

The Lincoln Absolute 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. Donors/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.

Gifts made into Absolute Trusts, like the Lincoln Absolute Discounted Gift Trust, are not deemed to be settlements for IHT purposes. Although a Trust which is a settlement can offer more flexibility, a Trust which is not a settlement benefits from more favourable tax treatment. This tax treatment is explained in more detail later in this document (see page 4, "Inheritance Tax Charge").

Glossary of roles and terms

Donor/ 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 Absolute Discounted Gift Trust?

You could consider using an Absolute 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 unrestricted access to the capital and any growth in the Bond;
- are happy that "income" cannot be increased in the future;
- have identified the Beneficiary(ies) whom you wish to benefit and accept you will not be able to change your mind in the future; and
- do not want the funds in the Trust to be potentially liable to IHT charges under the discretionary trust regime. This is explained further in the 'Tax implications' section of the Absolute Discounted Gift Bond Trusts Guide.

If you cannot be specific in your choice of the Beneficiary(ies), the Absolute Discounted Gift Trust will not be appropriate and you should consider whether a Lincoln Discretionary Discounted Gift Trust would be more suitable. You should discuss your options with your financial adviser.

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

The Absolute 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.

How is the Lincoln Absolute Discounted Gift Trust established?

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

The application is for a Bond usually on the life or lives of the Beneficiaries. 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 Absolute 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 Absolute Discounted Gift Trust

The aims

The Lincoln Absolute 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.

The aim of the Lincoln Absolute 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 chosen Beneficiaries outside of your taxable estate.

The Trust in brief:

- The Trust fund is notionally split into two parts: the Donor's Fund and the Beneficiaries' Fund.
- Under the Donor'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.
- You decide at outset who the Beneficiaries are by naming them in the trust deed.
- The Beneficiaries are absolutely entitled to the Beneficiaries Fund, which means that their entitlement cannot be removed or changed under the Trust.

Please note: It is very important that you are certain you will not want to change your mind about the Beneficiaries of the Trust at a later date.

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 "Donors 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 Donors. If you are married (or registered civil partners) you can choose the joint Donor 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 Donors) 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 Donors during their joint lifetime and, thereafter, the survivor) you have the power to dismiss a Trustee provided at least one Trustee other than a Donor 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, entitlement to future income payments will cease, unless you have a joint Donor. On the death of the last Donor 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 Absolute 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 in fact 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 Donors – Discount Calculation

Where you as husband and wife (or registered civil partners) invest as joint Donors, 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 and 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 Donors, 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.

- When the Trust is established, you will be treated as having made a discounted gift for IHT purposes. This will be a potentially exempt transfer (PET). This means that, regardless of the size of the gift, no tax liability will arise at the time of the gift.
- There is no requirement for you to inform HMRC of the Potentially Exempt Transfer when the Trust is established.

On your death

- If you survive for seven years after establishing the Trust, no IHT liability will arise in respect of the gift.
- If you die within seven years of making the gift the value of the gift will be taken into account in determining the IHT liability on your estate.

On death of a Beneficiary

- On a Beneficiary’s death, the value of his interest in the Trust fund will form part of his taxable estate. The value of the Beneficiary’s share of the Trust will be reduced to reflect the value of the Discount.
- Whether IHT would then arise on the deceased Beneficiary’s estate will depend on the Beneficiary’s individual circumstances.
- In cases where a minor child is named as a Beneficiary there could be a problem if they pre-decease you. As a minor cannot normally make a Will, intestacy would arise. This could have the effect of causing the benefits of the Trust to return to you.
- In most cases a minor Beneficiary is likely to be a grandchild (rather than a child). In this case the reversion would be to their parents i.e. your children or son/daughter in law.

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 to 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 Event gains on encashment of the Bond, for partial surrender, full surrender, death or assignment, will be taxed on the Beneficiaries if they are aged 18 or over.

If the Beneficiaries are aged under 18 then chargeable event gains are taxed:

- 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.

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

OEICS, have serious tax and trust administration disadvantages when held inside a trust like this.



Capital Gains Taxes (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 Absolute 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 instructions from the Trustee(s).

Although the Trustees have wide powers to invest Trust assets as they wish, the Absolute 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

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