



DISCRETIONARY DISCOUNTED GIFT TRUST KEY FEATURES AND BENEFITS

In this document the term “spouse” includes a reference to a registered civil partner under the Civil Partnership Act 2004

1. WHAT IS THE LONDON & COLONIAL DISCRETIONARY DISCOUNTED GIFT TRUST?

The London & Colonial Discretionary Discounted Gift Trust is a trust that enables an investor to make a lump sum investment which will:

- provide him/her with a series of tax-efficient capital payments on set dates for the rest of his/her life;
- provide for the residual investment fund to be available for distribution to the investor’s Beneficiaries on his or her death; and
- mitigate the impact of inheritance tax (IHT) on the investor’s death.

The Discretionary Discounted Gift Trust is designed for investors who wish to make a lump sum investment into a London & Colonial Offshore Open Bond (the “Bond”) that is effective for IHT purposes yet wish to retain a right to a stream of capital payments for the rest of their lives that can be used as income.

A trust is a legal relationship which exists when an asset is held by a person or persons (called the Trustees(s)) for the benefit of another person or persons (called the Beneficiary(ies)). The Trustees have the control and legal ownership of the asset but must use it for the benefit of the Beneficiaries.

The person who creates the trust, with cash or an existing Bond, is called the Settlor.

The Settlor can be more than one person – say a married couple.

When a Bond is held subject to a Discretionary Discounted Gift Trust, the ownership of the Bond is effectively split. The legal owners of the Bond are the Trustees. The Trustees collectively control all dealings with the Bond on behalf of the Beneficiaries under the trust. The Trustees are, in effect, the stewards of the trust property. The Beneficiaries under the



trust will be entitled to enjoy the trust asset - in the case of a Bond, the proceeds on encashment or part encashment. A person(s), called the Appointor, decides which Beneficiary benefits, to what extent and when (see below).

The key feature of a Discretionary Discounted Gift Trust is that it is effectively split into two separate trusts - the Settlor's Fund and the Beneficiaries' Fund. The Settlor's Fund (the Settlor's entitlement to a series of capital payments) is held for the absolute benefit of the Settlor. The Beneficiaries' Fund is held for the benefit of the Discretionary Beneficiaries.

Because the Settlor retains an entitlement under the trust in the shape of the Settlor's Fund, the size of the gift he is making when he sets up the trust is discounted, ie. only a portion of the sum settled into the trust is treated as a gift for IHT purposes. The size of the discount depends on the Settlor's age, gender, state of health and the size and frequency of the capital payments he will receive – see section 6 “More details of the discount” below.

In order to ensure that the trust is effective for inheritance tax purposes, the Settlor cannot benefit from the Beneficiaries' Fund in any way. The Settlor will, however, be one of the Trustees and the initial Appointor under the trust. The Appointor decides who (from the classes of Beneficiaries specified in the trust) should benefit from the Beneficiaries' Fund and when. After the Settlor's death, the Trustees take over the power of appointment.

If the Appointor does not appoint all of the trust fund by the end of the Trust Period (80 years) then the individual or individuals named by the Settlor as Default Beneficiaries will benefit. In practice it is most unlikely that the trust property will not have been distributed within this 80 year period.

The main objective of the Discretionary Discounted Gift Trust is to allow the Settlor to make an IHT effective gift whilst ensuring that he remains entitled to tax-efficient payments from the trust fund as long as he lives. Where two people are Settlers, the payments will continue throughout their joint lives and the life of the survivor.

2. WHAT ARE THE KEY OBJECTIVES IN USING THE DISCRETIONARY DISCOUNTED GIFT TRUST?

You should consider using a Discretionary Discounted Gift Trust if you:

- are aged under 90 and in reasonably good health; and
- wish to make an inheritance tax (IHT) effective lifetime gift of your existing London & Colonial Offshore Open Bond or cash to be invested in a London & Colonial Bond; and
- are happy to give up access to the capital and any growth on the Bond in return for a right to receive regular capital payments from the Bond for the rest of your life; and



- are happy that the level and frequency of your capital payments cannot be increased or reduced in the future; and
- wish to retain flexibility over the choice of the ultimate Beneficiaries ie. the persons who will receive the benefits under the trust.

3. WHEN SHOULD THE DISCRETIONARY DISCOUNTED GIFT TRUST NOT BE USED?

The Discretionary Discounted Gift Trust should not be used if you:

- are aged 90 or over (or treated as such for underwriting purposes); or
- are not interested in inheritance tax planning; or
- wish to retain total control of and access to the capital at any time; or
- can afford to make an outright immediate gift and retain no flexibility or control (subsequent to the gift) over its final destination.

In such cases, London & Colonial offers a range of other trust wordings that may be suitable. Please contact your financial adviser for more information.

4. HOW IS THE DISCRETIONARY DISCOUNTED GIFT TRUST ESTABLISHED?

The Discretionary Discounted Gift Trust can be used with cash intended for an investment in a new London & Colonial Bond or with an existing London & Colonial Bond which is not already held in trust. Where a new Bond is to be effected, the trust will be established by the Settlor and additional Trustees with the Settlor giving the Trustees a cheque payable to London & Colonial. The Trustees will then make an application for the Bond. It will normally be advantageous to effect the Bond on a joint lives last survivor basis on the lives of two or more of the Discretionary Beneficiaries. Neither the Settlor nor his/her spouse should be lives assured.

When the trust is established with an existing Bond, the Settlor assigns the Bond to the Trustees named in the trust deed which is executed by the Settlor and the Trustees.

The Settlor specifies in the trust deed the amount and frequency of the capital payments (the Settlor's Fund) that he or she wishes to receive from the trust. These cannot be subsequently changed. It will be the responsibility of the Trustees to ensure that the Settlor receives his or



her entitlements. In practice a withdrawal form will be completed to ensure that the specified capital payments are made directly to the Settlor's bank account.

5. KEY PROVISIONS OF THE DISCRETIONARY DISCOUNTED GIFT TRUST

As indicated above the Discretionary Discounted Gift Trust is split into two funds.

THE SETTLOR'S FUND

Under the trust the Settlor is entitled to the Settlor's Fund. This means that when he survives to the appropriate anniversary of the trust, he will become entitled to a capital sum at that time.

The following important points should be noted in relation to the Settlor's entitlement to regular capital payments:

- The trust permits there to be more than one Settlor. For example, investors who are married, or in a registered civil partnership, can, by choosing a joint settlor trust wording at outset, ensure that capital payments will continue to the surviving Settlor after the death of the first Settlor.
- The Settlor must choose at outset the initial level of capital payments from the trust (e.g. £2,000 pa or £200 per month) and any rate of increase. This cannot later be changed.
- The Settlor can choose at outset for there to be a deferral period before payments begin.
- The Trustees can use their 5% tax-deferred withdrawal allowances to take part surrenders from the Bond and so finance the payments to the Settlor to which he is entitled under the trust. Indeed, for administrative ease the Trustees can instruct London & Colonial to pay these direct to the Settlor.
- Because the capital payments to the Settlor originate from the Settlor's Fund, which is held on a bare trust for the Settlor, it is understood that Her Majesty's Revenue and Customs (HMRC) will not treat these as distributions for the purpose of the inheritance tax exit charge (see section 9 "The UK Tax Implications of the Discretionary Discounted Gift Trust").

THE BENEFICIARIES' FUND

- During the Trust Period (80 years) the Appointor (the Settlor(s) and, after the Settlor's death, the Trustees) may appoint the trust benefits (capital or income) to any of the Discretionary Beneficiaries. These Discretionary Beneficiaries include the Settlor's spouse (provided he or she is not also a Settlor), children and grandchildren, brothers



and sisters and their issue as well as any person nominated by the Settlor(s) to the Trustees in writing.

- Because the Settlor is entitled to capital payments from the trust during his or her lifetime, it would be unusual for an appointment of benefits to be made whilst the Settlor is alive.
- An appointment to the Settlor's spouse during the Settlor's lifetime should be approached with extreme caution as if the Settlor enjoys an indirect benefit the gift with reservation rules may apply. Such appointments should therefore only be considered in extreme circumstances.
- As the trust is a discretionary trust, no Beneficiary is entitled to any benefits until the Appointor makes an appointment in his or her favour. If any income arises to the Trustees from the trust investments (not relevant while the sole trust asset is the London & Colonial Bond) they can accumulate it for up to 21 years (this is the maximum time income can be accumulated under English law). After that time the Trustees will have to distribute all income to whichever Beneficiary they decide. However, no Beneficiary will have the right to any income – distributions will be at the discretion of the Trustees.
- The Settlor cannot benefit from the Beneficiaries' Fund in any circumstances. Where there is more than one Settlor, neither of them can benefit.
- The Settlor(s) names (as Default Beneficiaries) the individual or individuals who are to benefit from the trust fund at the end of the Trust Period (if no appointment is made before then), and if more than one the shares in which they are to benefit.
- The Trustees have wide powers to invest and deal with trust property - of course this will only become relevant in practice after the death of the Settlor.

6. MORE DETAILS OF THE DISCOUNT

What is a discounted gift?

Because the Settlor retains a right to future regular capital payments from the trust this right will have a value for IHT purposes and this remains within his taxable estate. For the purposes of calculating the gift at outset, the value of the full investment can therefore be reduced (or “discounted”) for the purposes of IHT by this “retained value”.

However, although the right to future regular capital payments has a value during the Settlor's lifetime, no value will be included in the Settlor's estate on his death in respect of the Settlor's Fund. This is because the Settlor's right to the stream of future capital payments



ceases on death and therefore immediately before the Settlor's death it has no value. It is this factor which gives the trust its IHT efficiency.

How is the size of the discounted gift determined?

The value of the Settlor's Fund, i.e. the right to future regular capital payments, is calculated taking into account the Settlor's (or both Settlers' if appropriate) gender, age, state of health and the amount and frequency of the capital payments they are entitled to.

For cash gifts used to buy new Bonds, the difference between the value of the Settlor's Fund and the amount of the cash gift will be treated as a transfer of value for IHT purposes and will be a chargeable transfer.

When an existing Bond is made subject to the trust, the value of the gift will be calculated by reference to the value of the Bond at the time unless the value is less than the original investment in which case the relevant value will be the amount of the initial premium (taking account of any withdrawals previously taken) less an allowance for any decrease in the value of units since the inception of the Bond.

HMRC Inheritance Tax will normally need to be informed of this transfer – see section 9 “The UK Tax Implications of the Discretionary Discounted Gift Trust” below.

In practice, while HMRC may accept the general basis of valuation mentioned above, each case may be considered individually for negotiating a value. It is for this reason that London & Colonial require that medical evidence must be supplied by the Settlor before establishing the trust. This evidence will be used by London & Colonial to assess the discounted gift value when the trust is established. This evidence will then be available should it be required to agree a valuation with HMRC when the trust is established or on the Settlor's death.

HMRC will not currently accept that a discount will be available in the case of a Settlor who has an actual (or underwriting) age of 90 or more.

What is the position as regards the discounted gift when there are joint husband and wife Settlers?

Where there are two Settlers (say husband and wife), they should contribute equally to the trust by, say, providing a cheque on a joint bank account.

Where a husband and wife invest as joint Settlers using jointly owned funds, each will be treated as making an investment of 50% of the total investment and each will be treated as a Settlor of one trust made up of that person's discounted gift into the trust. However, the calculation of the present right to future capital payments will take account of the fact that payments can be made throughout their joint lifetime and the lifetime of the survivor; and HMRC has issued guidance notes on how this calculation should be done.



7. THE LAW OF THE TRUST

The law of this trust is that of England and Wales but the trust can be used by investors domiciled in the remainder of the UK if they are happy for English law to govern the trust. The tax implications of the trust will be the same throughout the UK. It is not thought possible, for legal reasons, to effect a similar trust subject to the law of Scotland.

8. THE TRUSTEES

The Settlor(s) is/are automatically appointed as the original Trustee(s). At least one additional Trustee must be appointed and this is provided for in the draft trust deed.

The Settlor during his lifetime (or both Settlers during their joint lifetime and, thereafter, the survivor) can appoint further Trustees later on and also has the power to dismiss a Trustee provided at least one Trustee other than the Settlor remains.

The Trustees must act unanimously.

The liability of individual Trustees is limited so that they will not be held liable for any loss to the trust fund provided they act in good faith. Trustees who are paid for their services are also liable for negligence.

Professional trustees are permitted by the trust deed to charge normal professional fees. The Trustees are permitted to take part in transactions and Trustees' decisions in which they have a personal interest.

9. THE UK TAX IMPLICATIONS OF THE DISCRETIONARY DISCOUNTED GIFT TRUST

(1) INHERITANCE TAX (IHT)

(a) Establishment of the trust

- When the trust is established, the Settlor will be treated as having made a discounted gift for inheritance tax purposes. The size of this gift will be equal to the difference between the amount of cash used to buy a new Bond (or the value of the existing Bond, adjusted as appropriate, as explained above in 6.) and the value of the Settlor's retained right to capital payments which will depend on the Settlor's gender, age, state of health at outset and the amount and frequency of the capital payments.



- For IHT purposes the gift will be a chargeable lifetime transfer (CLT). If this amount plus the amount of any other CLTs made by the Settlor in the previous 7 years does not exceed the nil rate band for IHT (£312,000 in tax year 2008/09) there will be no IHT liability when the gift is made and, if the Settlor survives for seven years, no IHT liability will arise at all in respect of the gift. If the Settlor's nil rate band is exceeded there will be a lifetime liability at 20% on the excess, increasing to 40% if the Settlor dies within 7 years (although IHT taper relief may then be available).
- Where there are two Settlers (say husband and wife) who currently own a Bond in joint names or who draw a cheque for investment on a joint bank account, each is treated as contributing to the trust in the proportion applicable to the discounted gift each makes. For the implications of this on the discounted gift calculation, see section 6 above.
- Having calculated the discounted gift, the Settlor(s)'s annual exemption(s) can then be deducted to calculate the chargeable lifetime transfer.
- Where a person makes a gift that is a CLT he may need to report it to HM Revenue and Customs on Forms 100 and 100a.

Whether a gift will need to be reported depends on the amount of the gift and the nature of the assets gifted. The gift will need to be reported if:-

- (1) Where the gift is of cash, it causes the donor to exceed the then nil rate band taking account of CLTs made in the previous 7 years.
- (2) Where the gift is of an existing Bond, it either causes the donor to exceed 80% of the then nil rate band taking account of CLTs made in the previous 7 years or the amount gifted exceeds the then nil rate band less CLTs made in the previous 7 years.

If the gift is of an existing Bond, form D34 will also need to be completed.

(b) Death of the Settlor

- On the death of the Settlor (or, where relevant, either of the Settlers) more than 7 years after the creation of the trust, the value of the Bond will be outside of the Settlor's estate for IHT purposes.
- If the Settlor does not survive his gift by 7 years, the potential IHT liability on the original chargeable lifetime transfer will have to be recalculated at the full death rates applicable at the date death. However, no IHT will arise if the gift was within the Settlor's available nil rate band. If the nil rate band was exceeded, so that lifetime tax at 20% was paid, the charge will increase to 40%. IHT taper relief may be available in which case the IHT liability will start to reduce once the Settlor survives his gift by three years.



- If the Settlor is the sole or last life assured to die under the Bond, the cash value of the Bond will be paid free of inheritance tax to the Trustees (although a chargeable event gain may then arise that will give rise to income tax implications - see 9(2)(ii) below.)
- If the Settlor is survived by another life assured under the Bond, the Bond will continue unaffected by the Settlor's death.

(c) IHT whilst the trust is in existence

As this is a discretionary trust, this means that special IHT charging rules apply. Under these rules there may be IHT charges

- on every ten-year anniversary of the trust - "the Periodic Charge" or
- whenever property leaves the trust (e.g. when capital is advanced to a Beneficiary or an absolute appointment of benefit is made) - "the Exit Charge"

THE PERIODIC CHARGE

Periodic charges at ten-yearly intervals may be applied to the value of the assets in the trust (although special rules apply to determine the value of trust property for a discretionary discounted gift trusts - see below). The rate of inheritance tax charged will be determined based on an assumed transfer by an assumed transferor. This will mean that it will broadly be necessary to take account of

- the value of the property in the trust on the ten-year anniversary, certain additions made to the trust and the value, when they were set up, of any other trusts created on the same day (the assumed transfer)
- the Settlor's cumulative total of chargeable transfers made in the seven years immediately preceding the creation of the trust (assuming there has been no added property) and any sums paid out of the trust in the 10 years prior to the anniversary (the cumulative total of the assumed transferor)

As a result of the calculation of the tax on the assumed lifetime transfer an effective lifetime rate of tax will be established. The maximum effective rate will be 20% and this will only apply in extreme cases. 30% of this rate is taken and that is the rate that will be applied to the actual value of the trust property at the ten-year anniversary.

The maximum liability will thus be 6% (30% of 20%) of the value of the trust property over the available nil rate band but frequently it will be much less or nil.

In cases where the Settlor has not made any chargeable transfers in the 7 years before he creates the trust, no payments have been made out of the trust in the last 10 years and there has been no added property, there will be no liability provided the value of the trust property



at the time of the periodic charge does not exceed the nil rate band applicable at the ten-year anniversary. Any excess over the then nil rate band will suffer IHT at an effective rate of 6%.

Example

Alan creates a Discretionary Discounted Gift Trust in October 2008 for £300,000. The value of Alan's retained rights is £150,000 and so the discounted gift is £150,000 based on an annual cash payment of £15,000 (5% of the premium to the Bond).

Alan has made no chargeable transfers in the previous 7 years. No payments are made out of the trust (other than those to Alan from the Settlor's Fund) in the first 10 years. In October 2018 the trust fund is worth £300,000 and the nil rate band is £400,000. No IHT is payable.

For the purposes of calculating the value of the trust fund for the periodic charge, HMRC has confirmed that the present value of the Settlor's right to future capital payments at that time (i.e. at the ten-year anniversary) should be deducted from the value of the trust fund (i.e. the Bond). This means that an amount in respect of the then value of the Settlor's rights would need to be deducted from the value of the Bond.

Had the value of the Bond been £475,000 after 10 years with the Settlor's rights valued at £25,000, then the value of the relevant property in the trust would have been £450,000 and IHT of £3,000 would have arisen (£50,000 @ 6%). This equates to a charge at 0.66% on the whole value of the trust property.

If all of the trust fund is distributed before the tenth anniversary, in many cases no tax charge will arise (see the "Exit charge" below). If assets remain in the trust after a distribution, or if further assets are added to the trust, the Trustees will need to take specialist tax advice.

THE EXIT CHARGE

Exit charges will be based on the value of property leaving the trust or being appointed absolutely to a Beneficiary.

HMRC has confirmed that no exit charge will arise on payments made to the Settlor under a Discretionary Discounted Gift Trust because this property is already held absolutely on bare trust for him.

Exit charges within the first 10 years will be nil if the value of the initial chargeable lifetime transfer (before applying any IHT exemptions or reliefs) going into the trust (including the cumulative total of the Settlor's chargeable transfers in the 7 years prior to creating the trust and the value of any added property) is below the available nil rate band at the time of the exit. This means that if the available nil rate band when the trust was created was not exceeded there is a good chance that there will be no exit charge. If an exit charge does arise, it will increase according to the number of quarter years that have expired since the trust was created.



The amount of any exit charge occurring after the first 10 years will depend on the rate of tax charged at the last ten-year anniversary (if any) and the length of time (in quarter years) that the property has been in the trust since the last periodic charge. If there was no charge at the previous ten-year anniversary there will be no exit charge.

Example

In October 2024, 6 years since the first ten-year anniversary (when a 0.66% IHT rate was charged), the Trustees of Alan's trust make a part encashment of the Bond and pay £50,000 to a Beneficiary. The IHT charge will be $£50,000 \times 0.66\% \times 24/40 = £198$.

As stated above, no IHT charge will arise on property paid out of the trust if there was no IHT charge at the last ten-year anniversary.

Exit charges should not arise on loans made by the Trustees to Beneficiaries.

The occasion of a periodic charge and transactions that can give rise to an exit charge, such as capital payments to the Beneficiaries, may also have to be reported to HMRC if they exceed a certain amount. The forms to use here are IHT 100c and d (and form D34 where a life policy is involved).

If there are joint Settlers (who should contribute equally), the trust is effectively treated as two separate trusts, each settled by one Settlor, for all IHT purposes. IHT calculations are then applied to each of the trusts. The trust fund would effectively be divided into proportions reflecting the value of the discounted gift made by each Settlor for the purposes of calculating the ten-year periodic charge and any exit charge.

(2) INCOME TAX

(In all cases, it is assumed that the Settlor, Beneficiaries and the Trustees are UK resident and domiciled - special rules apply where this is not so and professional advice should be taken in such cases).

(i) Payments to the Settlor

The payments made to the Settlor in respect of his entitlement under the trust are capital payments and not subject to income tax.

The Settlor's capital entitlements will be funded by the Trustees making encashments from the Bond. The Trustees are entitled to withdraw from the Bond, free of tax at that time, an amount of up to 5% of the premium invested, each year, for 20 years. To the extent that such a 5% allowance is not taken in one year it can be carried forward to the next year and so on. As long as payments are kept within the cumulative total of unused annual 5% allowances no income tax implications will arise for the



Trustees or the Settlor at the time of withdrawal. These 5% withdrawals will be taken into account in determining the taxable chargeable event gain when the Bond is finally encashed.

(ii) Chargeable event gains

During the Settlor's lifetime and in the tax year in which the Settlor's death occurs

For income tax purposes, any chargeable event gains arising under the Bond will be assessed on the Settlor. If there are joint Settlers, each will be assessed on a portion of the gain based on the proportion of his contribution. Please refer to the London & Colonial Offshore Open Bond literature for full details of Bond taxation.

After the end of the tax year in which the Settlor's death occurs

Following the Settlor's death, any chargeable event gains arising in a tax year after that in which the Settlor died will be assessed on UK resident Trustees at the special rate of 40%. To the extent that chargeable event gains fall within the £1,000 standard rate tax band (which would be available to the Trustees following the Settlor's death), there will be a charge at 20%. These rules also apply if the chargeable event gain arises at any time that the Settlor is non-UK resident.

Prior transfer to a Beneficiary

It may be that after the Settlor's death the Trustees will consider encashing the Bond and releasing the proceeds to a Beneficiary.

As an alternative to encashing the Bond prior to making a payment to a Beneficiary (obviously, after the Settlor's death), the Trustees could make an absolute and irrevocable appointment of benefits in favour of an adult Beneficiary. They could then assign the Bond to the Beneficiary who is to benefit. That assignment would not give rise to a chargeable event. Any chargeable event gain arising on any subsequent encashment by the Beneficiary would then be assessed to tax on that Beneficiary.

(iii) Payments to Beneficiaries

- If the Trustees make an encashment of or withdrawal from the Bond to make a payment to Beneficiaries (normally after the death of the Settlor), the income tax and IHT consequences of this are as outlined above.
- As long as payments to Beneficiaries are made and documented as an advancement of capital and do not acquire the character of income, there should be no income tax implications for the Settlor or the Beneficiaries.



It should be noted that a change of Trustee and the death of a Trustee have no tax implications.

(iv) Tax on pre-owned assets

With effect from 6 April 2005 an income tax charge is levied when a person continues to benefit from property which he or she owned in the past but has given away. This is called a tax on pre-owned assets and it needs to be considered in connection with any IHT planning scheme. With respect to the London & Colonial Discretionary Discounted Gift Trust, the tax will not apply as the Settlor's rights under the trust are specifically carved-out and retained for the Settlor's benefit. As the Settlor has no right to any benefit under the Beneficiaries' Fund, which is the property he has given away, HMRC has confirmed that a pre-owned assets tax charge should not apply.

(3) CAPITAL GAINS TAX

No capital gains tax should arise in relation to any dealings with a Bond held subject to a London & Colonial Discounted Discretionary Gift Trust.

This Guide is based on London & Colonial's understanding of UK law and HMRC practice as at 1 November 2008. While every care has been taken, neither London & Colonial nor any of its representatives, officials or employees can accept any responsibility for any loss occasioned as a result of the information contained in this Guide in any circumstances whatsoever. Potential investors are strongly recommended to take independent professional advice before creating the trust.