

The Lincoln Discretionary Discounted Gift Trust Guide

Trusts

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Lincoln will only accept applications for this product through financial advisers.

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 March 2008. It is not intended to be a comprehensive guide to the law and the tax implications of using a Trust. This 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 responsibility for any loss arising from its use. Settlers/policyholders are strongly recommended to take independent professional advice before creating a trust.

What is a 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 control and legal ownership of the asset but must use it for the benefit of the Beneficiaries.

When a Bond is placed into Trust, the ownership of the Bond is effectively split.

- The legal owners of the Bond will be the Trustees. The Trustees collectively control all dealings with the Bond on behalf of the Beneficiaries, under the Trust. The Trustees are in effect the "stewards" of the Trust property.
- The Beneficiaries under the Trust will be entitled to enjoy the Trust asset - in the case of a Bond, the proceeds on encashment and the payment of death benefit from the Bond.

Trusts are often used to facilitate inheritance tax (IHT) planning, for example, to make an effective gift of an asset and potentially reduce the taxable estate of an individual. The tax treatment of the Discretionary Discounted Gift Trust is explained in more detail later, see page 4 "Inheritance Tax Charge".

Glossary of roles and terms

Settlor/ investor	Individual(s) making the investment in the Bond and establishing the Trust.
Beneficiaries	Individuals who will benefit from the Trust assets. Usually they will be the named "Lives Assured" for your Bond.
Trustees	The individuals named in the Trust document responsible for managing the Trust assets.
Regular income	Withdrawals of capital.

Who could consider using the Lincoln Discretionary Discounted Gift Trust?

You could consider using a Discretionary Discounted Gift Trust if you:

- are aged under 90;
- are in good health;
- have an estate in excess of the nil rate band – in 2008/2009 this is £312,000 or £624,000 in the case of married couples or civil partners and widows/widowers who are entitled to a deceased spouse's unused transferable nil rate band allowance;
- wish to retain the right to a "regular income" for the rest of your life;
- are happy to give up access to the capital and any growth in the Bond;
- are happy that "income" cannot be increased in the future;
- wish to retain flexibility over the choice of Beneficiaries, and
- wish to make a gift which, after a discount, will not cause you to exceed your nil rate band for IHT.

Please note - the Lincoln Discretionary Gift Trust may not be suitable if the beneficiary(ies) are known at outset and are not going to be changed. In these circumstances the Lincoln Absolute Discounted Gift Trust could be considered. You should discuss your options with your financial adviser.

When should the Lincoln Discretionary Discounted Gift Trust not be used?

The Discretionary Discounted Gift Trust may be inappropriate if you:

- are not interested in IHT planning;
- wish to retain control of and access to the capital and possibly any growth in the Bond;
- can afford to make an outright gift;
- are in poor health; or
- are aged 90 or over
- are certain of your intended beneficiaries and do not need the flexibility of the Discretionary Trust and would prefer for your intended gift to be treated as a Potentially Exempt Transfer (PET).

If the intended gift would cause you to exceed your IHT nil rate band, you may wish to consider splitting the investment between the Lincoln Discretionary Discounted Gift Trust to use your available nil rate band, and the Lincoln Absolute Discounted Gift Trust for amounts above that.

How is the Lincoln Discretionary Discounted Gift Trust established?

With the Discretionary Discounted Gift Trust, you first apply for an Investment Bond.

The application is for a Bond usually on the lives of some of the Beneficiaries initially nominated. Up to four lives can be included. In order to ensure favourable tax treatment, neither you nor your spouse (civil partner) can be a life assured.

You and your chosen additional Trustees then complete the Lincoln Discretionary Discounted Gift Trust deed. This incorporates a transfer of the Investment Bond into the Trust which will take place as soon as the Bond is issued by Lincoln. This will happen after Lincoln completes the medical application process which will establish the amount of discount that could apply to the gift.

The Trust deed specifies your entitlement to cash sums if alive on the appropriate anniversary of the Trust. These could be fixed cash sums or a fixed percentage (not exceeding 5%) of the original investment. The regular withdrawal instruction in the Trust should match that in the Bond application. The Trustees will complete a withdrawal authority (in the Bond application form) to ensure that the Bond regular income is paid directly to your bank account.

Key details of the Lincoln Discretionary Discounted Gift Trust

The aims

The Lincoln Discretionary Discounted Gift Trust is designed for individuals who wish to make a lump sum investment into Lincoln's Discounted Gift Bond (which is considered a gift for IHT purposes) yet wish to retain a right to a regular income as well as an element of control over the eventual distribution of the remainder of the fund to his/her beneficiaries.

The aim of the Lincoln Discretionary Discounted Gift Trust is to ensure that you are entitled to regular income payments from the Trust until your death. These regular income payments will be funded by regular withdrawals from the Bond by the Trustees. The remainder of the Trust fund is held for the benefit of the Beneficiaries outside of your taxable estate.

The Trust in brief:

- The Trust fund is notionally split into two parts: the Settlor's Fund and the Beneficiaries' Fund.
- Under the Settlor's Fund, you retain a right to future regular income payments until your death, subject to adequate capital remaining in the Trust.
- The Beneficiaries' Fund is made up of the remainder of the Trust fund, and is to be used for the benefit of the Beneficiaries of the Trust.
- After your death the Trustees can distribute the remaining Trust fund to the Beneficiaries.
- The Appointor (initially you) decides who (from the Discretionary Beneficiary Classes specified in the Trust)

should benefit from the Beneficiaries Fund. After your death the Trustees take over this power of appointment.

- You name (as Default Beneficiaries) the individual(s) who are to benefit from the Trust fund at the end of the Trust period (if not previously appointed) and the shares in which they are to benefit.
- The Beneficiaries can include your 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 you to the Trustees in writing.
- You could leave an indication of wishes as to who you would like to benefit under the Trust. This would not be binding on the Trustees but they would, no doubt, take it into account when deciding when and to whom benefits should be paid.
- As the Trust is a Discretionary Trust, no beneficiary is entitled to anything until the Appointor makes an appointment in his/her favour. If any income arises to the Trustees from the Trust investments (not relevant while the sole Trust asset is the Bond) they can accumulate it for up to 21 years – this is the maximum time income can be accumulated under English Law. After that time the Trustees will have to distribute all income to whichever Beneficiary they decide. However, no Beneficiary will have the right to any income. Distributions will be at the discretion of the Trustees.
- In the unlikely event of the Appointor making no appointments by the end of the Trust period (80 years) then the individual(s) named by you as Default Beneficiaries will benefit.

How does the Trust work?

The Trust gives you an entitlement for the remainder of your life to a stream of cash payments on a monthly, quarterly, half yearly, or annual basis depending on selections you make. This portion of the Trust Fund is the "Settlor's Fund". The value of this is shown on your illustration as the "Retained Interest". You cannot benefit from any other part of the Trust fund.

The balance of the Trust fund is known as the Beneficiaries' fund. Its value is shown on your illustration as the "Discounted Value of the Gift". This will be available to be used for the benefit of the Beneficiaries under the Trust.

The Trust allows for joint Settlers. If you are married (or registered civil partners) you can choose the joint Settlor Trust wording which means that regular income payments (from the Bond) can continue after the death of either you or your spouse/partner.

The Trustees

You (or both of you in the case of joint Settlers) are automatically one (or both) of the initial Trustees. At least one additional Trustee must be appointed. You and the additional Trustees jointly execute the trust deed.

During your lifetime (or for joint Settlers during their joint lifetime and, thereafter, the survivor) you have the power to dismiss a Trustee provided at least one Trustee other than a Settlor remains.

The Trustees must act unanimously.

How is income paid?

The level of regular income, commencement date, and frequency of income you require is stated by you in the Trust Deed. This cannot be changed at a later date. As you survive to each payment date you will become entitled to the cash payment.

The Trustees have wide powers to invest the Trust property but under the provisions of the Trust they cannot exercise any of their powers in such a way that would change or remove your right to income.

Once the Trust is established you cannot directly change the level of regular income. If you wish to reduce or give up the right to some of your regular income you can do this outside the terms of the Trust by writing to the Trustees. You cannot under any circumstances increase the level of income.

It is strongly recommended that you seek independent professional advice before considering giving up your right to future income payments.

Your regular income will be financed by the Trustees making regular withdrawals from the Bond. These will be paid by Lincoln at the instruction of the Trustees usually directly into your bank account. The tax implications of income payments are explained in the Key Features of the Lincoln Discounted Gift Bond.

Distribution of the Trust proceeds?

On your death your entitlement to future income payments will cease, unless you have a joint Settlor. On the death of the last Settlor the remainder of the Trust fund will then be held for the benefit of the Beneficiaries. The Trustees can then surrender the Bond and distribute the proceeds, or they can keep the Bond running as long as at least one life assured is alive.

The tax implications of the Lincoln Discretionary Discounted Gift Trust

Inheritance tax - Discounted Gift calculation:

The Trust enables you to reduce for IHT purposes the value of the gift you make to the Trust and potentially any Inheritance Tax liability on your estate. The Trust establishes your right to a regular income payment for the remainder of your life. The value of this right reduces (i.e. "discounts") the value of the gift. This is known as the Discount.

The value of the discount is based on the income you can expect to receive over your lifetime. The calculation of the Discount will depend on your age, gender, and state of health at commencement of the Bond, and the amount and frequency of the income payments. The longer you are expected to live the more income you can expect to receive and therefore the greater the value of the discount. If you are in poor health the value of the discount may not be very high and there may be no discount at all.

The value of the gift will be calculated by reference to the value of the Bond at outset. The value of the Discount will then be deducted to ascertain the value of the Discounted Gift for Inheritance Tax purposes.

Joint Settlers – Discount Calculation

Where you as husband and wife (or registered civil partners) invest as joint Settlers, provided you each contribute equally, you will be treated as making an investment of 50% each of the total investment. The discount will be calculated individually for each of you. The value of the discount may vary as it will depend on your differing ages, genders, and states of health.

Discount calculation basis

The Discount will be calculated using the medical evidence supplied by your doctor prior to acceptance of the Bond application. The discount will be calculated by Lincoln using current HMRC guidance but the value of the discount cannot be guaranteed. HMRC may accept the valuation used by Lincoln; however, each discount value is reassessed by HMRC when declaring your estate and they may set a different level of discount. It is for this reason that Lincoln require that medical evidence must be supplied by you before the Bond passes to the Trust. This evidence will be used by Lincoln to calculate the discounted gift value. This evidence will then be available should it be required to agree a valuation with HMRC on your death.

Inheritance Tax Charge (IHT)

Establishment of the trust

- For IHT purposes a transfer of value (a gift) takes place at the time the Trust is created.
- The value of the gift will be discounted for IHT purposes in accordance with HMRC guidance.
- Where you are Joint Settlers, each of you is treated as contributing 50% to the investment and therefore 50% of the gift. The discounted gift applicable to each of you will be calculated individually.
- The discounted gift will be a chargeable lifetime transfer (CLT) to the extent it exceeds the IHT annual gift exemption. In 2008/2009 this is £3,000 for each of you (£6,000 each if you have not used the exemption for the previous tax year). This will mean a liability to IHT at 20% will arise on creation of the Trust if the amount of the discounted gift, plus all other CLTs made by you in the previous seven years, exceeds the nil rate band in 2008/2009. This is £312,000.
- A further tax liability could arise on your death see below.
- If the CLT arising on the gift into this trust, when added to CLTs you have made in the previous seven years, causes you to exceed the nil rate band (see above) and so tax is due, you must report the transfer to HMRC Inheritance Tax on forms IHT100, IHT100a and D34.

On your death

- If you survive for seven years after establishing the Trust, no additional IHT liability will arise in respect of the gift.
- Further inheritance tax could potentially arise where the discounted gift exceeds the nil band and you die 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 you have survived the gift by 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 your estate on your death will be correspondingly reduced by any non-exempt chargeable transfers made within the seven years preceding your death.

IHT on the Trust

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

- “the Periodic Charge” - on every ten-year anniversary of the Trust, and
- “the Exit Charge” - whenever property leaves the Trust (e.g. when capital is advanced to a Beneficiary).

There are no reporting requirements for the periodic and exit charges provided, broadly, that the notional chargeable transfer on which any tax would be paid does not exceed 80% of the nil rate band that applies at the date of the charge.

The periodic charge

Periodic charges at ten-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 ten-year anniversary, and the value, when they were set up, of any other Trusts created on the same day (the assumed transfer)
- your cumulative total of chargeable transfers made in the seven years immediately preceding the creation of the Trust and any sums paid out of the Trust in the ten 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 you have not made any chargeable transfers in the seven years before creating the Trust, and no payments have been made out of the Trust in the previous ten years 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 ten-year anniversary. Any excess over the then nil rate band will suffer IHT at an effective rate of 6%.

For these purposes the value of the Trust property will be the value of the Bond less the then value of your right to future regular income payments. Examples used in this document are not real cases and are for illustrative purposes.

Example

Ben creates a Discretionary Discounted Gift Trust in March 2008 for £280,000. The value of Ben’s retained rights is £150,000 and so the discounted gift is £130,000 based on an annual cash payment of £14,000 (5% of the premium to the bond).

Ben has made no chargeable transfers in the previous seven years. No payments are made out of the Trust (other than those to Ben from the Settlor’s Fund) in the first ten years. In March 2018 the Trust fund is worth £315,000 and the nil rate band is £400,000. This is a projection therefore we have assumed an increase in the nil rate band and fund value for illustrative purposes. No IHT is payable.

For the purposes of calculating the value of the Trust fund for the periodic charge, HMRC has confirmed that the present value of the Settlor’s right to future cash payments at that time (i.e. at the ten-year anniversary) should be deducted from the value of the Trust fund (i.e. the Bond). This means that an amount in respect of the then value of the Settlor’s rights

would need to be deducted from the value of the Bond.

Had the value of the Bond been £490,000 after ten years with the Settlor’s rights valued at £40,000, then the value of the relevant property in the settlement would have been £450,000 and an IHT charge of £3,000 would have arisen (£50,000 at 6%). This equates to a charge at the rate of 0.61% on the whole value of the Trust property.

Tax charges on exit

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

HMRC has confirmed that no exit charge will arise on payments made to the Settlor under a Discretionary Discounted Gift Trust because this property is already held absolutely on Bare Trust for him.

Exit charges (should they arise on other payments out of the Trust) within the first ten years will be nil (regardless of the amount leaving the Trust) if the value of the initial chargeable transfer going into the Trust (including the cumulative total of your chargeable transfers in the seven years prior to creating the Trust) 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 quarter years that have expired since the Trust was created.

The amount of any exit charge occurring after the first ten years will depend on the rate of tax charged at the previous ten-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 ten-year anniversary there will be no exit charge.

Example

In March 2024, six years since the first ten-year anniversary (when a 0.61% IHT rate was charged), the Trustees of Ben’s Trust make a part encashment of the Bond and pay £100,000 to a Beneficiary.

The IHT charge will be: $£100,000 \times 0.61\% \times 24/40 = £366$.

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

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

If there are joint Settlers, the Trust is effectively treated as two separate Trusts, each settled by one Settlor, for IHT purposes. This means that two nil rate bands would, effectively, be available.

IHT gift and Reservation of Benefit legislation

The IHT gift and Reservation of Benefit provisions apply where you have gifted property and continued to enjoy benefit; in which case the gifted property will then remain in your taxable estate and no IHT advantages will be secured. These provisions will not apply to the Lincoln Discounted Gift Trust because of the way the Discount is established.

Tax on pre-owned assets legislation

The tax on pre-owned assets provisions apply where you have gifted property and continued to enjoy a benefit, but the gift is not subject to the gift with reservation of benefit rules. This legislation applies an income tax charge on the benefit enjoyed. These provisions will not apply to the Lincoln Discounted Gift Trust because of the way the Discount is established.

Income tax

Further details on the tax treatment of the Bond are covered in the “Key Features of the Lincoln Discounted Gift Bond” section “What about tax”? Please discuss your tax position with your financial adviser. Any tax liability which arises can be apportioned between two event types.

Your “regular income”

Your entitlement to “regular income” under the terms of the Trust will be funded by the Trustees through regular withdrawals from the Bond. The tax treatment on withdrawals from the Bond are explained in the Key Features document.

As long as withdrawals from the Bond do not exceed 5% of the original investment there will be no immediate income tax implications. This tax deferral can only continue for 20 years. If the payments exceed the 5% cumulative allowance or you survive for 20 years, the tax on chargeable event gains will apply and be payable by you.

In order to reduce the likelihood of difficulties in this area the Lincoln Discounted Gift Bond does not allow regular income to exceed 5% per annum of the investment in the Bond.

Other “Chargeable Event” gains

Any chargeable events gains on encashment of the Bond, for partial surrender, full surrender, death or assignment will be taxed as follows:

- on you if the chargeable event gain arises in your lifetime or in the tax year of your death; and
- on the Trustees if the chargeable event gain arises in a tax year after that in which you died. The tax will be assessed on UK resident Trustees at the special rate of 40% less a basic rate credit (in 2008/2009 this is 20%) for a Bond issued by a UK life company to reflect tax suffered in the life fund. This means that if the basic 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. These rules also apply if the chargeable event gain arises at any time that the Settlor is a non-UK resident.

In all cases, it is assumed that the Settlers, the Beneficiaries and the Trustees are UK resident - special rules apply where this is not so.

Capital Gains Tax (CGT)

As explained in the Key Features document there are no capital gains tax implications for the Bond as the underlying asset of the Trust, either when the trust is created or subsequently.

The Investment Bond

The initial underlying investment of the Lincoln Discretionary Discounted Gift Trust is a single premium life assurance bond – the Lincoln Discounted Gift Bond. Full details of this Bond are explained in the “Key Features of the Lincoln Discounted Gift Bond” which should be read in conjunction with this document.

Investment Bonds fully encash on the death of the last surviving life assured, and on surrender or assignment. It is therefore preferable that there is more than one life assured as this gives more control over the timing of encashment of the Bond for both investment and tax purposes.

The lives assured under the Bond, who would usually be the Beneficiaries under the Trust, should be selected carefully with a view to them surviving you. Neither you nor your spouse/civil partner can be lives assured under the Investment Bond, to ensure the Trust does not breach anti-avoidance tax rules.

Should the Investment Bond encash because the last surviving life assured dies, your entitlement under the Trust will continue. The Trustees could in such a case reinvest the proceeds into another Bond.

Once the Bond is made subject to trust, any subsequent dealings with the Bond will be between the Trustees (as the legal owners) and Lincoln, although the regular income payments will be paid directly to your bank account on instruction from the Trustee(s).

Although the Trustees have wide powers to invest Trust assets as they wish, the Discretionary Discounted Gift Trust is based on an Investment Bond (a non-income producing asset). This is because other income producing assets, such as Unit Trusts and OEICS, have serious tax and trust administration disadvantages when held inside a trust like this.

