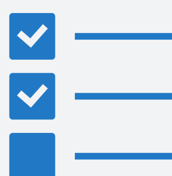
MEDICAL & DENTAL
Powered by Acumen Financial Planning

A guide to IHT: Discounted Gift Trusts



1. The Discounted Gift Trust

The underlying function of the trust is to provide an income to the settlor, as such ad hoc payments to the trust beneficiaries while the settlor is alive are not normally available.

The amount invested is 'effectively' split into two parts, a carve out to provide for the income to the settlor, and the balance which is a gift for the benefit of the trust beneficiaries.

As the income is coming back to the settlor there is an immediate discount to the normal seven-year clock rules. On the death of the settlor, the income payments cease.

The level of the discount is driven by the client's age, sex, health (driving mortality) and the level of the prescribed income.

The trust can be set up under either a Discretionary or an Absolute basis. Discretionary and absolute trusts have different tax rules (in certain areas) applied to them.

After seven years the full amount of the original investment is outwith the settlor's estate for IHT.

2. The Settlor

The person who sets up the trust is called the settlor. The settlor can be either single or joint.

The settlor takes an income from the fund for the rest of their lives. The amount of income is fixed and cannot be changed.

The settlor is entitled to the prescribed income, they are not entitled to any return of the original capital invested.

The settlor of the trust is automatically a trustee.

3. The Trustees

The trustees are the people who control the trust and the investment therein, it is important that they are chosen carefully.

Under the DGT the trustees commonly invest in an investment bond (which is ideally suited to investments within a trust).

The trustees can be changed by the settlor during his/her lifetime, they have the power to appoint and remove trustees.

There are many options that are appropriate to use and it is very much dependent on your own personal circumstances and objectives.

A qualified financial planner can assess your situation and review and plan what may arise in the future with regards to any IHT liability.

Medical & Dental 2021. This document contains information correct at the time of publication (18.01.2021) and does not constitute advice.

Example

Mrs Smith is age 72, good health, a widow with two children and four grandchildren

Her estate is some £2.2m made up of:

House	£500,000
Pension fund	£400,000
Bonds	£400,000
ISAs	£800,000
Cash	£100,000
=	£2,200,000

She has regular income as follows:

State pension	£ 10,000
Bond withdrawals	£ 20,000
ISAs	£ 20,000
=	£ 50,000

This covers the annual expenditures of £50,000, emergency fund of £50,000 is part of the £100,000 cash.

Challenges within the current set up

a. Inheritance Tax (IHT) liability of some £320,000
Estate £2.2m less £400,000 (pensions exempt) - £1,000,000 (2 times nil rate bands) i.e. £800,000 at 40% tax
b. ISAs while free of income tax and CGT are not free of IHT
c. Bonds are subject to IHT on existing capital and all growth
d. If no action taken the IHT liability will get bigger over time

Objectives

a. To ensure income requirements are met
b. To mitigate IHT liability where practical

Recommendations

a. Encash bonds and half the ISAs, total £800,000
b. Invest in a DGT, receive income for rest of life of £40,000 pa
c. Immediate discount of £420,000 gives an immediate tax saving of £168,000
d. If Mrs Smith survives 7 years full £800,000 out of estate saving in total £320,000
e. All the growth in the fund is also excluded from the estate, for the future benefit of the children and/or grandchildren

Summary

Significant tax saving for the family with no adverse impact on Mrs Smith's own retirement plan.

Acumen Financial Planning 2021. This document contains information correct at the time of publication (18.01.2021) and does not constitute advice.