Discretionary Discounted Gift Trust

A customer guide

AVIVA WEALTH

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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 Onshore Bond to trustees (who will hold the assets on behalf of your chosen beneficiaries), 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. By being able to select the beneficiaries of the Trust, 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.

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’.

What products can I use it with?

The Discretionary Discounted Gift Trust can be established with a new Aviva Onshore 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 Onshore 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 Onshore Bond. These documents then need to be sent to Aviva together with your Payment. The addess is **Aviva, PO Box 3838, Norwich, NR1 3SQ.**

The objective: How to leave more for your family by passing on your wealth in a tax-efficient way

You’ve worked hard all of your life and built up a reasonable nest egg for your retirement. You’ve realised that the value of your assets could expose your beneficiaries to inheritance tax, so you could gift some money without affecting your lifestyle.

With the inheritance tax nil rate band frozen at its current level of £325,000 until April 2028 (and expected to remain at this level until April 2030, following changes announced in the Autumn Budget 2024), the impact of this together with high levels of inflation, has meant that more estates are now paying inheritance tax.

You could consider lifetime gifts as a tax efficient option, however, you might not want to make outright 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 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, 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 Onshore 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 '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 to a future 'income' stream from 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 for inheritance tax purposes will essentially be the amount of the investment, less the present value of the future 'income' stream to which you are entitled;
- the value of the gift (excluding the entitlement that funds your 'income' stream) 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 Onshore 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, that is to say 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 '**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 HM Revenue & Customs ('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 **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.
- Neither you, nor your spouse (if applicable), should be included in the class of potential beneficiaries (as that would have adverse tax implications).

- If you are included as a beneficiary of the beneficiary fund, this will result in the funds in the Trust being included in your estate for inheritance tax, eliminating any inheritance tax benefits of the Trust.
- If your spouse is included as a beneficiary of the Trust, this does not in itself give rise to adverse tax consequences. However, it is highly possible that you could have an indirect benefit, which would then cause adverse tax consequences and negate any inheritance tax benefits that would otherwise be achieved.
- For example, if a payment is made to your spouse from the Trust, which is used to pay for a car which you can also use. In this case a gift with reservation of benefit arises, and this means the value of the gift used to purchase the car will remain in your estate for inheritance tax. Indirect benefits could arise from any purchase of goods, experiences and services. Given the broad potential for this to cause adverse tax consequences, we would generally recommend your spouse is excluded from being able to benefit from the Trust during your lifetime. We would recommend you seek your own legal and tax advice if you are intending to include your spouse as a beneficiary of the Trust.

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 2027/28 (and expected to continue at this level until April 2030), then inheritance tax is payable on the excess at half the death rate (that is, 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 ongoing 'income' stream 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%), subject to any available nil rate band. Any tax payable on death will be reduced by any tax that was paid when the transfer was made.

If you die three or more years after the transfer, the inheritance tax rate that applies to the transfer will be reduced by 20% for each complete year after the third year

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 and age or other reason. HMRC current practice is to treat anyone aged 80 or over (including any medical loading) as uninsurable.

If you make total chargeable lifetime transfers totalling in excess of £260,000 (80% of the nil rate band in tax years up to and including 2027/28) in the same tax year and in the seven years before the transfer, you must complete form IHT100a, and send it to HMRC by the end of the sixth month after the transfer. You should note that a return is required if this condition is met, even if no IHT is actually payable (because the total chargeable lifetime transfers are less than the available nil rate band). The trustees may also have to complete form IHT100c when reporting a proportionate (exit), or form IHT100d when reporting a principle (periodic) charge. These forms can be found on the HMRC website, **gov.uk/guidance/tell-hmrc-that-inheritance-tax-is-due-on-a-gift-or-trust-iht100**

If the policy and hence the Trust are effected by one person, that is 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 mitigate 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.

Margaret has therefore invested her spare capital into two separate funds, one to maintain her current standard of living while making an unconditional gift to the beneficiary fund to realise an inheritance tax saving.

She discusses bonds as a possible option with her financial adviser. Margaret understands that the value of a bond can fall, but is happy to take this risk. So she decides to invest £100,000 in an Aviva Onshore 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 future 'income' stream entitlement is estimated as £51,600 making the chargeable lifetime transfer £48,400 (as at November 2024). 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. However, as the 'income' stream also terminates on her death (and therefore has no value at that point), she has effectively saved 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 original value of her 'income' stream entitlement) = £20,640 (plus 40% of any investment growth).

As the value of the chargeable lifetime transfer is less than £260,000, there is no requirement for Margaret to complete a form IHT100a. However, these forms are available from **hmrc.gov.uk** whenever they are required.

UK income tax where a UK insurance bond is chosen

You, as the settlor of the Trust, will be liable to income tax on any gain that arises under the Onshore Bond while 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 Onshore 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 Onshore 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 onshore 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 (40%) or additional (45%) rates of tax, or if the gain takes you into a higher or additional rate tax band. The tax bands in England and Wales, that apply to chargeable event gains, can be found at **gov.uk/income-tax-rates** You might be able to claim top slicing relief to reduce the tax payable. For further details, please see our guide 'Onshore Bond - Making withdrawals less taxing' (IN06079). We recommend getting professional advice from your accountant or tax adviser if you have a chargeable event gain, to ensure the chargeable event gain is reported appropriately. In certain circumstances top-slicing relief may be available to reduce the amount of the tax payable, although the rules are complex and specialist advice should be sought.

UK capital gains tax

Your Onshore 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.

An 'Expression of Wishes' can be used to provide guidance to the trustees on your intentions regarding the beneficiaries of the Trust.

If the beneficiaries or trustees of the Trust are changed, it is the responsibility of the trustees to update the trust record on HMRC's Trust Registration Service within 90 days.

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 event under an Onshore 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 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, that is, not as a gift;

d) partial cashing-in of the bond in excess of cumulative yearly 5% tax deferred allowance.

e) assignment of the bond for no consideration in the same policy year as another chargeable event.

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).

For more information about chargeable events please see our guide 'Onshore Bond - Making withdrawals less taxing' (IN06079).

7. What is a chargeable gain under an Onshore Bond?

A chargeable gain is triggered by a chargeable event, such as cashing in your Onshore 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 cumulative yearly 5% tax deferred 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 cumulative yearly 5% tax deferred 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.

When a chargeable event gain is triggered, a UK resident settlor has the right to reclaim any tax payable from the trustees. If the settlor does not reclaim the tax, it will mean that the value will remain within the settlor's estate for Inheritance tax.

If the settlor does not reclaim the tax, it could mean that this a transfer of value for Inheritance tax purposes, unless it is covered by an available exemption. Where there is more than one settlor, each settlor will be assessed separately on their share of the gain.

8. What is an assignment of an investment bond?

An assignment of an investment bond essentially means transferring ownership (in whole or in part) to a different owner – your chosen beneficiary(ies). In some circumstances there can be tax benefits to assigning a bond, but the rules are complex and the treatment will depend on the reason for assignment and the tax position of the assignor and assignee. Before assigning a bond or segments of a bond, the trustees should consult their professional tax adviser, as the assignment of a bond could have tax consequences for the assignor and/or assignee.

9. 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.

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

HMRC have confirmed in guidance published in **gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm44112** 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.

Trust Registration

If your policy is written into a trust, there may be an action to register the trust with HMRC.

The trust register will need to be updated periodically on the occurrence of certain events, such as a change to the beneficiaries or trustees of the trust within 90 days.

Registration and ongoing maintenance of the trust record is the trustee's responsibility.

Failure to register to maintain the HMRC trust record on a timely basis (90 days) can lead to penalties of up to £5,000, being issued to the trustees by HMRC.

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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