MEDICAL & DENTAL FINANCIAL PLANNERS

A guide to IHT: Gift Trusts

1. The Gift Trust

A key element of the gift trust is it maintains an element of control with the settlor (compared to a direct gift, where the beneficiary then owns the relevant funds).

The amount of the gift is most commonly invested in an investment bond (which is ideally suited to investments within a trust).

The settlor requires to survive seven years for the value of the gift to be outwith their estate.

The settlor has no access to either the original capital or any growth on the investment.

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.

2. The Settlor

The person who sets up the trust is called the settlor.

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.

The trustees have discretion over how and when any beneficiary benefits from the 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.

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Example

Mr. and Mrs. Jones both age 70, good health, with two children and four grandchildren

Their estate is some £2.2m made up of:

House	£500,000
Pension fund	£400,000
Bonds	£400,000
Unit trusts	£200,000
ISAs	£600,000
Cash	£100,000
	= £2,200,000

They have regular income as follows:

State pensions	£20,000
Bond withdrawals	£20,000
ISAs	£20,000
	= £60,000

This covers their annual expenditures of £60,000, emergency fund of £50,000 is part of the £100,000 cash.

Challenges within the current setup:

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. Unit trusts and bonds are income tax efficient, however both subject to IHT on existing capital and all growth
d. If no action taken the IHT liability will get bigger over time

Estate planning has been discussed with Mr. & Mrs. Jones for the last few years. Now having reached 70, with their children in the mid 40s and grandchildren getting close to secondary school age, they are now more ready to do some IHT planning and make a gift, they do however wish to retain control over the funds at present.

Objectives

a. To mitigate IHT liability where practical
b. To maintain control over when the family get access to the gift funds

Recommendations

a. Encash bonds
b. Invest £400,000 in a gift trust, increase withdrawals from ISAs/unit trusts to replace income
c. Assuming both survive seven years saves £160,000 of IHT (+ growth) over this period
e. Funds from trust can be passed to family at any time (don't need to wait for conclusion of seven years), giving control to the client but with element of flexibility

Summary

Significant tax saving for the family while maintaining control of the trust fund.

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