam absolute gift trust for the benefit of a grandchild, then all chargeable event gains will be taxed on the grandchild. This means that, if the grandchild has no or little other income, chargeable event gains may well fall within the grandchild's personal allowance and be tax free. This could be very attractive where segments within a bond are being encashed on a regular basis to provide a stream of cash payments to pay for, say, school fees or the costs of a university education for the grandchild.

Section 4: The trust provisions in detail

The Sanlam absolute gift trust provides that the beneficiary named in the trust deed is entitled absolutely to both the income and capital of the trust. If there is more than one beneficiary named, they benefit in the shares specified and neither the beneficiaries nor their entitlements can be changed.

The following is a summary of the key provisions as they appear in the specimen Sanlam absolute gift trust deed.

Section 1 – Execution of the deed and trust declaration

The deed is executed by the donor. Additional trustees should be appointed using a Deed of Appointment of Trustees. A specimen deed is available from Sanlam Investments and Pensions.

Section 2 – New or existing bond

Alternative provisions are applied depending on whether a new bond is being effected in trust or an existing bond is being transferred into trust. The details of the new or existing bond need to be inserted in section 2 of the trust.

Section 3 – Definitions

In this part of the trust, the terms used throughout the trust are defined to avoid repetition. The most important definition is that of the beneficiaries.

The beneficiaries are those named in the trust deed. To identify them, the donor inserts their full names. If there is more than one, their shares also need to be specified, otherwise they benefit equally. It is essential that the cumulative shares add up to exactly 100%, otherwise adverse tax consequences may arise to the trust.

Section 4 – Principal trust terms

In this section, the rights of the beneficiaries are defined (that they are absolutely entitled to the trust capital and income). However, because in most, if not all, cases the beneficiaries will be children under the age of 18 (16 in Scotland), the trustees are also given powers to use the trust income (if it arises) and capital for the beneficiary's maintenance, education or benefit. When

the child reaches the age of full legal capacity, he or she will be able to take control of his or her share of the trust fund.

Section 5 – Administrative provisions

The trustees also have wide administrative powers to deal with the trust fund and to reinvest the proceeds of any investment in any way they wish. They also have the power to borrow funds, to make payments to parents or guardians of minor beneficiaries (which is particularly relevant to this trust) and to delegate certain powers.

Section 6 – Appointment, removal, retirement and remuneration of trustees

The trust contains comprehensive provisions applying to the trustees.

The power to appoint new or additional trustees is vested in the donor during his or her lifetime and, after his or her death, in the trustees. The donor also has the power to remove any trustee, provided at least one trustee, other than the donor or donor's spouse, remains after such removal. There is no power to remove a trustee after the death of the donor, and it must be remembered that the trustees under a trust subject to English law, or the law of Northern Ireland, must act unanimously. In Scotland, trustees can make decisions by a simple majority.

If two persons are joint donors, they exercise their powers jointly during their joint lives and, after the death of the first, the survivor exercises the donor's powers alone.

There are also powers dealing with the retirement of Trustees and corporate trustees.

Trustees who act in their professional capacity are entitled to charge fees for services provided.

Section 7 – Further trust provisions

These mainly deal with the trustees' liability in relation to the trust.

The liability of individual trustees is limited so that they will not be held liable for any loss to the trust fund, provided they act in good faith. Trustees who are paid for their services are also liable for negligence.

Section 8 - Proper law

The donor may choose whether the trust is to be governed by the law of England and Wales, Scotland or Northern Ireland. This choice will normally be determined by where the donor's permanent home is. The law selected does not affect the beneficial provisions of the trust, or the tax implications in the UK, but may be relevant to the donor and/or trustees, should they need to clarify any legal points in connection with the trust, or in the event of dispute.

If no selection is made to the contrary, the trust will be governed by the law of England and Wales.

Section 9 - Signatures

The donor(s) should sign in section 9. Any signatures should be duly witnessed by an independent person.

Section 5: The UK tax implications

In the following section, it is assumed that the donor, the beneficiaries and the trustees of the trust are UK resident and domiciled. Special rules apply where this is not the case.

Inheritance tax (IHT)

Establishment of the trust

- For IHT purposes, a transfer of value (a gift) takes place at the time the trust is created.
- Where there are two donors, each is treated as making a gift based on the amount actually transferred by each of them.
- When a new bond is being effected subject to trust, the value transferred will be the premium paid (the amount invested in the bond after deduction of any initial adviser fees). If the amount of the gift exceeds the donor's available IHT annual exemption, currently £3,000 for each donor (£6,000 maximum for each donor if the exemption for the previous tax year has not been used), it will be a potentially exempt transfer (PET). This means that, regardless of the amount of the transfer, no tax liability will arise at the time of the transfer.

A tax liability on the gift could only arise if the donor dies within seven years of making the transfer and even then, only if the value of the gift together with any chargeable transfers made in the seven years immediately preceding the gift exceeds the available IHT nil rate band at the date of death. On the donor's death within seven years of making the gift, the value of the original gift will be taken into account in determining the IHT liability due on the donor's estate.

- When an existing bond is made subject to trust, the value of the gift will be the market value of the bond (or, if greater, the premiums paid to date less the value of any part surrenders and an allowance for any decrease in the value of units since allocation at inception of the bond).

Additions to the trust by the donor

- Any additional premium paid by the donor into a bond held by the trust (for example, as a top up to an existing investment) will be a further gift, and

the IHT implications will be as described above for the initial gift. To the extent that the additions are not covered by the annual exemption, the amount of the gift that will be treated as a PET will be equal to the amount by which the value of the investment is increased by the transfer.

Death of a beneficiary

- The beneficiaries are treated as owning the trust property for IHT purposes.
- On the death of a beneficiary, the value of the beneficiary's underlying interest in the trust property (the bond) will be included in his or her estate. So, if there is more than one beneficiary, the value included in the deceased beneficiary's estate will be the value of his or her share of the trust fund.
- If, as will usually be the case, the beneficiary is under the age of 18 (16 in Scotland), unmarried and not in a civil partnership, the assets will usually pass to the deceased beneficiary's parents under the rules of intestacy.

Death of the donor

- On the death of the donor (or, where appropriate, either of the donors) more than seven years after establishing the trust, the value of the trust investments will be outside of the donor's estate for IHT purposes.
- IHT could potentially be a problem where the value of the original gift to the trust is not covered by any available exemption(s) and the donor dies within seven years of creating the trust. This is because the original PET will become chargeable on the death of the donor. Even then, as stated above, if the value of the original gift is within the available IHT nil rate band, no liability will arise on the gift itself. However, the nil rate band available to determine the liability arising on the estate on the death of the donor will be correspondingly reduced.

No other IHT charges will arise under the Sanlam absolute gift trust. In particular there will be no periodic charges or exit charges when payments are made to the beneficiary – such charges are only relevant to trusts that are settlements. The Sanlam absolute gift trust is not a settlement.

Capital gains tax

Creation of the trust

There will be no capital gains tax (CGT) implications arising as a result of the donor holding a new bond under the Sanlam absolute gift trust. However, a CGT charge may arise on the disposal of assets, such as shares or units in a collective investment scheme, if these are sold in order to provide the cash investment into the bond.

There are generally no CGT implications if a bond is transferred to a trust (unless the donor is not the original owner of the bond and it had been acquired for financial consideration).

Trust capital gains

Because chargeable gains arising from a bond are subject to income tax not capital gains tax, there will be no CGT implications for the trustees if encashments are made under the bond.

Income Tax

Income tax implications will arise where a chargeable event gain arises from the bond.

The general rule is that any chargeable event gains arising from the bond will be assessed to income tax on the beneficiary, even if the beneficiary is a minor and the bond is still legally owned by the trustees (see below for absolute trusts where the beneficiary is a minor unmarried child of the donor). This means that an income tax charge will only arise in respect of an onshore bond if the beneficiary is a higher rate taxpayer (where the rate of income tax suffered will be 20% (40% less the 20% tax credit)).

In the exceptional case of a beneficiary having taxable income of more than £150,000 in a tax year, the rate would be 25% (45% less the 20% tax credit). In the case of chargeable event gains arising under an offshore bond, the gains will be taxed at the beneficiary's appropriate rate of tax for savings income. This means that, to the extent that they exceed the beneficiary's personal allowance, they will be subject to income tax at 10%, 20% or a higher rate of 40% (and exceptionally 45%).

In determining whether a beneficiary will be subject to higher or additional rate tax on a chargeable event gain arising on an onshore or offshore bond, top-slicing relief may also be available.

If the beneficiary of the trust is a child of the donor, and that beneficiary is unmarried and under the age of 18, then any chargeable event gains will be assessed for income tax on the donor if, when added to any other income on gifts made by the donor to that child, the total income exceeds £100 in a tax year. The £100 limit applies per parent donor per child.

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