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The discounted gift scheme is an arrangement which is designed for exactly your requirements. It works, in broad terms, as follows:

Firstly, from the amount of capital which is to be gifted you should calculate exactly the amount of 'income' which you require. It is possible to build in regular, fixed increases in the level of 'income' to be taken but this must be decided at outset; once the arrangement has been set up it is not possible to vary the 'income' level other than through these pre-set increases.

Based on your age and state of health, the insurance company will place a value on this income using actuarial tables.

You then create a trust. This can be either a bare/absolute trust or on a flexible/discretionary basis.

For inheritance tax purposes you will be making a gift of the amount placed into trust discounted by the actuarial value of the regular 'income' payments that you wish to retain. This is because a transfer for inheritance tax purposes is valued as the amount by which your estate is reduced by making it.

The 'income' remains yours and so is not included in the value of the gift.

With a discretionary trust you have the option to change the beneficiaries or the proportions in which they benefit once the trust has been set up.

Appointing benefits away from one beneficiary in favour of another has no inheritance tax implications for the trust or any beneficiaries.

Using the discretionary trust means that additional liabilities to inheritance tax may arise on each 10 year anniversary of the creation of the trust and when assets (other than the 'income' payments you have reserved) leave the trust.

Where the trust is established as a bare/absolute trust, the beneficiaries cannot be changed and they have an absolute entitlement to the funds.

With any trust involving life assurance policies it is essential that you appoint at least one additional trustee to act with you during your lifetime and to deal with the trust after your death.

# What is a discounted gift trust?

## Gift value

While your estate will be reduced by the full amount of the investment, the value of the gift made when you created the trust will be reduced by the discount and any available exemptions. Where a discretionary trust is used, this will create a chargeable lifetime transfer (CLT). Any amount of the chargeable transfer which exceeds the nil rate band will be subject to tax at the lifetime inheritance tax rate of 20%.

Provided that the transfer, together with any other chargeable transfers you have made in the previous seven years, is below the nil rate band no inheritance tax will be payable. If a bare/absolute trust is selected, these limits do not apply.

If you were to die within the seven years following the creation of this scheme the discounted transfer would be deemed to be still part of your estate on death and your estate would receive a 'credit' in respect of any tax paid when the scheme was set up.

By entering into this arrangement (assuming that the 'income' valuation is not challenged by HM Revenue & Customs) your estate for inheritance tax purposes will be immediately reduced by the value of income taken with the remainder of the gift falling outside your estate after seven years.

As you are aware, the discounted value is subject to agreement by HM Revenue & Customs (Inheritance Tax) and is calculated actuarially on the assumption that the recipient of withdrawals is in good health for his/her age.

In practice, while HM Revenue & Customs may accept the general basis of calculation, each case may be considered individually for negotiating a value and any figures provided serve as a guide only and there is no guarantee given that they will be accepted by the HM Revenue & Customs, especially if a claim arises in the early years of the plan.

HM Revenue & Customs has confirmed that this type of arrangement is not subject to the Pre-Owned Asset Taxation (POAT) regime. The POAT regime was introduced to stop the practice of giving away assets to avoid inheritance tax while enjoying the benefits of said assets.

## Discretionary trust tax rules

Once the scheme is in force, the trust will become a separate entity for inheritance tax purposes and, as mentioned above, additional tax charges could apply. If, however, there is no tax when you set the arrangement up it is most unlikely that these charges would apply, since they depend on future investment growth within the trust. However, no guarantees can be given.

The first charge to consider is the periodic charge which will be assessed against the trust every 10 years. This would apply only if the trust was then valued at more than the nil rate band. The nil-rate band is currently £325,000.

The tax charge is currently a maximum of 6% of any value in excess of the nil rate band.

The value of the trust will be taken as the value of the bond reduced by any discount, calculated as above, based on your age at that time. The discount will therefore reduce at each periodic charge.

The second occasion of charge will be when monies, excluding regular payments made to you, leave the trust. The rate of tax will depend on the tax charged either when the arrangement is set up or at the ten year anniversary immediately before the payment is made. Again, a maximum rate of 6% would apply but if no tax was paid at outset or at the ten yearly anniversary points no tax would be charged at exit either.

**A more detailed description of the scheme can be found in the provider brochure.**

# Get in touch

For more information or to arrange a meeting, please email us at info@mattioliwoods.com.



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