
Profile

PENSIONS | INVESTMENTS | TAXATION AND TRUSTS

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The Legal & General Discounted Gift Scheme Trusts - Technical Guide.

The purpose of the Discounted Gift Scheme

The Discounted Gift Scheme can provide a person with the opportunity to reduce their potential inheritance tax 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.

The Discounted Gift Scheme

There are two types of trusts available under the Discounted Gift Scheme: Discretionary and Absolute trusts.

The choice of trust will depend on tax considerations and how much control over the trust and the beneficiaries the person who created the trust wishes the trustees to retain.

The person who creates the “Discretionary” trust is known as the “Settlor” and the person who creates an “Absolute” trust is known as the “Donor”.

Please see the Completion Guide on how to complete a trust deed.

Each person intending to make a cash gift must first complete a medical questionnaire, which is then used, in conjunction with a medical report obtained from his or her doctor, used to establish the person’s life expectancy. Based on this, and the monetary amount of the fixed regular payments he or she wishes 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.

The trust is set up by the person executing the trust deed and 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 an Investment Bond, which is a single premium whole of life assurance policy, making sure that the fixed regular withdrawal section of the Bond application form matches the retained rights as expressed in the trust deed.

Where there is a joint gift into the Discounted Gift Scheme, the cash gift must be provided in equal shares.



Any questions?

If you have any questions or comments in relation to this article email tax.estatenlannina@landq.com



The person establishing the trust creates a trust with two interests:

- **The Retained Rights**

These comprise the right of the person making the gift to receive fixed regular payments at specified intervals for life from the policy taken out by the trustees or until the value of the policy is exhausted, whichever comes first. Once selected, the person's retained rights cannot be varied. The gift with reservation of benefit provisions do not apply as these retained rights do not form part of the gift to the beneficiaries since they are held by the trustees absolutely for the person who made the gift from outset. 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 inheritance tax liability.

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 Settlor's or Donor's rights to receive regular payments in the future have a value for inheritance tax purposes. The present value of these retained rights reduces the value of the overall gift made. The retained rights are described as the "discount" and have no value for inheritance tax purposes since the payments will cease on the death of the Settlor/Donor or the last Settlor/Donor where there was a joint gift into the Discounted Gift Scheme. The methodology used in calculating the discount has been confirmed by HM Revenue & Customs.

The policy comes to an end on the earlier of its surrender or on the death of the last person named as a life assured. The Settlor of a discretionary trust or the Donor of an absolute trust and their spouse or registered civil partner must not be named as the lives assured. This is to prevent any possibility of the gift with reservation of benefit provisions applying to the Discounted Gift Scheme. Any other beneficiary of the trust can be named as a life assured. In the event of the Settlor/Donor surviving all the lives assured under the policy, the trustees must reinvest the sum assured paid out on death into a new policy to preserve the Settlor/Donor's retained rights to receive fixed regular payments.

Under the terms of the trust deed the trustees cannot surrender the policy (which is made up of a number of separate policies or segments) during the Settlor's or Donor's lifetime other than to pay specified trust expenses, such as the payment of inheritance tax or income tax that is attributable to the trust fund and professional trustees fees where the trustees agree to pay such fees. This is necessary because the Settlor or Donor is entitled to receive fixed regular payments from the policy and any surrender would prejudice that entitlement. This gives the Settlor or Donor a degree of control, in that he or she is entitled to receive fixed regular payments at specified intervals, and neither the trustees nor the beneficiaries can prevent that payment being made during the Settlor or Donor's lifetime.

Following the death of the Settlor/Donor, or the last Settlor/Donor 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 policy cease to apply.

Inheritance Tax

Absolute Trust

Creating the Absolute Trust

The creation of an absolute trust by the Donor is a transfer of value for inheritance tax purposes. The transfer of value under the Discounted Gift Scheme absolute trust is measured at outset by taking the cash gift and deducting the actuarial value of the Donor's retained rights to receive fixed regular payments. This transfer of value will constitute a discounted potentially exempt transfer. It is treated as a potentially exempt transfer because the beneficiaries are absolutely entitled, subject to the Donor's rights, to receive the trust property when the Donor's rights cease on his or her death. As such there is no settlement and hence no relevant property. The Donor's retained rights are not given away but are carved out under the trust and retained by the Donor. The benefit of the policy (subject to the Donor's retained rights) is the absolute property of the named beneficiaries. There are two sets of policy rights, each held on an absolute trust, one set belonging absolutely to the Donor and the other set to the beneficiaries. If the cash gift is made by more than one Donor it is regarded as being provided in equal shares by each Donor.

The future growth on the invested gift is immediately outside the Donor's estate and provided that the Donor lives for at least seven years from the date of the gift into the trust, the gift falls entirely outside the Donor's estate on death.

Death of the Donor

An inheritance tax liability on the discounted gift into an absolute trust could only arise if the Donor were to die within seven years of making the gift into the trust. The discounted gift is measured at the outset by taking the cash gift and deducting from it the actuarial value of the Donors retained rights to receive future regular payments as determined on the date the gift is made. The Donors retained rights will have no value for inheritance tax purposes because such rights cease on his or her death. In assessing the value of the Donors retained rights for the purposes of calculating the inheritance tax transfer of value, special valuation rules are used. These special valuation rules calculate the hypothetical open market value of the retained rights using the age, gender and actual state of health of the Donor and the quantum of the fixed regular payments they have chosen to receive. Basically, the rules determine how long the Donor is likely to live and therefore how much they will receive by way of the fixed regular payments.

If the value of the discounted gift (after deducting any inheritance tax exemptions available when the gift was made) when taken together with the value of all chargeable transfers (including potentially exempt transfers that have subsequently failed due to the Donor's death) made by the Donor in the seven years immediately prior to setting up the Discounted Gift Scheme, exceeds the nil rate band applicable at the time of the Donor's death, inheritance tax will be due on the excess value of the discounted gift at the death rate of 40%. This liability would fall on the trustees of the Discounted Gift Scheme, although taper relief would be available if the Donor had survived for at least three complete years from making the gift, which would help to reduce the amount of any tax payable. With regards to calculating any inheritance tax due on the Donor's death estate, it should be noted that the nil rate band available to the Donor's personal representatives would be reduced by the value of all chargeable transfers made by the Donor in the seven years before he or she died. For the purpose of this calculation, taper relief cannot be used to reduce the value of the chargeable transfers that are taken into account.

For a joint Donor Discounted Gift Scheme, the cash gift into the absolute trust is deemed to be provided in equal shares by both Donors. On the death of the first joint Donor, the surviving Donor will continue to receive the total payments previously paid to both Donors. Each

Donor's retained rights at the time the trust is created would need to be valued. Only married couples or registered civil partners can establish a joint Discounted Gift Scheme.

Any inheritance tax due as a result of the Donor's death will normally be paid by the trustees out of the trust fund. The Discounted Gift Scheme absolute trust gives the trustees the power to surrender policies to pay inheritance tax or income tax that is attributable to the trust fund. For a joint Donor Discounted Gift Scheme, the surviving joint Donor will continue to receive the fixed regular payments previously shared between the two joint Donors, this entitlement remaining unaffected by the trustees' payment of any tax liability arising from the first Donor's death.

No Grant of probate is required on the death of the Donor in respect of the trust assets, as these are legally owned by the trustees.

Adding to the Absolute Trust

For inheritance tax reasons it is not possible to top up the policy at a later date and it is also not advisable for further investments to be added after the trust has been created.

Death of an Absolute Beneficiary

For inheritance tax purposes, the beneficiary is treated as owning the trust assets (less the value of the Donor's retained rights) comprised in the trust fund and if there is more than one beneficiary, then each will be treated as owning their specified share of the trust assets. On the death of a beneficiary the value of their share of the trust fund (less the actuarial value of the Donor's retained rights to receive fixed regular payments at that point in time, apportioned, if necessary, to reflect the beneficiary's interest in the trust) would be included in the deceased beneficiary's estate for inheritance tax purposes. Where there is no surviving Donor, it is the full value of the deceased beneficiary's share of the trust fund that would be included in his or her estate.

Whether there would be any liability to inheritance tax following a beneficiary's death will depend on the value of the trust fund (less the actuarial value of the Donor's retained rights at that point in time), the value of that beneficiary's personal estate and who benefits under the beneficiary's will or on their intestacy. The beneficiary's personal representative would normally be liable to pay any inheritance tax due on the beneficiary's death.

Discretionary Trust

Inheritance Tax Charges

There are three occasions when a charge to inheritance tax can arise in relation to a discretionary trust:

- On creation of the trust; this is known as a creation or entry charge.
- On every ten-year anniversary of the trust starting from its creation; this is known as the ten year or periodic charge.
- When property leaves the trust; this is known as an exit or proportionate charge.

Creation Charge

The transfer of value for inheritance tax purposes under the Discounted Gift Scheme discretionary trust is measured at outset by taking the cash gift and deducting the actuarial value of the Settlor's retained rights to receive fixed regular payments. This transfer of value will constitute a discounted chargeable lifetime transfer.

The gift for inheritance tax purposes is divided between:

- An absolute interest for the Settlor comprising his or her retained rights to receive fixed regular payments at specified intervals; and
- A discretionary trust, which is the settlement, comprising of trust assets (usually referred to as relevant property) net of the value of the Settlor's retained rights, which are held on trust for one or more discretionary beneficiaries. It is this element that constitutes the chargeable transfer.

If the value of the discounted gift (after deducting any inheritance tax exemptions) together with the value of all chargeable lifetime transfers made by the Settlor in the seven years immediately prior to setting up the trust exceeds the nil rate band applicable at the time the trust is created, inheritance tax will be due on the excess value of the discounted gift at the lifetime rate.

If any tax due is paid by the trustees from the trust then the lifetime rate is 20% on the excess value of the discounted gift over the available nil rate band. If the tax is paid by the Settlor then the effective rate is 25%. This is because the gift must be grossed up for inheritance tax purposes so that the transfer of value (which is defined as the loss to the Settlor's estate) will include the value of the discounted gift and the amount of the tax paid in respect of it. The Discounted Gift Scheme has been designed on the assumption that the Settlor will pay any inheritance tax creation charge. If there is more than one Settlor, the cash gift is deemed to be provided in equal shares by both Settlers. For a joint Settlor trust, each Settlor is treated as if they had each created a separate discretionary trust equal to one half of the cash given. A further inheritance tax liability on the discounted gift could arise if the Settlor dies within seven years of making the gift into the trust.

If the amount of the chargeable lifetime transfer made in establishing the trust plus the cumulative total of chargeable lifetime transfers in the seven years immediately before the trust is created exceeds set limits the transfer will need to be reported by the Settlor to HM Revenue & Customs using forms IHT100 and 100a.

Periodic Charge

An inheritance tax liability may arise on each ten year anniversary of the creation of the trust. The charge is based on the value of the property in the trust, which is referred to as "relevant property". Under the Discounted Gift Scheme, the relevant property will be the value of the policy less the actuarial value of the Settlor's retained rights to receive fixed regular payments as calculated at that point in time. Therefore, the Settlor's retained rights will need to be valued on each ten year anniversary. The value of the retained rights at the ten year anniversary will be affected by the Settlor's age and state of health.

For a joint Settlor Discounted Gift Scheme, each Settlor is treated as if they had each created a separate discretionary trust equal to one half of the cash gift with the value of the retained rights being apportioned between those two discretionary trusts for the purposes of calculating the inheritance tax due (if any) at the ten year anniversary.

In order to calculate any tax that may be due, it is assumed for inheritance tax purposes that a chargeable transfer occurs on the tenth anniversary. For the Discounted Gift Scheme chargeable transfer at the ten year anniversary, it is assumed that the policy will be the only trust investment, that no further assets have been added to the trust and that no other trusts (subject to the ten year charge) were created by the Settlor on the same day as the Discounted Gift Scheme trust was created.

The chargeable transfer for the Discounted Gift Scheme, during the Settlor's lifetime, is the value of the policy less the actuarial value of the Settlor's retained rights to receive fixed regular payments as calculated at that point in time plus the total value of chargeable transfers made by

the Settlor in the seven years immediately before the trust was set up. Payments to satisfy the Settlor's retained rights or to pay specified trust expenses are disregarded.

The chargeable transfer for the Discounted Gift Scheme, after the Settlor's death, is the value of the policy plus the total value of chargeable transfers (including potentially exempt transfers that have failed due to the Settlor's death) made by the Settlor in the seven years immediately before the trust was set up plus the value of any property withdrawn from the trust in the previous ten years which has been subject to an exit charge.

For the purposes of the ten year calculation, the nil rate band applicable for the tax year in which the ten year anniversary falls is used.

A complex calculation is then undertaken to calculate the rate of tax that will be applied to the value of the relevant property in the trust at the ten year anniversary. The maximum rate of tax that can be charged on the relevant property is currently 6%. If none of the assumed chargeable transfer is above the nil rate band then the rate of tax applied to the relevant property in the trust will be nil. Any tax that is payable or other reportable event will need to be reported by the trustees to HM Revenue & Customs using forms IHT100 and 100d.

Exit Charge

No exit charges will arise each time a payment in satisfaction of the Settlor's retained rights is made. This is because the Settlor's retained rights do not constitute relevant property.

An inheritance tax liability may arise on each occasion that capital is paid or distributed to a beneficiary of the trust. If the amount so distributed exceeds set limits, then it will need to be reported by the trustees to HM Revenue & Customs using forms IHT100 and 100c. This charge is based on the value of property leaving the trust and the length of time that it has been held in the trust.

Exit charge before first ten year charge

The calculation of the exit charge is similar to that of a ten year charge (making use of the relevant values at the time the trust was created) but uses the nil rate band at the time of the exit event. However, the actual rate of tax so calculated (currently a maximum of 6%) is then reduced by the number of complete successive quarters (each quarter being a period of three months) that have elapsed since the creation of the trust. This reduced rate of tax is then applied to the amount of capital that is intended to be distributed.

Exit charge between ten year anniversaries

The calculation of the exit charge uses the relevant values at the last ten year anniversary and the nil rate band at the time of the exit event. This rate of tax (currently a maximum of 6%) is then reduced by the number of complete successive quarters that have elapsed since the last ten year anniversary. This reduced rate of tax is then applied to the amount of capital that is intended to be distributed.

Death of the Settlor

An inheritance tax liability in respect of a discounted gift into the discretionary trust could arise if the Settlor dies within seven years of making the gift into the trust. The discounted gift is measured at the outset by taking the cash gift and deducting from it the actuarial value of the Settlor's retained rights to receive future regular payments as determined on the date the gift is made. The Settlor's retained rights will have no value for inheritance tax purposes because such rights cease on his or her death.

In assessing the value of the Settlor's retained rights for the purposes of calculating the inheritance tax transfer of value, special valuation rules are used. These special valuation rules

calculate the hypothetical open market value of the retained rights using the age, gender and actual state of health of the Settlor and the quantum of the fixed regular payments they have chosen to receive. Basically, the rules determine how long the Settlor is likely to live and therefore how much they will receive by way of the fixed regular payments.

If the value of the discounted gift together with the value of all chargeable transfers (including potentially exempt transfers that have subsequently failed due to the Donor's death) made by the Settlor in the seven years immediately prior to setting up the Discounted Gift Scheme, exceeds the nil rate band applicable at the time of the Settlor's death, inheritance tax will be due on the excess value of the discounted gift at the death rate of 40%. This liability would fall on the trustees of the Discounted Gift Scheme, although taper relief would be available if the Settlor had survived for at least three complete years from making the gift, which would help to reduce the amount of any tax payable. With regards to calculating any inheritance tax due on the Settlor's death estate, it should be noted that the nil rate band available to the Settlor's personal representatives would be reduced by the value of all chargeable transfers made by the Settlor in the seven years before he or she died. For the purpose of this calculation, taper relief cannot be used to reduce the value of the chargeable transfers that are taken into account.

For a joint Settlor Discounted Gift Scheme, each Settlor is treated as if they had each created a separate discretionary trust equal to half of the cash gift. On the death of the first joint Settlor, the surviving Settlor will continue to receive the total payments previously paid to both Settlers. Each Settlor's retained rights when the trust is created would need to be valued. Only married couples or registered civil partners can apply to set up a joint Discounted Gift Scheme.

Any inheritance tax due on death would normally be paid by the trustees out of the trust fund. The Discounted Gift Scheme discretionary trust gives the trustees the power to surrender policies to pay any inheritance tax or income tax that is attributable to the trust fund. In addition any lifetime tax that was paid when the discounted gift was made can be deducted from the tax liability arising on death, although any excess lifetime tax will not be repaid. For a joint Settlor Discounted Gift Scheme, the surviving joint Settlor will continue to receive fixed regular payments previously shared between the two joint Settlers unaffected by the trustees' payment of the tax liability.

No Grant of probate is required on the death of the Settlor in respect of the trust assets, as these are legally owned by the trustees.

Adding to the Discretionary Trust

For inheritance tax reasons it is not possible to top up the policy at a later date and it is also not advisable for further investments to be added after the trust has been created.

Death of a Beneficiary

The death of a beneficiary under the discretionary trust will not have any inheritance tax consequences for the trust.

Income Tax

The Discounted Gift Scheme has been specifically designed for use with an Investment Bond, which is a single premium whole of life assurance policy. The Bond is subject to income tax under the chargeable events regime.

Income tax is only payable if:

- A chargeable event occurs and
- A chargeable gain arises as a result and
- The gain is attributed to a chargeable person.

A chargeable event can arise on:

- Death of the last life assured under the policy
- Full surrender of the policy
- Certain part surrenders of the policy
- Assignment or part assignment of the policy for money or moneys worth
- Maturity of the policy

The switching of an underlying investment fund is not a chargeable event.

When a chargeable event occurs a calculation must be made to see if a chargeable gain has arisen.

There is a gain on a chargeable event where the whole of the rights under the policy (or one or more individual segments) are given up, for example, in the case of a full surrender. The chargeable gain arises if the amount paid from the policy whilst it has been in force exceeds the premiums paid plus the total gains on previous chargeable (excess) gains.

Where there has been a part surrender or part assignment for money or money's worth under a policy a periodic calculation must be made at the end of the policy year in which that event occurred to see whether a chargeable gain has arisen. A policy year begins on the date the policy is issued and future policy years on each subsequent anniversary of that date.

A part surrender results in a chargeable (excess) gain where the 5% allowance is exceeded. The 5% allowance allows withdrawals of up to 5% of the premium paid under a policy in the policy year in which the premium is paid and in the following 19 years without an immediate income tax liability. This means that 100% of the premium paid can be withdrawn over 20 years at a rate of 5% a year.

The 5% allowance is cumulative; if it is not fully used in one policy year the unused balance can be carried forward and is available to be used in the next or subsequent policy years until such time as 100% of the premium paid has been withdrawn. For example, 4% per policy year can be taken each policy year for 25 years. A chargeable (excess) gain arises if the withdrawal exceeds the cumulative 5% allowance. The amount of the gain is the amount of the excess.

Setting the level of the Settlor/Donor's fixed regular payments at below 5% of the cash sum gifted will reduce the risk that the 5% allowance will be exceeded in the future. If the trustees have to surrender one or more individual policies or segments that make up the Investment Bond (for one of the permitted reasons), then this will increase the likelihood of the continuing fixed regular payments exceeding the 5% allowance. This is because the level of the fixed regular payments must be maintained at the same monetary amount as they were prior to the surrender of one or more individual policies and to do this it will be necessary to increase the rate of the fixed regular payments being taken from the remaining policies.

If a chargeable event has occurred and a chargeable gain arises, then the income tax charge can be calculated.

The income tax charge is subject to top slicing relief, which is available only to individuals. Chargeable event gains are charged to income tax in the tax year that the event occurs, even though the gain may have accrued over many years. Top slicing relief can help reduce the impact of a chargeable event gain for tax purposes by reducing the amount of the gain that is subject to tax at higher rate.

If the policyholder's other taxable income for the tax year in which the gain arises is less than the higher rate income tax band, but the total of this other taxable income and the chargeable

event gain takes the policyholder into the higher rate income tax band, then top slicing relief will apply. If none of the gain falls in the higher rate income tax band, then no top slicing relief is due. If the whole of the gain falls in the higher rate income tax band, then the amount of top slicing relief will be nil.

For a full surrender, top-slicing relief is calculated by dividing the chargeable event gain by the number of complete policy years up to the date of the chargeable event. For part surrenders, top-slicing relief is calculated by dividing the chargeable event gain by the number of complete policy years since the previous chargeable event up to the end of the policy year in which the part surrender takes place. For part surrenders under a non-UK policy, top slicing relief is calculated by dividing the chargeable event gain by the number of complete policy years since the inception of the policy up to the end of the policy year in which the part surrender takes place.

This gives the amount of the slice (the top sliced gain), which is then added to the policyholder's other taxable income for the tax year in which the gain arises. The tax applicable to the part of the top sliced gain that falls within the higher rate income tax band is calculated at 40%. For a UK policy, the notional 20% tax credit is then deducted from the income tax liability. The resulting tax liability is then multiplied by the number of years used for top slicing purposes to determine the actual amount of income tax due on the total chargeable event gain.

The chargeable events regime sets out who is the chargeable person where a policy is held in trust.

A chargeable person includes the Settlor/Donor, the Trustees or the Beneficiaries. Where the Discounted Gift Scheme has been created by joint Settlers/Donors, any chargeable event gain is calculated equally, with half being assessed to income tax on each Settlor/Donor or the trustees of the respective trusts created by each Settlor/Donor.

Absolute Trust

The taxation of the chargeable event gain depends on whether the beneficiary who is absolutely entitled to the trust assets is above or below the age of 18.

Beneficiary is under the age of eighteen

Any chargeable event gains arising on full or part surrender of the policy will be assessed on the Donor provided that the Donor was UK resident during the tax year in which the chargeable event is deemed to have arisen.

Where the Donor incurs an income tax liability following a chargeable event, he or she can recover the tax from the trustees and this should not give rise to a gift with reservation of benefit for inheritance tax purposes. If the Donor does not exercise his or her power to recover tax from the trustees that omission could be treated as a transfer of value for inheritance tax purposes to the extent that it does not fall within the Donor's annual exemption and/or qualify for the normal expenditure out of income exemption.

Any chargeable event gains arising in a tax year following that in which the Donor became non-UK resident or died will be assessed on the UK resident trustees at the rate applicable to trusts (currently 40%). If the trustees are not UK resident for tax purposes then the income tax charge falls on the UK resident beneficiaries at their rate of income tax if and when they receive benefits from the trust.

During the tax year in which the death of the first joint Donor occurs, any chargeable event gain is assessed half on the deceased Donor's estate and half on the surviving Donor. Following the end of the tax year in which the death of the first joint Donor occurs, any chargeable event

gain is assessed half on the surviving Donor and half on any beneficiary or the trustees in respect of any minor absolute beneficiary.

Beneficiary is aged eighteen or over

HM Revenue & Customs practice is to assess any chargeable event gain made on fully or partly surrendering the policy on the beneficiary provided that the beneficiary was UK resident during the tax year. This is so notwithstanding the fact that the policy is still legally owned by the trustees. If there is more than one beneficiary each will be assessed to income tax based on their specified share of the trust fund.

Discretionary Trust

For income tax purposes, any chargeable event gains made on fully or partly surrendering the policy will be assessed on the Settlor provided that the Settlor was UK resident during the tax year in which the chargeable event is deemed to have arisen.

Where the Settlor incurs an income tax liability following a chargeable event, he or she can recover the tax from the trustees and this should not give rise to a gift with reservation of benefit for inheritance tax purposes. If the Settlor does not exercise his or her power to recover tax from the trustees that omission could be treated as a transfer of value for inheritance tax purposes to the extent that it does not fall within the Settlor's annual exemption and/or qualify for the normal expenditure out of income exemption.

Any chargeable event gains arising in a tax year following that in which the Settlor became non-UK resident or died will be assessed on the UK resident trustees at the standard rate of income tax (currently 20%) and on amounts exceeding the standard rate threshold at the rate applicable to trusts (currently 40%). If the trustees are not UK resident for tax purposes then the income tax charge falls on the UK resident beneficiaries at their rate of income tax if and when they receive benefits from the trust, although the beneficiary's cannot make use of top slicing relief in this situation.

During the tax year in which the death of the first joint Settlor occurs, any chargeable event gain is assessed half on the deceased Settlor's estate and half on the surviving Settlor. Following the end of the tax year in which the death of the first joint Settlor occurs, any chargeable event gain is assessed half on the surviving Settlor and half on the UK resident trustees.

Capital Gains Tax

The Discounted Gift Scheme has been specifically designed for use with an Investment Bond, which is a single premium whole of life assurance policy. No capital gains tax arises on full or part surrender of the policy or on any switches of the underlying funds within the policy.

The Settlor/Donor

Any person can create a trust provided that they are aged 18 or over and have full mental capacity. The trusts can be set up either by a single person or jointly by two persons. Only married couples or registered civil partners can set up a joint Discounted Gift Scheme.

For a single Settlor Discounted Gift Scheme, the Settlor's spouse or registered civil partner is automatically included as a discretionary beneficiary of the discretionary trust. The Settlor can exclude their spouse or registered civil partner from being able to benefit under the trust until after the Settlor's death.

If both spouses or registered civil partners are planning to individually establish similar trusts it is important that neither can benefit from the other's discretionary trust so as to avoid the transactions being regarded as a gift with reservation of benefit. Each Settlor should exclude

their spouse or registered civil partner from being able to benefit whilst the Settlor is alive when creating the trust.

The Trustees

The trustees' role is to manage the trust assets in accordance with the terms of the trust deed. Any person can be appointed as a trustee provided that they are aged 18 or over and have full mental capacity. The Settlor/Donor is automatically appointed one of the trustees when the trust is created, although he or she can decline this appointment if they so wish. The trust requires a minimum of two individual trustees. If the Settlor/Donor is to be a trustee at least one additional trustee must also be appointed. Where there is only one Settlor/Donor, his or her spouse or registered civil partner, can be the additional trustee. For a joint Settlor/Donor trust at least one additional trustee must be appointed. It may be beneficial for one of the trustees to be a professional adviser such as a solicitor or accountant. There is no restriction on appointing a trustee who is also a beneficiary under the trust.

The Settlor/Donor, during his or her lifetime, can appoint additional trustees. Following the death of the Settlor/Donor, the remaining trustees can appoint additional trustees.

Under the terms of the trust deed, professional trustees are allowed to charge normal professional fees for their services. The trustees are permitted to surrender a number of separate policies or segments that make up the policy to pay specified trust expenses that are attributable to the trust fund including professional trustees' fees and any inheritance tax or income tax attributable to the trust fund. The impact of this is that the level of the fixed regular withdrawal payments from the remaining policies will have to increase to ensure that the monetary value of the retained rights continue to be met and this may have income tax implications. Lay trustees are not entitled to any reward for their services.

The Beneficiaries

The decision as to who will be included as a beneficiary of the trust rests with the Settlor/Donor. The Settlor/Donor cannot be a beneficiary or benefit in any way from the trust that he or she has created, except for the fixed regular payments at specified intervals that were chosen when the trust was created.

Absolute Trust

The Donor specifically names the beneficiaries when the trust is created and if there is more than one their specified percentage shares. Once named these beneficiaries (and their specified percentage shares) cannot be changed. These beneficiaries would normally be the Donor's children, grandchildren or great grandchildren. The Donor and the Donor's spouse or registered civil partner must not be named as beneficiaries of the trust for inheritance tax reasons. The beneficiaries are absolutely entitled to the trust property. The absolute beneficiaries' entitlement is subject to the Donor's retained rights to receive fixed regular payments. Therefore, it is not possible for the trustees to make payments to a beneficiary during the Donor's lifetime. The absolute beneficiaries cannot compel the trustees to transfer the policy to them during the Donor's lifetime or to deal in any way with the policy so as to defeat the Donor's rights. This is so whether they are adults or minors. No further beneficiaries can be added to the trust once it has been created. Following the Donor's death, the adult beneficiaries can demand that the trustees transfer the trust assets or the proceeds from the trust assets to them.

Discretionary Trust

The beneficiaries are made up of classes of discretionary or potential beneficiaries and automatically include the Settlor's spouse or registered civil partner (unless specifically excluded at outset by the Settlor), widow or widower, the Settlor's children, grandchildren, great grandchildren and their spouses or registered civil partners, the Settlor's brothers and

sisters, nieces and nephews, uncles and aunts and any person that the Settlor wants to specifically include when the trust is created. The trustees can exclude beneficiaries. The discretionary beneficiaries have no right to any income generated by the trust and also have no right to the capital of the trust unless the trustees exercise their discretion in their favour. Whilst the Settlor can give the trustees a letter of wishes outlining his or her objectives, it is the trustees who determine who will ultimately benefit from the trust and in what proportion. The discretionary beneficiaries' entitlement is subject to the Settlor's retained rights to receive fixed regular payments. Therefore, it is not possible for the trustees to make payments to a beneficiary during the Settlor's lifetime. Following the Settlor's death, the trustees can exercise their discretion and benefit the beneficiaries.

The Settlor/Donor, during his or her lifetime, can add additional beneficiaries to the discretionary trust.

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