Discretionary Discounted Gift Trust

A customer guide

What is the Discretionary Discounted Gift Trust?

The Discretionary Discounted Gift Trust is a trust that allows you to make an inheritance tax effective gift of an Aviva investment bond to trustees, whilst keeping an 'income' stream for yourself. This isn't income in the ordinary use of the word, but is a regular stream of capital payments. You can also control who will benefit from the trust fund after your death.

Who is it suitable for?

It's suitable for anyone who wants to reduce their potential inheritance tax (IHT) bill; who can give up access to the cash given away, but who needs to keep an 'income' stream.

What products can I use it with?

The trust can be established with a new Aviva investment bond.

Remember that investment bonds invest in the stock market, so the value of the money invested can go up and down and may be less than you originally invested. Before investing, you should read the bond's Key Features and Terms and Conditions carefully. It's important to understand the product fully and to make sure it's suitable for you.

How do I apply?

If you're to be underwritten (see later in booklet) then you shouldn't complete or submit any documentation - other than the Health Questionnaire - until you receive the result of the underwriting and a Discount Schedule.

Firstly, you'll need to complete the Discretionary Discounted Gift Trust Deed. The trustees (appointed in the Deed) will then need to complete an application form for an Aviva investment bond. These documents then need to be sent to Aviva together with your Payment. The addess is Aviva, PO Box 520, Norwich NR1 3WG.

Please note:

In this booklet, references to 'spouse' are intended to include 'civil partner' and references to 'widow' or 'widower' to include 'surviving civil partner'.

The objective – how to leave more for your family by reducing your Inheritance tax (IHT) liability

You've worked hard all of your life. You own your own home and have built up a reasonable 'nest egg' for your retirement. You'll probably be unhappy to learn that, unless you take steps to prevent it, HM Revenue & Customs (HMRC) could be one of the main beneficiaries of your estate when you die.

The steady improvements in the standard of living and the value of property over the years have resulted in more and more people becoming concerned about leaving an inheritance tax bill for their children. One way to reduce inheritance tax is to make lifetime gifts. However, you might not want or be able to make unconditional gifts, and lose control over what happens to the money gifted. For example:

- you might need the income from your investments to top-up your earnings or pension, and an unconditional gift would mean that you'd lose that income;
- you may want to retain some control over how the money you want to give away is invested;
- where your gift is intended for children or grandchildren who are still under 18 and unmarried, an outright gift may not be appropriate;
- you may want to ensure that future (unborn) children or grandchildren can benefit from the gift as well;
- you may want your widow or widower to be able to benefit from the gift after your death.

A possible solution – Discretionary Discounted Gift Trust from Aviva

The Discretionary Discounted Gift Trust ('the Trust') is designed for use with a new Aviva single premium investment bond. The benefits of writing Aviva investments under the Trust are as follows:

- the Trust can create an effective gift (chargeable lifetime transfer) for inheritance tax purposes (see section headed 'UK inheritance tax');
- you retain the right to regular cash sums, from the trust which effectively replaces the income stream from your investments;
- you decide the amounts of these cash sums at the outset;
- because you retain rights under the Trust, the size of the gift for inheritance tax purposes might be less than the total value of your investment;
- the value of the gift will fall out of charge on death if you survive for seven years from the date of the chargeable lifetime transfer;
- any investment growth within the Trust won't be included in your estate for inheritance tax;
- you and/or your trustees can retain control over which of the beneficiaries receive benefits, and when;
- unlike assets in your estate, payments to the trustees on your death won't be delayed by the need to obtain probate (or equivalent), provided there is at least one trustee in place at that time;
- professional investment management (for investment policies) through leading fund managers;
- Trust documentation is provided with no additional charges over and above those within the policy chosen.

How does the Discretionary Discounted Gift Trust work?

You set up the trust by completing the Discretionary Discounted Gift Trust Deed.

The Trustees you appoint in the Trust Deed then apply for an Aviva investment bond.

N.B. You shouldn't complete or submit the Deed and bond application before you've received an underwriting decision (if you're eligible for underwriting - see below).

Within the Deed you appoint trustees, name your default beneficiaries and specify the size and frequency of your cash withdrawals, i.e. your income stream from the Trust.

Aviva will pay withdrawals on the instructions of the trustees. The trustees must make sure that you, the settlor, don't receive more than your entitlement under the Trust.

Your entitlement comes to an end on your death and your beneficiaries are entitled to the remaining trust fund.

Where your investment with Aviva is at least £50,000, we can establish your state of health (through a process known as 'underwriting'). This will enable us to provide a more accurate estimate of any discount available (see the section entitled '**UK inheritance tax**'). To start this process you need to complete and submit a health questionnaire before you complete and submit the Trust Deed and bond application. However, any discount quoted is never guaranteed and ultimately HMRC will decide what, if any, discount will be allowed.

In summary:

- You should complete the underwriting form (where applicable), then the Discretionary Discounted Gift Trust Deed, choose your additional trustees and name your default beneficiaries.
- The policyholder is also the creator (settlor) of the trust.
- The Trust can cater for both single and joint policyholders.
- Within the Trust Deed you state the size and frequency of your cash withdrawals. Once the Trust is complete you can't change these.
- You choose who should act as trustees.
- Because you keep the right to cash withdrawals, the size of the gift for inheritance tax purposes might be smaller than the investment made (see section **UK inheritance tax**).
- There are two classes of beneficiary. At the outset, you choose the 'default beneficiaries' who will benefit if no other appointment is made within the trust period (125 years). If your circumstances change and you'd like the trustees to consider appointing all or part of the trust fund to another potential beneficiary you should complete a 'letter of wishes' to the trustees detailing your revised intentions.
- You shouldn't be included in the class of potential beneficiaries (as that would have adverse tax implications).

UK inheritance tax

The gift into the Discretionary Discounted Gift Trust is a chargeable lifetime transfer. The annual exemption, if available, may be used to reduce the chargeable value.

The bond must not be written on your life or the life of your spouse i.e. you must choose other lives insured, such as the beneficiaries under the trust. If the bond were to be written on the life of you and/or your spouse, that might cancel out the inheritance tax benefits of the trust.

If the aggregate value of your chargeable lifetime transfers in any seven year period exceeds the available nil rate band, which is £325,000 for tax years up to and including 2024/25, then inheritance tax is payable on the excess at half the death rate (i.e. currently at 20%).

The trust fund may also be subject to periodic inheritance tax charges at every 10 year anniversary of its creation. A charge will arise on the relevant value of the trust fund that exceeds the then available nil rate band. Any chargeable lifetime transfers you made in the seven years up to creating the trust will also be taken into account in the calculation. The charge is 20% of 30% (equals 6%) of the relevant value of the trust fund in excess of the available nil rate band. The value of your entitlement isn't treated as relevant property and hence not included in the calculation of the periodic charge. However, at the first 10 year anniversary you'll be 10 years older than when the trust started, and your state of health might have deteriorated. The value of your entitlement could be considerably less than at the start of the trust, and might indeed be nil.

Exit charges might apply to capital distributed to beneficiaries. These will apply where there has been a charge to inheritance tax at the last 10 year anniversary or at the start of the trust if within the first 10 years. The charge will be based on the rate calculated at the last 10 year anniversary or at the start of the trust. The charge will be multiplied by the factor X/40 where X is the number of full three month periods since the last 10 year anniversary. Payments made to you as settlor (under your retained rights) won't be subject to exit charges.

If the seven year aggregate value of your chargeable transfers is below the available nil rate band at the start of the trust there will be no initial charge to inheritance tax. Similarly, if the relevant value of the trust property and chargeable transfers at subsequent 10 year anniversaries is less than the available nil rate band, there will be no inheritance tax charge.

If you die within seven years of making a chargeable lifetime transfer, the value of that transfer will become chargeable to inheritance tax at the rate applying on death (currently 40%). Any tax payable on death will be reduced by any tax that was paid when the transfer was made.

The actual policy proceeds will generally not be subject to inheritance tax as the policy itself won't be part of your estate. So any investment growth achieved in the bond whilst in trust won't form part of your estate.

The value of the chargeable lifetime transfer doesn't include the value of your retained right to withdrawals. As you keep those rights, they aren't part of the gift. It's these retained rights that give rise to any 'discount' that might be available. The value of your retained rights (and hence any discount) depends on your age and state of health at the time the trust is created, as well as the actual amounts retained.

Health and underwriting

Because your state of health at the outset is important, you should have some way to establish it. Where the investment made with Aviva is at least £50,000 we'll 'underwrite' as though you'd applied for a whole of life insurance policy and this will enable us to give a more accurate estimate of any discount that might be allowed by HMRC. Otherwise, it's still important that you obtain some evidence, such as a GP Report for example. This evidence will be needed when agreeing any discount with HMRC. We'll provide our estimate of the discount available and hence the size of the chargeable lifetime transfer. However, we can't guarantee any amount and ultimately this must be agreed with the Revenue.

You should note that HMRC won't allow any discount if they consider that you were uninsurable at the time the trust was created, whether because of health or age or other reason. HMRC current practice is to treat anyone aged 80 or over (including any medical loading) as uninsurable.

If you make chargeable lifetime transfers totalling in excess of £325,000 (the nil rate band in tax years up to and including 2024/25) in the same tax year or in the seven years before the transfer, you must complete a form IHT100 and IHT100a, and send this to HMRC. The trustees may also have to complete an IHT100 and either IHT100c or IHT100d when reporting a proportionate (exit) or principle (periodic) charge. These forms can be found on the HMRC website, **gov.uk/government/collections/hmrc-forms**

If the policy and hence the trust are effected by one person i.e. just one of the spouses, the investment shouldn't be paid from a joint account as this could have adverse inheritance tax consequences.

If the policy and trust are set up jointly by both spouses then neither spouse will be a beneficiary under the trust, and the investment can be paid from a joint account.

The inheritance tax treatment of trusts is complex and the above is simply a brief summary. Further information can be found on the HMRC website at **hmrc.gov.uk** or from your professional tax adviser. You should take your own legal and tax advice in relation to your own circumstances.

Example

Margaret is a widow aged 72 and in good health. She has an estate valued at £700,000 including £100,000 in liquid assets available for re-investment. Margaret's will leaves her estate to her children, and she realises that her estate will have an inheritance tax bill as all of Margaret's spouse's nil rate band was used when he died.

Margaret would like to lessen the potential inheritance tax bill. However, whilst she isn't spending any of her capital she needs the income stream from her investments to support her standard of living and can't make any unconditional gifts.

She discusses investment bonds as a possible option with her financial adviser. Margaret understands that the value of an investment bond can fall, but is happy to take this risk. So she decides to invest £100,000 in an Aviva investment bond and write this under a Discretionary Discounted Gift Trust for the benefit of her children. She retains the right to regular withdrawals of £400 per month to replace her investment income.

Margaret is already making use of her annual exemption for inheritance tax. Following underwriting, the value of Margaret's entitlement is estimated as £51,600 making the chargeable lifetime transfer £48,400 (as at May 2020). Margaret hasn't made any other chargeable lifetime transfers in the last seven years.

There is no immediate charge to inheritance tax and no exit charges apply to Margaret's withdrawals. Assuming the value of the relevant trust property is within the nil rate band at future 10 year anniversaries there will be no periodic charges.

If Margaret survives for seven years the lifetime transfer falls out of charge on death, thus saving 40% x £100,000 = £40,000 (plus 40% of any investment growth).

If she dies within seven years then the lifetime transfer of £48,400 (assuming that value is accepted by HMRC) is chargeable at death rates of tax. As that is within the nil rate band no tax will be paid, but that will use up £48,400 of the nil rate band that would otherwise be available for Margaret's estate. The inheritance tax saving would then be 40% x £51,600 (the value of her entitlement) = £20,640 (plus 40% of any investment growth).

As the value of the chargeable lifetime transfer is less than £325,000, there is no requirement for Margaret to complete an IHT100 or IHT100a. However, these forms are available from HMRC website at **hmrc.gov.uk** whenever they are required.

UK income tax

You, as the settlor of the trust, will be liable to income tax on any gain that arises under the investment bond whilst you're living (or in the tax year of your death) provided you're resident in the UK. (See '**What is a chargeable gain under an investment bond?**' in the '**Questions & Answers**' section.)

If a gain arises in a tax year after your death or when you aren't UK resident, then the trustees (if they are UK resident) are liable to income tax at the rate applicable to trusts (currently 45%) but with a credit of 20% because of tax suffered within the insurance bond. If the trustees aren't UK resident then any beneficiary ordinarily resident in the UK may be liable to income tax at their marginal rate on any money received from the trust, with no credit for corporation tax payable in the UK on policyholder funds.

You should note that a chargeable gain might affect eligibility for income-related benefits and allowances such as child tax credit.

Aviva policies and UK income tax

Any gain arising under an Aviva UK policy won't be subject to basic or starting rates of tax. This is because of corporation tax paid by Aviva on its policyholder funds. You'll only pay tax on the gain if you already pay income tax at higher rate, or if the gain takes you into the higher rate band. In this latter case top slicing relief can be claimed by an individual to reduce the tax payable. Where tax is payable the rate is currently 20% of the chargeable gain. Your financial adviser can explain more about this to you.

UK capital gains tax

Your investment bond will generally be exempt from capital gains tax in the hands of the trustees.

Questions and answers

1. Who is the settlor?

The person(s) who set(s) up the trust. They should be 18 or over and of full mental capacity.

2. Who can be a trustee?

Any adult, 18 or over, who is of sound mind may be appointed as a trustee. Also, a trust company may be appointed. There are a number of things to bear in mind when appointing trustees and you should speak to your own professional advisers about this. In the Discretionary Discounted Gift Trust the settlor is automatically a trustee. We recommend you appoint at least one other trustee.

3. Who has the power to change the beneficiaries under the trust?

When the trust is set up, the settlor(s) will choose who will benefit from the trust fund after their death. The settlor(s) can change the beneficiaries during their lifetime.

After the death of the only or surviving settlor, the trustees have the power to change the beneficiaries during the remaining term of the trust.

4. Can spouses/civil partners each take out their own trust arrangement?

Whilst this can be done, it shouldn't be done without discussion with your professional advisers, as this may counteract any inheritance tax advantage.

5. Can spouses/civil partners establish a Discretionary Discounted Gift Trust jointly?

Yes, this can be done using the Aviva Discretionary Discounted Gift Trust Deed.

6. What is a chargeable gain under an investment bond?

When a chargeable event occurs, a calculation is required to decide whether there is a chargeable gain.

The following are chargeable events for the investment bond:

a) death resulting in payment under the bond, i.e. when the last or only life insured dies;

b) fully cashing in the bond, or a whole individual policy within the bond;

c) assignment of the bond for money or some other consideration i.e. not as a gift;

d) partial cashing-in of the bond in excess of the 5% 'allowance'.

Before making a withdrawal, the trustees should consult their professional adviser regarding the tax consequences, as there are various options that can be considered (see section on income tax).

7. What about the inheritance tax 'gift with reservation' rules?

These rules say that you must make a gift 'virtually to your entire exclusion' if you're to get an inheritance tax advantage. Does the fact that you get cash sums from the trust fall foul of this?

No. When you create a Discretionary Discounted Gift Trust you effectively create two entitlements within the trust. There is your own entitlement to cash sums and that remains part of your estate. There is also the entitlement of your beneficiaries. That is the entitlement to the whole of the trust fund that isn't returned to you. It's the beneficiaries' entitlement that you're giving away and you've no right to that.

Because of this, our tax advisers confirm that the trust shouldn't fall foul of the gift with reservation rules.

8. What about the pre-owned asset tax (POAT) income tax charge?

HMRC have confirmed that, in their view, the Discretionary Discounted Gift Trust isn't caught by POAT. Their analysis is that the settlor's entitlement creates a bare trust and isn't a settlement to which the POAT legislation can apply.

Important notes

This booklet isn't intended to give advice. Anyone thinking of using a Discretionary Discounted Gift Trust or doing anything under the provisions of the trust, must rely on the advice of their own legal and/or financial advisers. We'd urge you to seek appropriate professional advice relevant to your own circumstances before proceeding. This is important for a number of reasons.

- Creating a trust has taxation as well as legal consequences.
- Once the trust has been created it can't be revoked.
- The trustees have a special duty to the beneficiaries and the misuse of a trust power by a trustee can make her/him personally liable for any resulting loss to the beneficiary.

References to tax treatment in this booklet are based on Aviva's understanding of current legislation and HMRC practice. Both of these are likely to change in the future, and this could result in tax being suffered under an existing arrangement. Every care has been taken as to its accuracy. However, neither Aviva nor its representatives can accept responsibility for loss, however caused, suffered by any person who has acted or refrained from acting as a result of material published in or in conjunction with this booklet.

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