

Strength through choice



Discounted Gift Scheme – Explanatory Guide

What is a Discounted Gift Scheme?

A Discounted Gift Scheme can provide a person with the opportunity to reduce their potential inheritance tax (IHT) liability by making a lifetime gift into a trust, which may be discounted for inheritance tax purposes, whilst retaining the right to receive fixed regular payments at specified intervals.

How could a Discounted Gift Scheme help your clients?

- It provides the potential for an immediate reduction in the value of a person's estate for IHT purposes.
- The entire cash gift will be outside the person's estate for IHT purposes after seven years.
- Any growth on the bond will immediately be outside the person's estate and therefore not liable to IHT.
- It provides the right to receive fixed regular payments at specified intervals for life or until the value of the bond is exhausted, whichever comes first.
- The trust fund can pay any IHT or income tax charges that are attributable to the trust fund.
- It provides the ability to take regular payments of up to 5% a year, of the original investment amount cumulatively (up to a maximum of 100% of the original investment) without any immediate income tax charge. Full or partial surrenders by the Trustees to meet specified trust expenses will reduce the amount of regular payments that can be taken without incurring an immediate income tax charge.
- After the person's death, the bond in the trust fund will be held for the benefit of their beneficiaries.

How does it work?

Each person that intends to make a cash gift must first complete a medical questionnaire. This is then used, in conjunction with a medical report obtained from their doctor, to establish the person's life expectancy.

Based on this information and the monetary amount of the fixed regular payments they wish to receive, a discounted gift valuation is produced. Once the person has decided to proceed, they must then decide which trust they would like to use.

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There are two types of Discounted Gift Trust available:

Absolute Trust

The beneficiaries are named at the outset, their shares are defined and these can never be changed. The beneficiaries are absolutely entitled to the trust fund, subject to the Retained Rights. The person who creates an absolute trust is described as the Donor.

Discretionary Trust

There are classes of beneficiaries (such as children, grandchildren) but their shares are not defined since the Trustees have absolute discretion over who can benefit from the trust, by how much and when, subject to the Retained Rights. The person who creates a discretionary trust is described as the Settlor.

Who sets up the Discounted Gift Trust?

The trust is set up by the person executing the trust deed and by making a cash gift to the Trustees. The amount of the cash gift must be entered on the trust deed. The amount of the fixed regular payments and their frequency must also be entered on the trust deed.

The Trustees then invest the cash into the Discounted Gift Portfolio Bond, which is a single premium whole of life assurance policy, making sure that the fixed regular withdrawal section of the Trustees' application form matches the Retained Rights as expressed in the trust deed.

The trust is created with two interests:

Retained Rights

These comprise the right of the person making the gift to receive fixed regular payments at specified intervals for life from the bond taken out by the Trustees or until the value of the bond is exhausted, whichever comes first. Once selected, the person's Retained Rights cannot be varied. The person who created the trust cannot benefit from any other part of the trust fund.

The Beneficiaries Rights

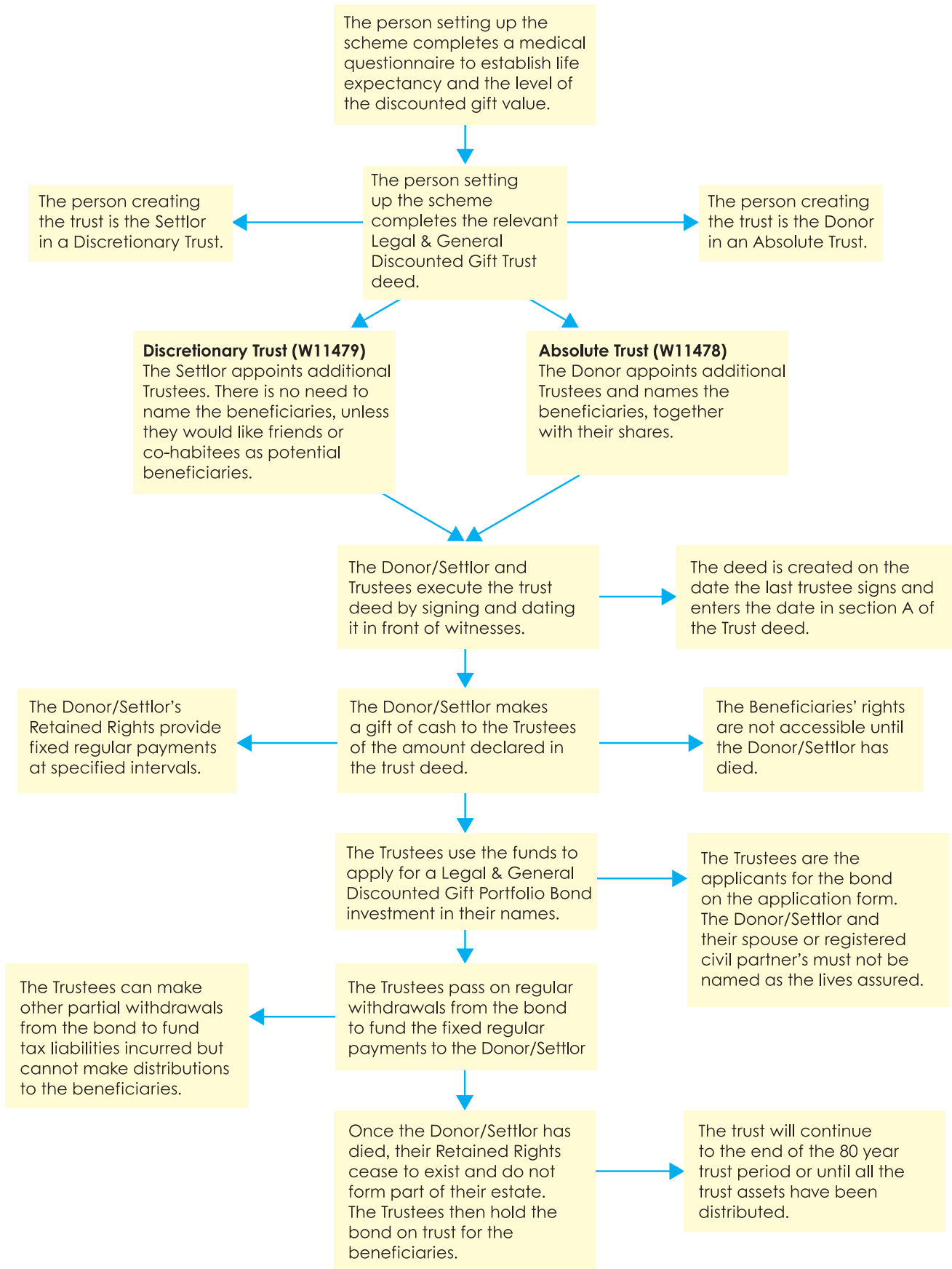
These comprise the cash gift less the actuarial value of the Retained Rights to receive fixed regular payments. This represents the part that has been gifted for the benefit of one or more beneficiaries and will be the value that is used for the purposes of calculating any IHT liability.

Key facts about the Discounted Gift Scheme

- The transfer of value that the Beneficiaries Rights represent under the Discounted Gift Scheme is determined at the outset by taking the cash gift made to the Trustees and deducting from it the actuarial value of the Retained Rights to receive fixed regular payments. This is because at the time the trust is created, the Donor/Settlor's rights to receive regular payments in the future have a value for IHT purposes.
- The present value of these Retained Rights reduces the value of the overall cash gift made. The Retained Rights are described as the "discount" and have no value for IHT purposes since the payments will cease on the death of the Donor/Settlor or, the last Donor/Settlor, where there was a joint gift into the Discounted Gift Scheme.
- The methodology used in calculating the discount has been confirmed by Her Majesty's Revenue & Customs (HMRC).
- Under the terms of the trust deed the Trustees cannot surrender the bond (which is made up of a number of separate policies or segments) during the Donor/Settlor's lifetime other than to pay specified trust expenses, such as the payment of IHT or income tax that is attributable to the trust fund. This is necessary because the Donor/Settlor is entitled to receive fixed regular payments from the bond and any surrender would prejudice that entitlement. This gives the Donor/Settlor a degree of control, in that they are entitled to receive fixed regular payments at specified intervals, and neither the Trustees nor the beneficiaries can prevent that payment being made during the Donor/Settlor's lifetime.
- Following the death of the Donor/Settlor, or the last Donor/Settlor where there was a joint gift into the Discounted Gift Scheme, the fixed regular payments cease and the restrictions placed on the Trustees preventing them from surrendering the bond, cease to apply.

This document should be read in conjunction with the Legal & General Discounted Gift Scheme Technical Guide and the Legal & General Discounted Gift Scheme Key Features.

The Discounted Gift Scheme Lifecycle



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