DISCOUNTED GIFT TRUSTS

PARAPLANNERS' ASSEMBLY

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A WEALTH *of* DIFFERENCE

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LEARNING OBJECTIVES

By the end of the session, attendees will be able to:

- Understand how Discounted Gift Trusts (DGTs) can benefit clients.
- Apply this knowledge to appropriate, individual, client scenarios.

AGENDA

- Session is for approx. 60 minutes including questions.
- Aim of session is to give an in depth analysis of Discounted Gift Trusts.

- DISCOUNTED GIFT TRUSTS
  - HOW DO THEY WORK
  - WHY ARE THEY ATTRACTIVE
- ABSOLUTE, DISCRETIONARY TRUSTS OR FPOA
- THINGS TO BE AWARE OF
- CASE STUDY 1
- CASE STUDY 2

1

DISCOUNTED GIFT TRUSTS

HOW DO THEY WORK AND WHY ARE THEY ATTRACTIVE?

DISCOUNTED GIFT TRUST

WHAT DOES IT DO?

- Immediate reduction in the estate
- The entire investment plus growth outside of estate after 7 years
- "Income" for life or until prior exhaustion of the fund
- Growth in a tax efficient environment, if offshore bond used.

DISCOUNTED GIFT TRUST

WHY IS IT NOT A GIFT WITH RESERVATION?

Rights under the trust

Settlor/Donor

- right to the withdrawals from the underlying Bond prior to it being settled into trust.
- absolute right to these "income" payments but is excluded from benefiting from capital in the trust.

Beneficiaries

The balance remaining in the trust after the death of the settlor(s)/donor(s) will be held for the beneficiaries in accordance with the type of trust chosen.

This carve out is known as a horizontal severance of rights whereby asset is split into individual rights.

HOW DOES THE DISCOUNT WORK CONT?

- On death, Inheritance tax is charged on estate immediately before death - Section 4(1) Inheritance Tax Act 1984 (IHTA '84).
- Section 171 of IHTA '84 states that immediately before death includes those changes in value (increase or decrease) which have occurred by reason of death.
- Under the DGT, the grantee's retained right to the selected level of partial surrenders ceases <u>on</u> death.
- Under operation of IHTA '84, the right is therefore treated as ceasing immediately before death and consequently no value is attributed to the Grantee's fund on the grantee's death.

TRUST STRUCTURE

TWO BASIC TYPES

(a) TRUST LEVEL CARVE OUT

'Income' rights paid to the settlor by the trustees

Trustees responsible for paying income rights as defined in the trust deed and bond is simply an asset of the trust.

(b) BOND LEVEL CARVE OUT

The original carve-out arrangements were based on a carve-out of bond withdrawals and the HMRC Internal Manual still refers to this basis for DGTs. Pre-selected withdrawals are paid directly to the settlor by the bond provider and the terms and conditions make the settlor's right to income mandatory during lifetime.

Releases the trustees from having to account for and/or make payments to the settlor.

TRUST STRUCTURE

EXTRA FLEXIBILITY?

(a) TRUST LEVEL CARVE OUT

Possible to change the investment in theory vehicle BUT:

- Chargeable event on surrender – bond has increased in value
- Cannot replicate 'income' from new bond – bond has decreased in value (remember income must be paid for life)

(b) BOND LEVEL CARVE OUT

Offshore Investment Bond packaged scheme.

- Linked Collective Investments
- Linked specialised investments with an External fund Manager
- No need to change wrapper to change investment strategy.

Flexibility on income is not necessarily a good thing with these schemes – transfer of value?

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DISCOUNTED GIFT TRUST

WHY NOT COLLECTIVES?

Possible – but tax consequences

- Under a DGT the settlor makes an immediate gift but retains a right to a series of capital payments, but how to deal with the possibility of income arising from the investments. It would be essential that any income was not used to support the settlor's rights under the DGT
- Income tax arising to the trustees will be assessed on the settlor
- For a DGT, the income tax assessment on the settlor could impact on the valuation of the discount / gift element
- It would be impossible to determine in advance the income yield or the capital growth on the portfolio and the likely income tax on these, it is difficult to see how these factors could accurately be taken into account in determining discounted gift value.

HOW DOES THE DISCOUNT WORK?

Rights carved out prior to settlement into trust – based upon Ingram and Another v Inland Revenue Commissioners

Income rights based on the open market value ("OMV") of the rights for life which are carved-out from the settlement. This is based on **what a willing buyer would pay for these rights on the open market**.

Factors that are considered:

FACTOR	COVERED BY
Age of client (note Bower decision)	Application process and verification of age
State of heath at application	Underwriting at outset using GPR or Medical Assessment
Actuarial calculation of life expectancy	HMRC guidance on mortality tables to use.
Interest rates (impacts future income rights)	HMRC guidance.

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DISCOUNTED GIFT TRUST

AN EXAMPLE

Firstly, let's consider the discount for a premium of £500,000 for someone aged 75 next birthday, taking 4% withdrawals monthly in arrears

£500,000 investment

Discount £176,925*

Gift £323,075* (CLT)

After 7 years CLT/PET falls outside of estate.
PLUS client has received £140,000 "income"

*Source Utmost Wealth discounted gift trust calculator 14/05/2023. Standard terms based upon normal health

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HMRC v BOWER & ORS (2008)

HMRC successfully argued, after appeal, that the value was based on not what a hypothetical buyer would pay for the 'income' rights but what happens in the real market. They produced evidence that showed that buyers of like income streams would wish to protect their capital outlay i.e. to protect them from the settlor's early demise. The evidence from the open market meant, in HMRC's view, that the income "stream" for anyone over 90 only had only a nominal value. This is because insurance is not generally available for those over 90 years old as it becomes too expensive.

If, when we underwrite your client, their actual or rated age is over 89 years we are unable to offer a discount due to this decision.

If your client's actual or rated age after underwriting is 90 to 94 it may be possible to proceed on a 'nil discount' basis.

This means their entire premium will be treated as their gift for IHT purposes.

GIFT WITH RESERVATION

WHY IS IT NOT A GIFT WITH RESERVATION?

- Rights are carved out prior to settlement – Ingram principle
- Finance Act 1986 Schedule 20 para. 7 is only relevant to

  "a policy of insurance on the life of the donor or his spouse"

Capital Redemption Bond

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DISCOUNTED GIFT TRUST

Using a CRB policy on death of the settlor:

- The bond can continue to provide “income” for beneficiaries.
- Does not have to be surrendered at inappropriate time – e.g. when markets are low.

When surrendered, tax efficiency can be maximised by:

- Assigning the bond from the trustees to adult beneficiaries if they are not additional rate tax payers - avoiding the trust tax rate of 45%.
- For higher and additional rate tax payers, possibly still better to assign - beneficiary’s spouse may not be a higher or additional rate tax payer
- Overseas residents can surrender policy off-shore, avoiding UK tax.

DISCOUNTED GIFT TRUST

SUMMARY

- Available to individuals, married couples or civil partners only who have UK liability to IHT
- Potential immediate "discount" in IHT liability
- An "income" for life (or earlier exhaustion of the fund)
- All "growth" outside client's estate for IHT purposes
- Not suitable if settlor does not require 'income'
- Underwritten at start – discount not offered to clients aged or rated to be aged 90 years or over
- No IHT if client survives for seven years
- Some continuing control over destination of proceeds
- Tried and tested!

3

ABSOLUTE, DISCRETIONARY TRUSTS AND FPOA TRUSTS

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MARCH 22ND 2006

IHT CHANGES TO TRUSTS

Absolute Trust

IIP (FPOA) Trust

A&M Trust

PET AND BENEFICIARY/LIFE TENANT DEEEMED TO OWN TRUST FUND FOR IHT PURPOSES

Discretionary Trust

CLT Entry/Periodic/Exit

Pre March 22nd 2006

Post March 22nd 2006

Absolute Trust

Discretionary Trust

Pre March 2006 FPOA Trust

POSSIBLE TYPES OF DISCOUNTED GIFT TRUST

DISCRETIONARY TRUST

PROS	CONS
› No beneficiaries with an interest in possession › Ability to change beneficiaries › No problems of beneficiaries pre-deceasing settlor › Better future tax planning opportunities	› Gifts in excess of NRB taxable › In relevant property regime so potential periodic and exit charges

ABSOLUTE TRUST

PROS	CONS
› Still in PET regime › No immediate IHT charge › No initial reporting › No Periodic or Exit charges › Totally IHT free after 7 years › Unlimited gift size	› Fixed beneficiaries › Tax and admin issues if beneficiary pre deceases the Donor

DEATH OF SETTLOR?

	DISCRETIONARY DGT	ABSOLUTE DGT
IHT on the Gift element	Transfer less available Nil Rate Band recalculated at death rates. IHT payable at 40% No tax due if value at the date of settlement less than available Nil Rate Band	If the value of the PET (plus any earlier chargeable transfers in the previous seven years) does not exceed the NRB, no tax will be payable on the PET itself. If PET > NRB, IHT payable by the donee.
Gifts subsequent to DGT	Increases the cumulation for any subsequent chargeable transfers, the tax on which would then have to be recalculated using the new cumulation figure.	
Further Issues	Possible Periodic and Exit charges	Potential 14 year rule issues
IHT tax rates	Taper relief available	

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TAPER RELIEF

IF DEATH OCCURS WITHIN 7 YEARS

TAPER RELIEF available on death within 7 years of gift. It applies to gifts above the nil rate band and cannot **reduce the tax paid** on a lifetime chargeable transfer below the tax payable at the time of transfer.

Remember if the gift is within the NRB (so chargeable at a zero rate) taper relief does not apply!

YEARS BETWEEN GIFT & DEATH	PERCENTAGE OF FULL CHARGE AT DEATH RATE
0-3	100
3-4	80
4-5	60
5-6	40
6-7	20

WHICH TRUSTS FOR WHICH CLIENTS?

ABSOLUTE	DISCRETIONARY
› Potentially larger amounts › Certainty of beneficiaries › If you have used your maximum amount under Discretionary Trust	› Usually restricted to the settlor's available NRB › Flexibility to change beneficiaries e.g. expecting more grandchildren

EXISTING PRE 2006 DISCOUNTED GIFT TRUSTS (DGTs)

WHAT HAPPENED IN 2006?

- Essentially more types of trust were brought into the “Relevant Property” (discretionary trust) regime…
- Before 22nd March 2006 lifetime gifts into trusts creating an interest in possession were treated as potentially exempt transfers (PETs)
- The value of the trust property was included in the life tenant’s estate
- New life tenants could be appointed an interest in possession and this new appointment was a PET from the previous life tenant to the new
- These trusts provided a great deal of flexibility and potentially significant IHT savings when compared with fully discretionary trusts.

FINANCE ACT 2006

Since 22nd March 2006 all new lifetime settlements are chargeable lifetime transfers (CLTs) rather than PETs.

- This includes trusts with an interest in possession (although not gifts into Bare trust which continue to be treated as PETs).
- The 2006 regime also brought some pre 22nd March 2006 settlements into the "Relevant Property" regime which previously were not.
- Transitional arrangements enabled some pre 2006 trusts to retain their pre 2006 tax treatment.

INTEREST IN POSSESSION TRUSTS CREATED PRE 22/03/2006

Pre-2006 IIP ending	IHT position
On full distribution of capital to pre-2006 beneficiary, bond surrendered and fully distributed to them (Remember bond cannot be surrendered during settlor's lifetime)	IIP ends but as interest was within their estate = IHT neutral
On full distribution of capital to pre-2006 beneficiary, bond surrendered and distributed to another beneficiary using flexible power of appointment (Remember bond cannot be surrendered during settlor's lifetime)	IIP ends and this would be a PET from IIP beneficiary to the beneficiary receiving funds (unless exempt – spouse etc)
Death of the IIP their interest ends and falls within their estate. What happens to this interest, and whether there's a successor interest, depends on the trust deed.	If interest automatically passes to spouse under trust then qualifies as TSI – s49D IHTA
	Otherwise this part of trust property becomes relevant property from that date and a chargeable death transfer is made. Note for trust charges the date of the settlement is still used.

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INTEREST IN POSSESSION TRUSTS CREATED PRE 22/03/2006

Pre-2006 IIP ending	IHT position
Trustees use power of appointment to change IIP post 6 October 2008 without distributing.	IIP ends. IIP makes a deemed transfer of value and the trust (or that part of trust) would be in the relevant property regime. Settlor is still the original settlor of trust as this is not an addition of property, i.e. there's only one settlor. IHT charges would be proportioned for the time it was relevant property. Finally, previous IIP beneficiary must be removed to avoid gift with reservation of benefit. In other words... avoid from doing this until settlor dies and make full distribution to end trust?

POSSIBLE INVESTORS?

A person(s) who:

- has cash to invest?
- wishes to reduce inheritance tax immediately?
- is happy to take withdrawals from Discounted Gift Trust(DGT)?
- is happy to only receive fixed or increasing payments from the DGT with no access to capital?
- is in reasonably good health?
- has all or some of their nil rate band available for a the discretionary version?
- wants to make a gift but restrict the donee's access?
- in the case of a bare trust DGT, is happy that beneficiaries cannot be changed?

COMMON QUESTIONS

1. Can the settlor vary his income levels?
2. Can a DGT be set up on a joint settlor basis?
3. Is it essential to undergo underwriting at outset?
4. Does the bond need to be encashed on the settlors death?
5. Why use a CRB?
6. Do the Pre Owned Assets Tax (POAT) rules apply?
7. Can my spouse have access?

4

THINGS TO BE AWARE OF

DISCOUNTED GIFT TRUST

AN EXAMPLE

Firstly, let's consider the discount for a premium of £500,000 for someone aged 75 next birthday, taking 4% withdrawals monthly in arrears

£500,000 investment

Discount £176,925*

Gift £323,075* (CLT)

After 7 years CLT/PET falls outside of estate.
PLUS client has received £140,000 "income"

*Source Utmost Wealth discounted gift trust calculator 14/05/2023. Standard terms based upon normal health

DISCOUNTED GIFT TRUST – 10 YEARS LATER

HOW ARE PERIODIC CHARGES CALCULATED?

- **Client is now 85 nbd**
- After withdrawing £20,000 p.a. for 10 years, the bond is worth circa £527,360 assuming 4.5% net growth
- The value of the future income stream is calculated to be circa £116,549.

What is the trust value for periodic charge purposes?

REVENUE AND CUSTOMS BRIEF 22 (2013)

DISCOUNTED GIFT SCHEMES

- HMRC issued updated guidance in August 2013
- The note explains how the relevant property value for a DGT should be calculated at the 10 yearly review
- Fund value - less “assurance” factor – less future withdrawals!

> Where the retained rights are of pre-determined regular withdrawals, the total fund value is discounted to the expected date of death of the settlor. From this value is to be deducted the present value of the expected future withdrawals to be taken by the settlor based on their life expectancy and discounting those payments to the date that each payment is to be made.

https://www.gov.uk/government/publications/revenue-and-customs-brief-22-2013-discounted-gift-schemes/revenue-and-customs-brief-22-2013-discounted-gift-schemes--2

DISCOUNTED GIFT TRUST – 10 YEARS LATER

HOW ARE PERIODIC CHARGES CALCULATED?

The widow is aged 85 next birthday, taking £20,000 p.a. withdrawals monthly in arrears

£527,360
fund value

£328,058
assurance value

Future income value
£116,549

Relevant property value
£210,508

IHT 100d not required as value below 80% NRB!

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DISCOUNTED GIFT TRUST – 10 YEARS LATER

WHAT IF THE SETTLOR HAS ALREADY DIED?

£527,360
bond value

↓

Less assumed NRB of £325,000

↓

£202,360
periodic charge value

→ **£12,141 periodic charge**
(£202,360 x 6%)

This makes a big difference to the case that we have just looked at!

1. INSURING LIFETIME GIFT EXAMPLE

ASSUMPTIONS

- Charles has a current estate of **£2,000,000**
- He is investing £1,000,000 into a DGT on an absolute basis
- He has made no other previous potentially exempt or chargeable transfers in the last 7 years
- Charles is now a widower after his wife died a few years ago
- For simplicity we'll assume that they never owned a house – so residence nil rate band is unavailable
- We will also assume that his wife's will never utilised her nil rate band on death and thus the full transferable nil rate band is now available to Charles.

1. INSURING LIFETIME GIFTS EXAMPLE

AFTER GIFT

	VALUE OF ESTATE	RETAIN FUND AND GIFTED FUND – NOTIONAL VALUES	IHT VALUE
Estate	**£2,000,000**		
Less DGT transfer	(£1,000,000)		
DGT 'Carved-out interest' (retained fund)		(£625,000)	NIL
PET (gifted fund)		**£375,000**	
Net Estate	**£1,000,000**		

What policies are required to cover the potential IHT liabilities?

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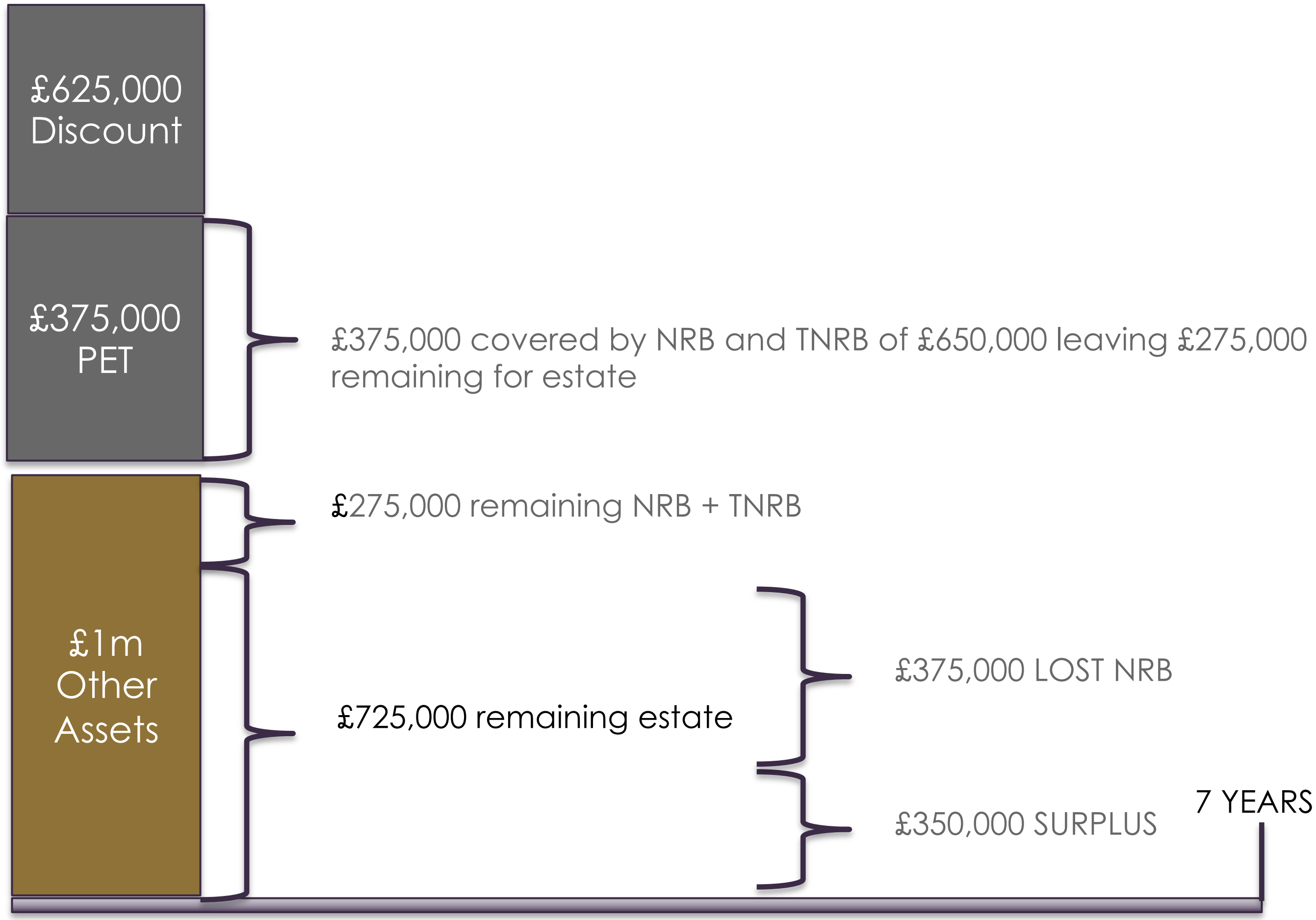
1. INSURING LIFETIME GIFTS EXAMPLE | ABSOLUTE TRUST

ASSUMING NO RNRB OR TRNRB IS AVAILBLE | GIFT STILL IN CHARGE

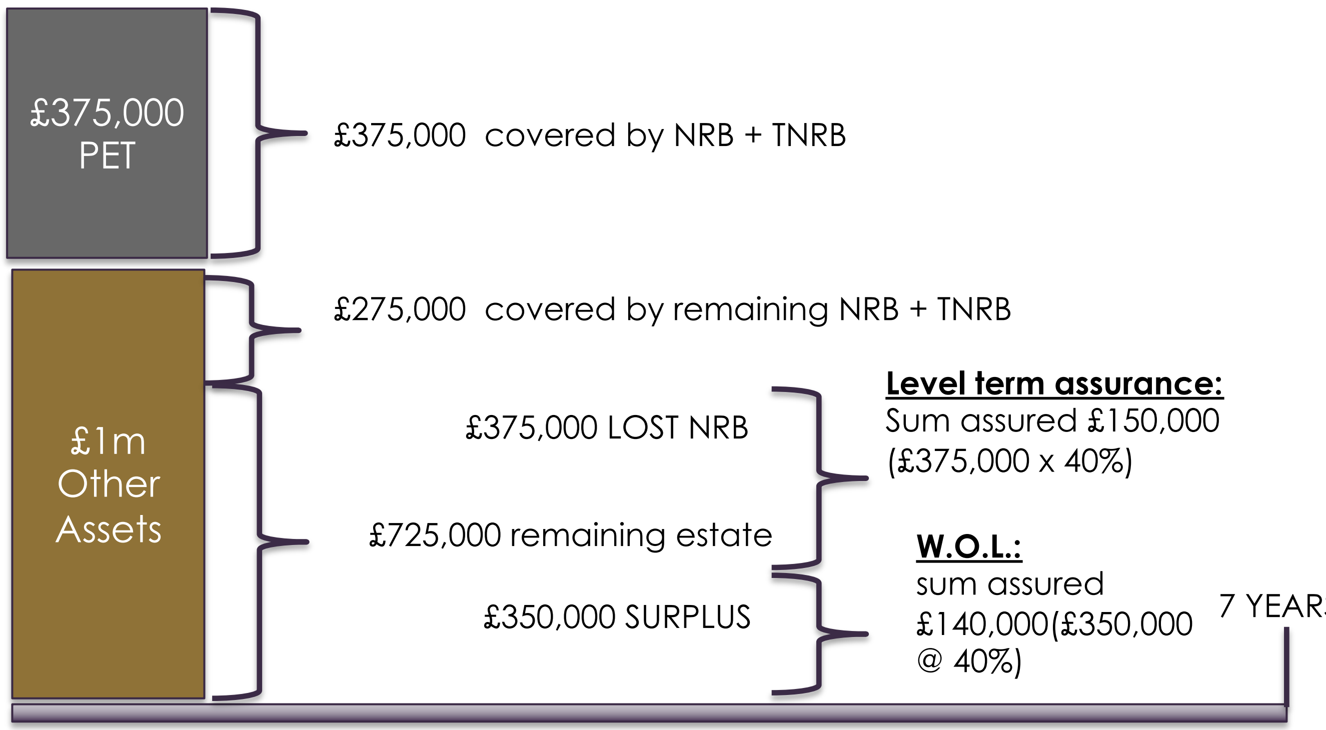


1. INSURING LIFETIME GIFTS EXAMPLE | ABSOLUTE TRUST

ASSUMING NO RNRB OR TRNRB IS AVAILABLE | GIFT FALLEN OUT OF CHARGE

1. INSURING LIFETIME GIFTS

ASSUMING NO RNRB AVAILABLE



2. WITHDRAWALS IN EXCESS OF 5% ENTITLEMENT

- When withdrawals under a DGT (assuming invested via an investment bond) exceed the annual 5% tax deferred entitlement or where the cumulative 5%'s are exhausted

- HMRC's view is that the personal income tax liability of any purchaser should be factored into the open market value of the right to receive regular income

- There are three areas where this may have an impact;

  - Overall discount value

  - Adviser charging

  - Conversion of an existing capital redemption bond into a DGT.

- Any liability to tax would cause the open market purchaser to amend their valuation of the retained rights and thus each of these factors could form part of the discount calculation.

3. OVERALL DISCOUNT VALUE

- Once the 5% tax deferred entitlement has been exhausted, any income paid to the settlor will create a chargeable gain and the entire annual withdrawal will potentially be liable to income tax

- HMRC view is that the open market purchaser of the retained rights will account for income tax at:

    - 40% if the bond is issued by a non UK provider and;

    - 20% for a UK provider (taking account of deemed tax deducted on the fund of 20%).

- In practice the impact of this rule is likely to be low given the life expectancy of the target market and the chance of exhausting the 5% entitlements

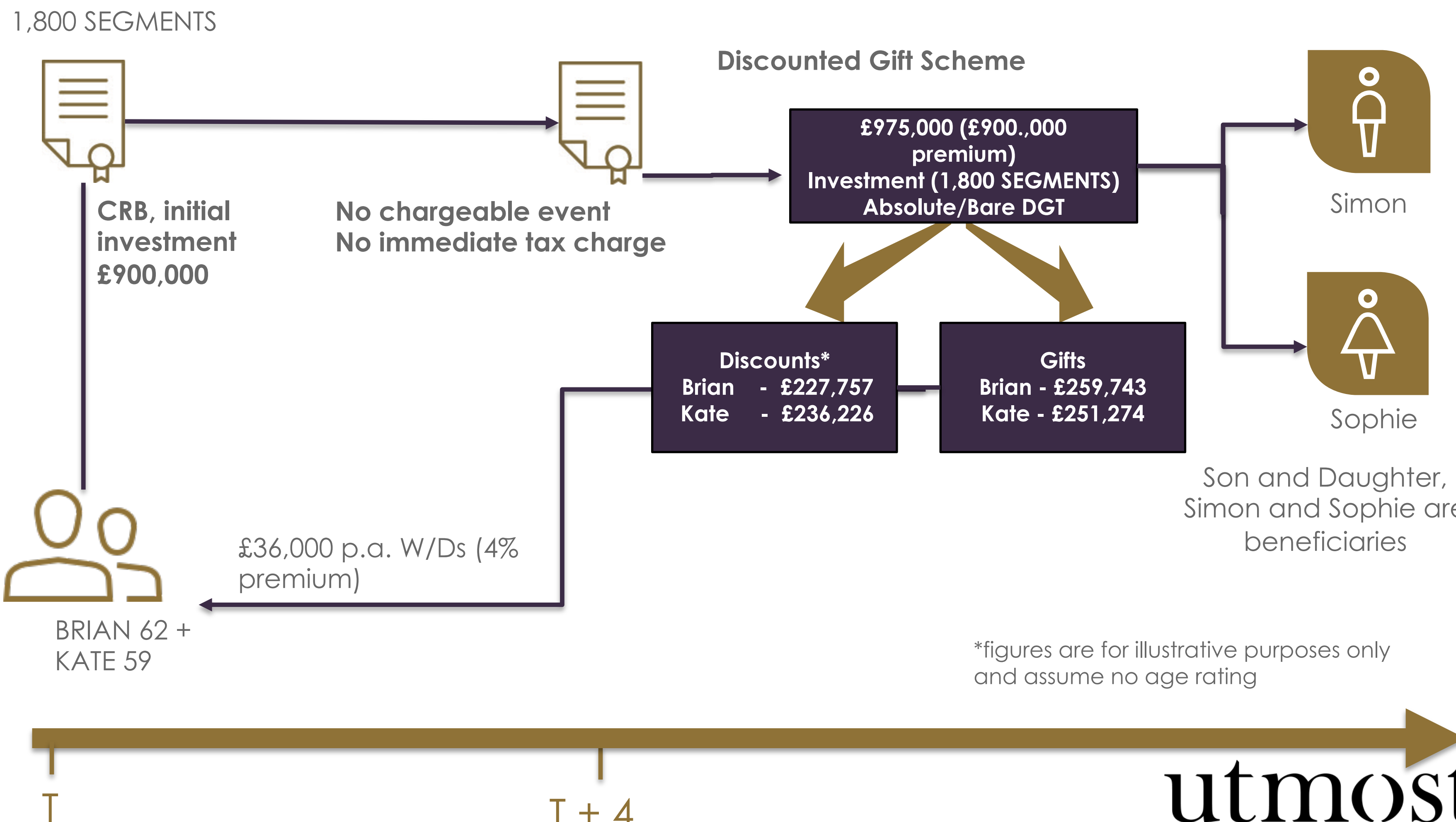
- However, it does have an impact on all cases due to probability.

4. ADVISER CHARGING

- Clarification on capital exhaustion raised some questions around the impact of adviser charging post RDR
- As adviser charging impacts on the 5% entitlement in any year it could create either immediately, or at some point in the future, an income tax liability that would normally fall on the settlor
- In addition as the adviser charge could be amended at any stage it would be impossible to ascertain when the 5% entitlement would be exhausted
- HMRC confirmed that as the settlor could seek reimbursement of any tax charge under S538 ITTOIA (Income Tax Trading and Other Income Act) 2005, any AC taken should not have any impact on the discount for the purposes of either the capital exhaustion point or annual chargeable events
- This is good news:
  - Discount calculations do not need to take AC into account
  - Providers only have to account for **actual withdrawals** taken by the settlor
  - Valuation of discounts post RDR is much simpler.

5. CONVERSION OF CAPITAL REDEMPTION BOND TO DGT

IHT PLANNING AND USING A DISCOUNTED GIFT SCHEME – BOND NOW WORTH £1.3M



5. CONVERSION OF CAPITAL REDEMPTION BOND TO DGT

- Where a settlor has taken capital withdrawals from a CRB and then converts to a DGT they need to be taken into account to work out when the capital is taxable
- It is necessary to differentiate between actual withdrawals taken and withdrawals within the 5% entitlements
- For example, if a person had a CRB for £100,000 and took a withdrawal of £10,000 in year 1 then this exceeds the 5% entitlement by £5,000. However, when working out how many 5%'s are still available the excess is irrelevant as this will be based on remaining capital amount of £95,000 rather than £90,000
- When setting up a CRB that may in the future convert to a DGT it is important to make clients aware that previous capital withdrawals may impact the discount given at conversion
- The conversion option still allows clients to convert to a DGT without having to surrender their bond.

6. CHARGEABLE EVENTS DISCRETIONARY DGTs

SETTLOR NOW DECEASED

ASSET/INVESTMENT	TYPE OF RETURN	WHO IS TAXED	RATE OF TAX
Gains realised in tax year of death			
Offshore bond	Chargeable gains	Settlor	Marginal rate (top-slicing)
Gains realised in a subsequent tax year			
Offshore bond	Chargeable gains	Trustees	45% (no top-slicing)

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7. CHARGEABLE EVENTS

BARE TRUST

For chargeable events arising during the donor's lifetime or in the year of the donor's death, both the donor and beneficiary have 'material interests' in rights under the policy.

The trustees are likely to make encashments to meet the donors right to the fixed payments under the trust and so, in light of this, any chargeable event gain would be assessable on the donor.

All chargeable event gains taxed on the beneficiary after the death of the settlor.

(5)

CASE STUDY 1

THE NEED FOR INCOME

Ian and Sophia Applegate are married and retired.

They have state and company pensions but also rely upon the income from their investments to supplement their pensions and pay for some of life's luxuries.

For example, they like to go on a cruise twice a year and this is funded from the income that their investments generate.

Three years ago they moved to a country house, with a livery business which Sophia runs with her two daughters. She rents ten acres of surrounding land.

They've both made wills principally leaving all their assets to each other with no charitable donations. Neither has made any gifts in the last 7 years.

Ian and Sophie are 61 and 60 next birthday.

THE APPLEGATES' ASSETS

Their home – held jointly	£1,000,000
Ian's ISA	£600,000
Sophia's ISA	£600,000
Joint collectives portfolio	£100,000
Cash in the bank – held jointly	£100,000
Livery Business – held jointly	£200,000
TOTAL	**£2,600,000**

Current IHT position:

Estate value	= £2,600,000
Nil Rate Bands	= £650,000 (2 X £325,000)
Residence Nil Rate Bands	= £ 50,000*
	= (**£700,000)**
Less BPR on Livery Business	= (**£200,000)**
Net estate	= £1,700,000
IHT @ 40%	= **£680,000 IHT**

*On second death asset £600k over £2m. RNRB is £175,000 so TRNB is £350,000 – tapered by £300k

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SOLVING THE CONUNDRUM

Ian and Sophia would now like to start dealing with their Inheritance Tax issues but are unsure how to give money away whilst maintaining their standard of living.

Their adviser talks to them about various options including;

- Revisiting their **Wills and Powers of Attorney** with their solicitor, to ensure these are up-to-date and relevant to their current circumstances and reflect their current wishes
- Other lifetime planning options including **lifetime gifts**
- The availability of **reliefs and exemptions**.
- **RNRB**
- **Spending their money?!**
- The use of **trusts** avoiding the **Gift with Reservation rules.**

As part of this discussion their adviser explains to them how a DGT works and how it might be suitable for their needs.

RESIDENCE NIL RATE BAND

THE 60% IHT TRAP DUE TO TAPERING

Second death 2023/24, property value at least £350,000:

Net Estate	NRBs	RNRBs	Total NRBs	Estate liable to IHT	IHT @ 40%
£2m	£650,000	£350,000	£1,000,000	£1.0m	£400,000
£2.7m	£650,000	£0*	£650,000	£2.05m	£820,000

***Tapered down by £350,000 as over £2m threshold by £700,000 on 1:2 basis**

Increase in estate value = £700,000
Reduction in RNRB = £350,000
Increase in IHT = £420,000
(420/700) x100 = 60% Tax!

WHAT DO THEY DECIDE TO DO?

Ian and Sophia decide a discounted gift trust (DGT) meets their requirements:

- It will provide an on-going "income" of capital*
- This will replace lost income from their investments
- They will not have access to their capital but this is not a concern
- Their children do not get access to the capital until second death
- This protects their "income" of capital until that time**
- ISAs? Tax free for income tax/CGT but still taxed on death.

*For tax purposes a return of capital as their on-going rights are derived from withdrawals from an investment bond. The "income" of capital will be fully taxable once the capital has been returned.

**Or until the fund is depleted.

DISCOUNTED GIFT TRUST

JOINT SETTLORS

Ian and Sophia taking 5% withdrawals monthly in arrears

£1,200,000 investment

Discounts
Ian - £368,382
Sophia - £372,470

Gifts (CLT)
Ian - £231,618
Sophia - £227,530

After 7 years CLTs are out of account.
PLUS £420,000 "income" of capital received.

*** Source Utmost Wealth discounted gift trust calculator 14/05/2023. Standard terms based upon normal health**

DISCOUNTED GIFT TRUSTS

TWO SINGLE SETTLOR TRUSTS

£600,000
Ian - 61 NBD – 5% income*

- **DISCOUNT** — **£340,059*** — **THE DISCOUNT**
- **GIFT** — **£259,941**** — **CLT**

£600,000
Sophia - 60 NBD – 5% income**

- **DISCOUNT** — **£343,838*** — **THE DISCOUNT**
- **GIFT** — **£256,162**** — **CLT**

The clients have made no previous CLTs in the 7 years preceding the effecting of the DGT.

*Income refers to regular withdrawals of capital for tax purposes

** Source Utmost Wealth discounted gift trust calculator 14/05/2023. Standard terms based upon normal health

DISCOUNTED GIFT TRUST

	Single settlor	Joint settlor
Ian's discount	£340,059	£368,382
Sophia's discount	£343,838	£372,470
Total	**£683,897**	**£740,852**

- £56,955 bigger total discount and therefore smaller CLTs
- Joint settlor cases will give a larger discount at the outset
- Joint settlor cases will mean the **current level of income** will continue after first death
- If a husband and wife (or civil partners) each effect a single settlor, the spouse cannot benefit from the other spouse's DGT until that spouse dies – the policy has no surrender option until the settlor's death.

DISCOUNTED GIFT TRUST | AN ALTERNATIVE

SINGLE VS. JOINT SETTLOR | THE ARGUMENT FOR SINGLE LIFE ARRANGEMENTS

- Although joint settlor cases will usually result in a higher discount (and therefore lower "gift" value) and,

- The current level of income of capital will continue on first death…

- A husband and wife (or civil partners) could each effect a single settlor DGT, excluding their spouses as beneficiaries but including their widow/widower

- This allows for capital to be appointed to the widow/widower following settlor's death whereas the joint scheme only allows the spouse to continue to receive the 'income'.

DISCOUNTED GIFT TRUST | AN ALTERNATIVE

SINGLE VS. JOINT SETTLOR | THE ARGUMENT FOR SINGLE LIFE ARRANGEMENTS

- On first death a DGT becomes a discretionary trust with the widow/widower as one of a range of potential beneficiaries

- The trustees could exercise their discretion to continue to provide withdrawals to the surviving spouse to maintain their income

- The trustees could also appoint capital to the surviving spouse and indeed the entire fund could be made available to the surviving spouse if necessary.

THE APPLEGATES' REVISED IHT POSITION

Their home – held jointly	£1,000,000
Joint collectives portfolio (gradually re-invested into ISAs)	£100,000
Cash in the bank – held jointly	£100,000
Livery Business – held jointly	£200,000
TOTAL	**£1,400,000**

Current IHT position:

Revised IHT position assuming Ian dies first within 7 years of DGT:

Estate Value £1,400,000

Nil Rate Bands ?

TRANSFERABLE NIL RATE BAND

- Finance Act 2008 introduced legislation to allow a claim to be made by the PR's to transfer any unused NRB on a person's death to the estate of their surviving spouse who dies on or after 9 October 2007 (Spouse includes registered civil partner)

- Claim must be made using form IHT402

- The provisions will broadly apply to anyone who dies after 9 October 2007, regardless of when their spouse died

- The amount of NRB available for transfer will be based **on the proportion of unused NRB at the time of death** of the first spouse but applied to the NRB applicable at the time of death of the survivor

- A maximum of 100% of the NRB will be available to transfer – can be accumulated on more than one occasion, such as where a person dies having survived more than one spouse.

THE FINANCE ACT 2008 AND S8A IHTA 1984

A person has an unused NRB if:

M > VT

M = maximum that could be transferred by the chargeable transfer on the persons death if it were to be wholly chargeable to tax at nil %.

VT = the value actually transferred by chargeable transfers (nil if no transfer was made).

THE FINANCE ACT 2008 AND S8A IHTA 1984

When a claim is made the percentage is:

$$\frac{\mathbf{E}}{\mathbf{NRBMD}} \times \mathbf{100}$$

- **E** = **M** – **VT**
- **M** = NRB **at first death** less any chargeable transfers in the 7 years before death.
- **VT** = chargeable value of legacies passing under the will, including assets passing on survivorship and assets held on IIPs trusts.
- **NRBMD** = NRB at date of death.

This can therefore be expressed as:

$$\frac{\mathbf{(M\text{-}VT)} \times \mathbf{100}}{\mathbf{NRBMD}} = \text{Percentage unused.}$$

ASSUMING IAN DIES FIRST WITHIN SEVEN YEARS OF THE GIFT

- Ian he left everything to his wife who is UK domiciled
- NRB was £325,000 at the time of Ian's death
- **M** is £325,000 - £231,618 = £93,382
- **VT** is NIL (everything left to wife UK domiciled – spousal exemption)
- **M** – **VT** = £93,382

Unused proportion is $\frac{£93{,}382}{£325{,}000}$ x 100 = 28.732% - unused NRB

Sophia dies more than seven years after the DGT has been settled.

The TNRB is therefore calculated as:

- £325,000 + (£325,000 x 28.732%) = £418,382

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THE APPLEGATES' REVISED IHT POSITION

Their home – held jointly	£1,000,000
Joint collectives portfolio (gradually re-invested into ISAs)	£100,000
Cash in the bank – held jointly	£100,000
Livery Business – held jointly	£200,000
TOTAL	**£1,400,000**

Current IHT position:

Revised IHT position assuming Ian dies first within 7 years of DGT:

Estate Value	£1,400,000
Nil Rate Bands	£ 418,382
Residence Nil Rate Bands	£ 350,000
	(£ 768,382)
Less BPR on Livery Business	**(£ 200,000)**
£1,200,000 - £768,382	£ 431,618
£431,618 @ 40%	**£ 172,647 IHT**

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THE APPLEGATES' REVISED IHT POSITION

ASSUMING TRANSFERS INTO DISCOUNTED GIFT TRUSTS HAVE FALLEN "OUT OF ACCOUNT" AND VALUES HAVE NOT ALTERED

Their home – held jointly	£1,000,000
Joint collectives portfolio (gradually re-invested into ISAs)	£100,000
Cash in the bank – held jointly	£100,000
Livery Business –held jointly	£200,000
TOTAL	**£1,400,000**

IHT position Ian and Sophia are still alive 7 years after DGT:

Nil Rate Bands	£ 650,000 (2 X £325,000)
Residence Nil Rate Bands	£ 350,000
	(£1,000,000)
Less BPR on Livery Business	**(£ 200,000)**
Net estate	£ 200,000
£1,200,000 - £1,000,000	£ 200,000
£200,000 @ 40%	**£ 80,000 IHT**

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CASE STUDY 2

THE NEED FOR INCOME

- Edward is 60 years old, widowed with two sons who will continue to farm his agricultural land
- He has recently sold part of his farmland to developers for £3m net
- Although all his assets were previously invested in his agricultural property and farming business so that APR and BR effectively brought his IHT liability to within his NRB and TNRB
- After the sale he now has a potential IHT liability on his cash assets of £3m
- He wishes to generate £120,000 from his investments in a tax efficient manner and to mitigate his IHT liability
- He has a low to moderate attitude to risk and does not want to invest in AIM shares.

EDWARD'S ASSETS

	VALUE	IHT VALUE
Home and Agricultural Property all with APR	£3,000,000	NIL
ISA	£200,000	£200,000
Cash in the bank	£3,000,000	£3,000,000
TOTAL	**£6,200,000**	**£3,200,000**

Current IHT position:

Nil Rate Bands = £650,000
£650,000

£3,200,000 - £650,000 = £2,550,000
£2,550,000 @ 40% = **£1,020,000 IHT**

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TWO DISCOUNTED GIFT TRUSTS

£750,000
Edward– 5% income*
Discretionary

DISCOUNT	GIFT
£425,324**	£324,676*
THE DISCOUNT	CLT

£1,650,000
Edward – 5% income**
Absolute for son

DISCOUNT	GIFT
£936,913*	£713,087*
THE DISCOUNT	PET

* Income refers to regular withdrawals of capital for tax purposes.

** Source Utmost Wealth discounted gift trust calculator 14/05/2023. Standard terms based upon normal health.

EDWARD'S REVISED IHT POSITION SEVEN YEARS LATER

ASSUMING TRANSFERS INTO DISCOUNTED GIFT TRUSTS HAVE FALLEN "OUT OF ACCOUNT" AND VALUES HAVE NOT ALTERED

	VALUE	IHT VALUE
Home and Agricultural Property all with APR	£3,000,000	NIL
ISA	£200,000	£200,000
Cash in the bank	£600,000	£600,000
TOTAL	**£3,800,000**	**£800,000**

Current IHT position:

Nil Rate Bands = £650,000

£650,000

£800,000 - £650,000 = £150,000

£150,000 @ 40% = **£60,000 IHT**

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- Our resource centre for Technical Support
- Browse our library of technical material, designed to support you and your clients including our up-to-date interpretation of regulatory and legislative changes
- Access topical industry updates and articles from our Utmost Wealth Solutions technical experts
- Trust Analysis Service - designed to equip you with clarity and assurance, so that you can talk about the inner workings of your client's trust with authority
- Utmost Trustee Solutions - Our independent professional trustee service will manage your client's trust sensitively and efficiently
- Meet the team that is dedicated to providing you with technical support.

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DISCOUNTED GIFT TRUSTS

PARAPLANNERS ASSEMBLY

STEVE SAYER APFS, TEP

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