Discretionary Gift Trust (Investment)

AVIVA

A customer guide

What is the Discretionary Gift Trust (Investment)?

The Discretionary Gift Trust (Investment) is a trust that allows you to make an inheritance tax (IHT) effective gift of cash, with the intention of investing into investment bonds and/or collective investments. You can also control who will benefit from the trust fund.

Who is it suitable for?

It is suitable for anyone who wants to reduce their potential IHT bill and who can give up access to the cash given away.

What products can I use it with?

The trust can be established with an onshore investment bond, or a holding of collective investments.

The Discretionary Gift Trust (Investment) is not suitable for use with Aviva protection policies; for such policies the Discretionary Gift Trust (Protection) must be used.

Remember that these products will involve investment in the stock market, so the value can go down as well as up and may fall below the amount of the original investment. Before taking out an investment, you and the trustees should read the relevant Key Features document carefully. It's important to understand the product fully and make sure it is suitable.

How do I apply?

Firstly you will need to complete the Discretionary Gift Trust (Investment) Deed. The trustees (appointed on the Deed) then complete the relevant application form for an Aviva investment bond or collective investments of their choice.

These documents then need to be sent to Aviva together with your payment.

If the trustees are investing in collective investments you should not send the Discretionary Gift Trust (Investment) Deed to us. However, you should still complete it fully and carefully and keep it safe.

Alternatively, if you have an existing bond you will have to complete the Discretionary Gift Trust (Investment) Deed, including the section referencing your policy number, and send it to us.

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 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 will probably be unhappy to learn that, unless you take steps to prevent it, HM Revenue & Customs 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 to make outright gifts and lose control over what happens to the money gifted. For example:

- 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, 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 Gift Trust (Investment)

The Discretionary Gift Trust (Investment) is designed to enable you to make a gift of cash with the intention of investing into Aviva investment bonds and/or collective investments. 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");
- the value of the gift will fall out of charge on death if you survive for seven years from the date you create the Trust;
- any investment growth within the Trust will not 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 will not 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 investment charges over and above those within the investment chosen.

How does the Discretionary Gift Trust (Investment) work?

- You should set up the Discretionary Gift Trust (Investment) by completing the Trust Deed.
- The policyholder is also the creator (settlor) of the trust.
- The Trust can cater for both single and joint settlors.
- By making your investment subject to a trust, you are making a gift for inheritance tax purposes.
- There are two classes of beneficiary. At the outset, you choose the default beneficiaries and they will benefit if no other appointment is made within the trust period (125 years). If your circumstances change and you would like to consider appointing all or part of the trust fund to another beneficiary, you should complete a letter of wishes to the trustees detailing your revised intentions.
- You should not be included in the class of potential beneficiaries (as that would have adverse tax implications).

UK taxation

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

Please note tax laws may change.

UK inheritance tax

The following tax sections describe the position of the trustees of your Discretionary Gift Trust (Investment) if invested in an investment bond. As the Trust gives the trustees wide powers of investment, your adviser may recommend investing into other assets such as collective investments or cash accounts. In these circumstances your adviser will be able to provide you with the tax implications of their recommendation.

If the aggregate value of your chargeable lifetime transfers in any seven year period exceeds the available nil rate band, which is currently £325,000, then inheritance tax is payable on the excess at half the death rate (ie 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 half of the current death rate (20%) of 30% of the excess. This equates to a rate of 6%.

Exit charges might apply when capital is 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.

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 payable when the Trust was created.

The actual policy proceeds will generally not be subject to inheritance tax as the policy itself will not be part of your estate.

If the trust is effected by one person, ie just one of the spouses, the premium(s) should not 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 premiums can be paid from a joint account.

If you make chargeable lifetime transfers in excess of £325,000 (the current nil rate band) 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 HM Revenue & Customs. The trustees will also have to complete an IHT100 and either IHT100c or IHT100d when reporting a proportionate (exit) charge or principle (periodic) charge.

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.

Example

Andrew Brown has an estate valued at £700,000 including £60,000 in liquid assets available for re-investment. His will leaves his estate to his children, and Andrew realises that they will have an inheritance tax bill since his spouse nil rate band was used when they died.

Andrew would like to mitigate the potential inheritance tax bill. He does not need his £60,000 free capital. He discusses investment bonds as a possible option with his financial adviser. Andrew understands that the value of an investment bond can fall, but is happy to take this risk. So he decides to invest in an Aviva investment bond and write this under a Discretionary Gift Trust for the benefit of his children.

Andrew's annual exemption for this year and the last is available, so this creates a chargeable lifetime transfer of £54,000. As he has made no previous chargeable transfers, there is no inheritance tax to pay, and no need to complete an IHT100 or IHT100a. Provided Andrew lives a further seven years, the gift will fall out of charge with a saving of 40% x £60,000 = £24,000 (on current rates).

UK income tax where a UK insurance bond is chosen

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

If a gain arises after the tax year of your death or when you are not 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 20% credit for tax suffered within the insurance bond. If the trustees are not 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 benefit.

Aviva onshore policies and UK income tax

For UK residents any gain arising under an Aviva onshore policy will not be subject to basic or starting rates of tax. This is because of corporation tax paid by Aviva on its policyholder funds. You will only pay tax on the gain if you already pay income tax at higher rates, or if the gain takes you into the higher rate band. Top slicing relief can be claimed by an individual to reduce the tax payable where appropriate. When income tax is payable on a chargeable gain the rate charged is the difference between basic rate and the marginal rate you pay.

UK capital gains tax

Your insurance policy will generally be exempt from capital gains tax in the hands of the trustees.

Questions & 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 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 Gift Trust (Investment) 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 can benefit from the trust fund. 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 should not be done without discussion with your professional advisers, as this may counteract any inheritance tax advantage.

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

Yes, this can be done using the Discretionary Gift Trust (Investment) Deed.

6. Can I use the trust with existing policies?

Yes, existing policies (provided by companies within the Aviva group) can be used.

7. What is a chargeable event 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, ie 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, ie 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).

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

A chargeable gain is triggered by a chargeable event, such as cashing in your bond. It's the amount by which the value of the policy exceeds the amount paid into it. You will also have a chargeable gain if you withdraw more than the 5% yearly allowance from your bond. Because your bond is made up of several life policies, there could be a chargeable gain in some circumstances. This could happen if you cash in completely and make a profit or even if you partially cash in. A chargeable gain relating to a life policy may be subject to income tax. Life policies are exempt from capital gains tax unless the policy is sold to someone else.

If your part-surrender exceeds the 5% allowance, it will produce a chargeable gain equal to the amount above 5% - even if the bond is actually showing an investment loss at the time. Any gain you make on your bond is potentially subject to income tax. Because we pay corporation tax on investment income and gains within its funds, you have no liability to basic rate income tax. You will only pay tax on the gain if you already pay income tax at more than the basic rate or if the gain itself takes your income into the higher rate band. You will then pay extra tax, currently at 20% (or 25% if you are an additional rate tax payer), on the gain or on part of the gain. The gain is also treated as income, so it may affect any income-related benefits (such as child benefit) that you may receive.

Important notes

This booklet is not intended to give advice. Anyone thinking of using a Discretionary Gift Trust (Investment) or doing anything under the provisions of the trust, must rely on the advice of their own legal and/or financial advisers. We would 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 cannot 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 HM Revenue & Customs' 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.

Trust Registration. If your policy is written into a trust, there may be an action to register the trust with HMRC. Registration is the trustee's responsibility. As part of our checks, we may ask to see evidence that this has been done. If you can't show us proof, this may delay your policy being processed. You can find more information about the Trust Registration Service on the Government website. If you're unsure about what you need to do, you should speak to a legal or financial adviser.

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