

## For financial advisers only | Discretionary Gift Trust

# A detailed guide

Please note – this communication isn't for private customers and shouldn't be given out to, or relied on by, them.

### What's a trust?

To put it simply, a trust is an arrangement to give money or assets to a third party to look after on behalf of another group of people. The people involved are:

- the trustees – the people who look after the trust fund
- the settlor – the person who gives the money or assets to the trustees
- the beneficiaries – the people who benefit from the trust fund

We offer discretionary and bare versions of certain trusts.

These trusts are all quite similar in a lot of ways. Their basic purposes are the same:

- To reduce the amount of inheritance tax (IHT) liable on the settlor's estate.
- To give money or assets to the trustees for the benefit of selected beneficiaries.

However, there are also quite substantial differences, particularly regarding tax liabilities and how flexible the trusts are. It's important to understand these differences so that your clients can choose the trust that's right for them.

The basic differences between a discretionary trust and a bare trust are that with a bare trust:

- adult beneficiaries (aged 18 years or over in England and Wales and aged 16 years or over with a Scots law trust) can demand their share of the trust assets at any time – the trustees have no control over when payments are made
- once the settlor has decided who the beneficiaries are going to be, they can't be changed. Their entitlements under the trust can't be changed either

With a discretionary trust, however:

- there's a wide class of possible beneficiaries that automatically includes immediate and extended family
- no one beneficiary has any rights or entitlements to either the income or capital of the trust
- the trustees have control over the trust's assets – they decide who gets what and when
- the settlor can add other beneficiaries at any time during the trust period

This guide gives more details about the Discretionary Gift Trust. It should answer any questions you might have but if you need any more information, please get in touch with your AEGON consultant.

## How does the Discretionary Gift Trust work?

The settlor makes what's called a 'lifetime gift' of cash or a bond to the trustees, which is a chargeable lifetime transfer (CLT) for IHT purposes. If cash, the trustees invest it in an AEGON bond. Any growth from this investment, from the date of the gift, won't be included in the settlor's IHT estate and, as long as the settlor lives for at least seven years from the date of the gift, the gift itself won't be included either. The trustees hold the trust assets and distribute them to the beneficiaries at their discretion, with the consent of the settlor, but the settlor can't benefit from the trust in any way.

This is just a brief summary of how the Discretionary Gift Trust works. It's important that you read the rest of the guide, particularly the 'Taxation' section.

## The settlor

### Who can create the trust?

The settlor must be aged 18 years or over and of full mental capacity. For tax purposes, the settlor is regarded as anyone who gifts assets to the trust either directly or indirectly. In England and Wales an attorney can't set up a trust on the settlor's behalf without the Court of Protection's approval. In Scotland it depends on the specific wording of the power of attorney whether the attorney has the authority to set up a trust.

### Can there be more than one settlor for the trust?

Yes, there can be joint settlors. In this guide, references to the 'settlor' also include 'settlors'.

### Can the settlor benefit from the trust fund?

No. The settlor can't, in any circumstances, benefit from the trust either directly or indirectly. The settlor has no right to either the capital of the trust or any income generated by it.

For IHT reasons, if a husband, wife or registered civil partner wants to create a trust that their spouse or registered civil partner can benefit from, and the spouse or registered civil partner also wants to set up a trust that their husband, wife or registered civil partner can benefit from, they should get legal and tax advice before setting up the trusts.

### How much is taken for IHT purposes when the settlor dies?

If the settlor dies within seven years of making the gift, then it becomes part of their IHT estate and is liable for IHT. However, available reliefs could reduce the tax payable on the gift.

If the settlor lives for seven years after making the gift, then its value won't be included in the settlor's estate. Any investment growth will also be left out of the estate. Please read the 'Taxation' section for more details.

### Is probate needed for the trust assets when the settlor dies?

No, because the trust assets are legally owned by the trustees.

## How's the trust set up?

The trust can be set up by:

### ■ making a cash gift to the trustees

The amount of the cash gift should be shown in the trust deed in the box titled 'Money'. The trustees will then invest in an AEGON bond to be held in the trust fund in the name of the trustees. The trust starts on the date when the cash gift is given to the trustees. This should be the date shown in the trust deed.

### ■ gifting an existing bond to the trustees

The details of the gifted investment should be shown in the trust deed in the box titled 'Policy(ies)'. The trust starts on the date when the gifted investment is given to the trustees. This should be the date shown in the trust deed.

## The trustees

### Who should be appointed as trustees?

The settlor appoints the trustees when the trust is set up. (For the purpose of this guide, the trustees are assumed to be individuals.) The settlor could be one of the trustees. The other trustees could be members of the settlor's family. It's a good idea to have at least two trustees, and it would be useful if one of these were a professional adviser such as a solicitor or an accountant. The trustees must be aged 18 or over and of full mental capacity.

### Can trustees be beneficiaries?

The trustees (but not the settlor) can be beneficiaries under the trust. However, if beneficiaries are to be trustees, it's important to choose people who'll be impartial and who won't try to defeat the interests of other beneficiaries in their own favour. Having a professional adviser such as a solicitor or an accountant can help with this.

### Does the settlor have the power to appoint and dismiss the trustees?

Yes. Trustees can be appointed by Deed of Appointment (or by Deed of Assumption and Conveyance in Scotland) and dismissed by Deed of Removal. Sample deeds are available from AEGON.

### Can a trustee retire?

Yes, as long as:

- they give 30 days' written notice
- there's more than one trustee left. If not, a replacement trustee must be appointed before the trustee can retire
- they complete a Deed of Resignation as a Trustee. Sample deeds are available from AEGON

### Do the trustees need consent before making payments to the beneficiaries?

Yes. The settlor must give their written consent before the trustees can make any payments to the beneficiaries.

## The beneficiaries

### Who are the discretionary beneficiaries?

The discretionary beneficiaries automatically include the settlor's husband or wife, widow or widower, registered civil partner, the settlor's children, grandchildren, great-grandchildren and their husbands and wives, the settlor's brothers and sisters, nieces and nephews, uncles and aunts. This isn't a full list – please see the trust deed for more details. The settlor can add other beneficiaries at any time during the trust period.

### What entitlements do the discretionary beneficiaries have?

No one beneficiary has automatic rights to either the capital of the trust or the income generated by it. It's up to the trustees to decide (with the settlor's consent) who gets what and when.

## Trust flexibility

### How long can the trust last?

The trust can last for up to 125 years. This means that the trustees don't need to distribute the whole trust fund to the beneficiaries as soon as the settlor dies. This is useful where the beneficiaries are minors, as the trustees can wait until they're mature enough before giving them the benefit. The trust will come to an end when all of the trust fund has been distributed.

### What investment powers does the trust have?

The trust has very wide investment powers, meaning the trustees can invest in any AEGON bond.

### Can the settlor make more gifts to the trust after it's been set up?

Yes, this is possible but it's usually more IHT efficient to create another Discretionary Gift Trust rather than adding to an existing trust.

## Taxation

If after reading this section you decide that the potential liability for immediate and future IHT isn't acceptable, you could consider the Bare Gift Trust instead. This won't involve an immediate liability to IHT but there isn't as much flexibility over the beneficiaries. Please ask for our *Detailed guide* for the Bare Gift Trust for more details.

### Inheritance tax – reporting requirements

HM Revenue & Customs (HMRC) needs to be told about CLTs over certain limits. This should be done on forms IHT 100 and IHT 100a within 12 months from the end of the month in which the gift is made.

The person(s) liable for any tax due is responsible for delivering the forms to HMRC, which in the case of the Discretionary Gift Trust will usually be the trustees. There are detailed guidance notes on how to complete the forms on form IHT 110. Where an existing bond has been assigned into the trust, form D34 also needs to be completed.

Copies of all the forms can be downloaded from [www.hmrc.gov.uk/inheritancetax](http://www.hmrc.gov.uk/inheritancetax)

### Inheritance tax – the settlor

The CLT is liable for IHT if:

- (a) the settlor dies within seven years of making the gift. In this case the value of the gift falls back into the settlor's IHT estate
- (b) the amount of the gift together with all other CLTs made by the settlor in the previous seven years is over the current IHT nil rate band (£325,000 until April 2015)

If (b) then the trustees must pay IHT of 20% on the excess. This is due six months after the end of the month in which the gift was made, unless made after 5 April and before 1 October in any year when the tax is due by 30 April in the following year. If the settlor decides to pay the IHT instead of the trustees, the value of the gift has to be grossed up to reflect the further loss to the settlor's IHT estate and the effective tax rate rises to 25%.

The CLT isn't liable for IHT if:

- (a) the settlor lives for seven years after making the gift
- (b) setting up the trust doesn't take the settlor over their available nil rate band. For this purpose, potentially exempt transfers (PETs) made in the previous seven years can be ignored

### Inheritance tax – the trustees

As mentioned above, if setting up the trust takes the settlor over their cumulative IHT nil rate band, the trustees have to pay the resulting IHT. They can use the bond to fund this but the settlor could be liable for income tax if the trustees:

- make a withdrawal across all segments of the bond, which goes over the 5% cumulative yearly allowance. The trustees could also be liable for an early surrender charge
- fully surrender individual segments, and the proceeds show a gain on the original investment after taking into account previous withdrawals from the segments. Again the trustees could be liable for an early surrender charge

The trustees might also have to pay a periodic IHT charge on each 10-year anniversary of the date of the trust. This is based on the value of the trust fund immediately before the anniversary. They can fund the periodic charge from the trust fund but the conditions described above will apply. The 10-year charge should be reported to HMRC on forms IHT 100 and IHT 100d within 12 months from the end of the month in which the anniversary occurred.

The trustees will be liable for any exit (proportionate) charge on payments made to beneficiaries. They can fund this charge from the trust fund but again, the same conditions will apply. Exit charges should be reported to HMRC on forms IHT 100 and IHT 100c within 12 months from the end of the month in which the payment out of trust was made.

You can get full details about the above IHT charges, together with worked examples, from us.

### Inheritance tax – the beneficiaries

No part of the trust fund is included as part of the beneficiaries' IHT estates, so there are no IHT implications for them.

### Income tax – the settlor

The settlor is responsible for any income tax due on gains arising as a result of the trustees cashing in or surrendering the policy (known as a chargeable event gain) during their lifetime and in the tax year of their death, as long as they're a UK resident. The tax charge will be at their own marginal rate of tax, subject to top-slicing relief, if appropriate.

### Income tax – the trustees

The trustees will only be liable for income tax on a chargeable event gain:

- in tax years after the tax year in which the settlor dies
- from the date the settlor stops being a UK resident

Income tax will be due on any gain at the rate applicable to trusts (50% for 2011/12). Trustees aren't entitled to top-slicing relief.

### Income tax – the beneficiaries

The beneficiaries will only be liable for income tax on a chargeable event gain if:

- the settlor is dead or no longer a UK resident, and
- the trustees aren't UK residents

Income tax will be due at their marginal rate and their share of the gain will be limited to the amount they receive from the trust.

### Capital gains tax

Investment bonds are generally exempt from capital gains tax, except where they have been acquired second-hand for actual consideration.

### Important note

Because the tax treatment of trusts can be complicated, a specialist tax adviser should be consulted, as they can give specific advice for each client's individual circumstances. For more information about trustee investment in onshore or offshore bonds, please get in touch with your AEGON consultant.

This guide is designed to give you some information about how the Discretionary Gift Trust works. It should be read together with the appropriate AEGON product brochures. It's essential that prospective users of this trust take legal and tax advice before going ahead. Accordingly, no responsibility can be taken for the legal or tax efficiency of the Discretionary Gift Trust in any particular jurisdiction.

This item is based on our understanding of current taxation law and HM Revenue & Customs practice in the United Kingdom and the Republic of Ireland, as at June 2011.

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