

**The Lincoln Discretionary Gift Trust  
Key Features and Benefits**

**Trusts**

# The Lincoln Discretionary Gift Trust

## Key Features and Benefits

### Important notes

#### Validity and operation of Trusts

This Guide is based on Lincoln's general interpretation of the law of England and Wales and HM Revenue and Customs' ("HMRC") practice as at 1 February 2007. It is not intended to be a comprehensive guide to the law and the tax implications of using a Discretionary Gift Trust. The legal and tax implications of using a trust will depend on the circumstances and requirements of each party and on whether legislation and HMRC practice has changed since the guide was prepared. Accordingly, Lincoln cannot accept any responsibility for any loss arising from its use. Settlers/policyholders are strongly recommended to take independent professional advice before creating a trust.

#### What is the Lincoln Discretionary Gift Trust?

A trust is a legal relationship which exists when an asset is held by a person or persons (called the trustee(s)) for the benefit of another person or persons (called the beneficiary(ies)). The trustees have the control and legal ownership of the asset but must use it for the benefit of the beneficiaries.

The Lincoln Discretionary Gift Trust provides a way of holding a life assurance protection plan or an investment policy (which we will refer to in this document jointly as "Policy" unless otherwise indicated) for the benefit of another individual or individuals.

When the Policy is made subject to a Discretionary Gift Trust, the ownership of the Policy is effectively split. The legal owners of the Policy will be the Trustees. The Trustees collectively control all dealings with the Policy on behalf of the Beneficiaries under the trust. The Beneficiaries under the trust will be entitled to the proceeds on encashment or part encashment or on payment of the sum assured following the death of the life assured.

The proposer (for a new policy) or the Policyholder (for an existing policy) who creates the trust is called the Settlor and can not benefit from the Policy in any way under the Discretionary Gift Trust. The Settlor will, however, be one of the Trustees and the initial Appointor under the trust. The Appointor decides who (from the classes of Beneficiary specified in the trust) should benefit from the trust fund (i.e. the Policy) and when. After the Settlor's death, the Trustees take over the power of appointment of Beneficiaries and additional Trustees.

If the Appointor does not appoint any Beneficiaries by the end of the trust period (80 years) then the individual or individuals named by the Settlor as Default Beneficiaries will benefit.

The main objective of the Discretionary Gift Trust is to ensure that the Policy is held for the benefit of the chosen Beneficiaries outside of the inheritance taxable estate of the Settlor.

#### Why should you use the Discretionary Gift Trust?

You could use a Discretionary Gift Trust if you:

- wish to make an inheritance tax ("IHT") effective lifetime gift of your Policy or cash to be invested in a Policy;

- do not need to retain access to the Policy for your own benefit in the future; and
- wish to retain flexibility over the choice of the ultimate Beneficiaries i.e. the persons who will receive the benefits under the trust.

#### When should the Discretionary Gift Trust not be used?

The Discretionary Gift Trust should not be used if you wish to retain access to the Policy or part of it for your own benefit or if you wish to make an outright immediate gift and retain no flexibility or control over who should benefit. Another reason why you may not choose a Discretionary trust might be because of the potential charges to inheritance tax that might arise under the inheritance tax regime applicable to discretionary trusts - see "Tax implications" opposite.

In addition, a special "split" trust is required if a protection plan also provides critical illness benefits that are to be retained and held for the benefit of the life or lives assured.

#### How is the Discretionary Gift Trust established?

The Discretionary Gift Trust can be used with either a new or an existing Policy which is not already held in trust.

The trust is established by the proposer for a new Policy or the Policyholder of an existing Policy (known as the Settlor) completing the Discretionary Gift Trust deed. Once the trust is established, additional Trustees should be appointed using a separate deed of appointment, a draft of which can be provided by Lincoln for the policyholder's legal and financial advisers to consider.

It is strongly recommended that at least one additional Trustee is appointed as, without additional Trustees, there will be a delay in securing access to the Policy benefits following the death of the last surviving or only Trustee.

Once the Policy is made subject to trust, any subsequent dealings with the Policy will be between the Trustees (as the legal owners) and Lincoln.

## Key provisions of the Discretionary Gift Trust

- During the trust period (up to 80 years) the Appointor (the Settlor and, after the Settlor's death, the Trustees) may appoint the trust benefits (capital or income) to any of the Discretionary Beneficiaries. These Beneficiaries include the Settlor's spouse (provided he or she is not also a Settlor), children and grandchildren, brothers and sisters and their children as well as any person nominated by the Settlor to the Trustees in writing.
- The Settlor could leave an indication of wishes as to who he or she would like to benefit under the trust. This would not be binding on the Trustees but they would normally take it into account in determining when and who to pay benefits to.
- As the trust is a discretionary trust, a Beneficiary is not entitled to any of the trust fund until the Appointor makes an appointment in his or her favour. If any income arises to the Trustees from the trust investments (not relevant while the sole trust asset is the Policy) they can accumulate it for up to a maximum of 21 years. After that time the Trustees will have to distribute all income to whichever Beneficiary they decide. However, a Beneficiary will not usually have the right to any income – distributions will be at the discretion of the Trustees.
- The Settlor must not benefit from the trust in any circumstances otherwise the trust will not be IHT effective.
- The Settlor names (as Default Beneficiaries) the individual or individuals who are to benefit from the trust fund at the end of the trust period (if no appointment is made before then), and if more than one the shares in which they are to benefit.
- The Trustees have wide powers to invest and deal with trust property where the Policy proceeds are not to be distributed immediately for the benefit of Beneficiaries, for example if the intended Beneficiaries are young children when the benefits are paid.

## The law of the trust

The Discretionary Gift Trust is governed by the law of England and Wales.

## The trustees

The Settlor (or both of them in cases of joint proposers/ Policyholders) is automatically one (or both) of the initial Trustees. It is strongly recommended that at least one additional Trustee should be appointed. This can be done by completing a deed of appointment of additional trustees - for new policies as soon as the Policy is issued. The Settlor during his lifetime (or both Settlers during their joint lifetime and, thereafter, the survivor) also has the power to dismiss a Trustee provided at least one Trustee other than the Settlor remains.

The Trustees must act unanimously.

## The Inheritance Tax implications of the Discretionary Gift Trust

### 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 Settlers, each is treated as making a

gift of one half of the value transferred.

## New policy

- When a new Policy is made subject to trust, the value initially transferred will be the amount of the initial premium.
  - Where the Policy made subject to trust is a regular premium protection plan, the premiums paid may be exempt as normal expenditure out of income. Broadly speaking, for this to be the case the payment must be habitual, out of income and must not affect the payer's standard of living. This exemption will not be relevant if the Policy being made subject to trust is a single premium bond.
  - If the amount of the premium or cash transferred to the trustees does not qualify for the normal expenditure exemption and it exceeds the available annual exemption (in 2007/8 £3,000 for each Settlor or £6,000 maximum for each Settlor if the exemption for the previous tax year has not been used), it will be a chargeable lifetime transfer. This means that a potential liability to IHT at 20% may immediately arise if the value of the gift, plus the value of all other chargeable transfers made by the Settlor in the previous seven years, exceeds the nil rate band at the time the Policy is put in trust.
  - A further tax liability (a further 20%) on the gift could arise if the Settlor dies within seven years of making the gift, although taper relief will be available if the Settlor survives for at least three years. On the Settlor's death within seven years of making the gift, the full value of the gift when made will also be taken into account in determining the inheritance tax liability on the Settlor's estate.

## Existing policy

- When an existing Policy is made subject to trust, the value of the gift will be the market value of the Policy (or, for other than a term Policy, the premiums paid to date if greater less any part surrenders less an allowance for any decrease in the value of units since allocation at inception of the Policy). Other than this the tax implications will usually be as set out above for a new Policy.

It should be noted that under a protection plan, even if it has no surrender value, if the life (lives) assured are in serious ill health this could mean that it has a value for inheritance tax purposes.

- If the total amount of the chargeable transfers made by the Settlor in a tax year exceeds £10,000, or causes the cumulative chargeable transfers made in the preceding 10 years including the current transfer to exceed £40,000, the gift will have to be reported to HMRC.

## Payment of additional premiums by the Settlor

Continuing premiums under a regular premium plan and any additional investment made into a bond by the Settlor will be further gifts, and the tax implications will be as described above for the initial transfer. Additional investments into the trust can also have an impact on the periodic and exit charges (see overleaf).

## Death of the Settlor

- On the death of the Settlor (or, where relevant, either of the Settlers) the value of the Policy put in trust will be outside of the Settlor's estate for IHT purposes.
- Inheritance tax could however potentially arise where the value of the non-exempt transfers to the trust exceed the nil rate band and the Settlor dies within seven years of making the transfer. In this case, a further tax liability (a further 20%) on the gift could arise although taper relief will be available if the Settlor survives for at least three years. If the value of the original gift is within the available nil rate band then, in most cases, no liability will arise on the gift itself. However, the nil rate band available to determine the liability arising on the Settlor's estate on his death will be correspondingly reduced by any non-exempt chargeable transfers made within seven years of the Settlor's death.
- Subject to the above, the Policy proceeds should be paid free of inheritance tax to the Trustees.

### IHT whilst the trust is in existence

As this is a discretionary trust it means that the special IHT charging rules apply. Under these rules there may be IHT charges:

- on every 10 year anniversary of the trust - "the Periodic Charge"; or
- whenever property leaves the trust (e.g. when capital is advanced to a Beneficiary) - "the Exit Charge".

## The periodic charge

Periodic charges at 10 yearly intervals may be applied to the value of the assets in the trust. The rate of inheritance tax charged will be determined based on an assumed transfer by an assumed transferor. This will mean that it will broadly be necessary to take account of

- the value of the property in the trust on the 10 year anniversary, certain additions made to the trust ("added property") and the value, when they were set up, of any other trusts created on the same day (the assumed transfer)
- the Settlor's cumulative total of chargeable transfers made in the seven years immediately preceding the creation of the trust (assuming there has been no added property) and any sums paid out of the trust in the 10 years prior to the anniversary (the cumulative total of the assumed transferor)

The maximum liability will be 6% of the value of the trust property over the available nil rate band but frequently it will be much less or nil.

In cases where the Settlor has not made any chargeable transfers in the seven years before he creates the trust, no payments have been made out of the trust in the previous 10 years and there has been no added property (in this connection it should be noted that regular premiums paid direct to Lincoln and which are exempt will not be added property for this purpose), there will be no liability provided the value of the trust at the time of the periodic charge does not exceed the nil rate band applicable at the 10 year anniversary. Any excess over the then nil rate band will suffer IHT at an effective rate of 6%.

### Example

Leo creates a Discretionary Gift Trust in February 2007 by investing £285,000 in a Lincoln Bond. He has made no chargeable transfers in the previous seven years. No payments

are made out of the trust in the first 10 years. In February 2017 the trust fund (i.e. the Policy) is worth £450,000 and the nil rate band is £400,000. The IHT charge will be calculated as £50,000 @ 6% = £3,000. This equates to 0.66% of the total value of the fund.

If all the trust fund is distributed before the tenth anniversary, in many cases no tax charge will arise (see next section). If assets remain in the trust after a distribution, or if further assets are added to the trust, the Trustees will need to take specialist tax advice.

Where the trust property is a protection life policy providing (primarily) benefits on death then unless the total of the premiums paid (unless the Policy is a term assurance) to date or the market value of the Policy (surrender value or ill health value) if greater exceeds the available nil rate band, no IHT will be due.

## The exit charge

Exit charges will be based on the value of property leaving the trust or being appointed absolutely to a Beneficiary.

Exit charges within the first 10 years will be nil (regardless of the amount exiting) if the value of the initial chargeable transfer going into the trust (including the cumulative total of the Settlor's chargeable transfers in the seven years prior to creating the trust and the value of certain added property) is below the available nil rate band at the time the trust is created. If an exit charge does arise, it will increase according to the number of quarters that have expired since the trust was created.

The amount of any exit charge occurring after the first 10 years will depend on the rate of tax charged at the previous 10 year anniversary (if any) and the length of time (in quarters) that the property has been in the trust since the last periodic charge. If there was no charge at the previous 10 year anniversary there will be no exit charge.

### Example

In 2023, 6 years since the first 10 year anniversary (when a 0.66% IHT rate was charged), the Trustees of Leo's trust make a part encashment of the Bond and pay £50,000 to a Beneficiary. The IHT charge will be £50,000 x 0.66% x 24/40 = £198.

No IHT charge will arise on property paid out of the trust if there was no IHT charge at the last 10 year anniversary.

Exit charges should not arise on loans made by the Trustees to Beneficiaries.

Certain transactions, such as capital payments to the Beneficiaries, may also have to be reported to HM Revenue & Customs even if no actual tax liability arises.

**If there are joint Settlers who have contributed equally, the trust is effectively treated as two separate trusts, each settled by one Settlor, for all IHT purposes. This means that two nil rate bands would, effectively, be available.**

## Income tax

Please note that in all cases it is assumed that the Settlor and the Trustees are UK resident - special rules apply where this is not so.

There is unlikely to be an income tax charge where the Policy is primarily providing protection benefits.

#### **During the Settlor's lifetime and in the tax year in which the Settlor's death occurs**

- For income tax purposes, any chargeable event gains arising under the Policy (only relevant in connection with an investment bond) will be assessed on the Settlor if UK resident. If there are joint Settlers, each will normally be assessed on one-half of the gain.

#### **After the end of the tax year in which the Settlor's death occurs**

- Following the Settlor's death, any chargeable event gains arising in a tax year after that in which the Settlor died will be assessed on UK resident Trustees at the special rate of 40% less a lower rate tax credit (20% in 2007/8) for a Bond issued by a UK life company to reflect tax suffered in the life fund. This means that if the lower rate is 20%, the rate payable on the gain would be 20%. To the extent that chargeable event gains fall within the £1,000 standard rate tax band available to the Trustees, there will be no charge to tax.

#### **Payments to Beneficiaries**

- If the Trustees make an encashment of or withdrawal from the Bond to make a payment to Beneficiaries, the income tax and IHT consequences of this are as outlined above.
- As an alternative to encashing the Bond prior to payment, the Trustees could make an absolute appointment of benefits in favour of an adult Beneficiary. They could then assign the Bond to the Beneficiary who is to benefit. That assignment would not give rise to a chargeable event. Any chargeable event gain arising on any subsequent encashment by the Beneficiary would then be assessed to tax on that Beneficiary.
- As long as payments to Beneficiaries are made and documented as advancements of capital and do not acquire the character of income, there will normally be no income tax implications for the Settlor or the Beneficiaries.

### **Money laundering**

Under the Money Laundering Regulations 2003 we are required, in certain circumstances, to obtain independent documentary evidence of the identity and permanent address of persons seeking to invest with us. Until we receive the documentation, we may be required to delay processing your instructions and/or withhold any payments due to you from us in respect of your investment. We may check your details with credit reference agencies, who may add details of our search to your record, and with fraud prevention agencies, who may record details of any false or inaccurate information provided by you where we suspect fraud. We may also disclose details of your conduct in relation to your application, account or policy to these agencies. We or other organisations may use and search these records to help make decisions about applications, accounts, claims and other services for you and members of your household and to prevent fraud and money laundering. We cannot accept responsibility for the accuracy of information provided by these agencies nor can we accept any liability for the consequences of our undertaking these checks or declining to accept your application. Please contact us if you would like details of these agencies and how they may use your information.

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