



DISCRETIONARY GIFT TRUST KEY FEATURES AND BENEFITS

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

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

The London & Colonial Discretionary Gift Trust provides a highly flexible method of holding a London & Colonial Offshore Open Bond (the “Bond”) for the benefit of other individuals.

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.

When a Bond is held subject to a Discretionary 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, although a person(s), called the Appointor, decides which Beneficiary benefits, to what extent and when (see below).

The person who creates the trust is called the Settlor. With the London & Colonial Discretionary Gift Trust, the Settlor may create the trust by transferring an existing Bond to the Trustees or by giving the Trustees a cheque payable to London & Colonial to invest in a Bond.

The Settlor can be more than one person – say a married couple. In order to ensure that the trust is effective for inheritance tax purposes, the Settlor(s) cannot benefit from the Bond in any way under the Discretionary Gift Trust. 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 trust fund (ie. the Bond) and when. After the Settlor's death, the Trustees take over the power of appointment.

If the Appointor makes no appointments 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 unlikely that the trust property will not have been distributed within this 80 year period.

The main objective of the Discretionary Gift Trust is to ensure that the Bond is held for the benefit of the chosen Beneficiaries so that its value will be outside of the taxable estate of the Settlor for inheritance tax purposes.

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

You should consider using a Discretionary Gift Trust if you:

- wish to make an inheritance tax (IHT) effective lifetime gift of your Bond or cash to be invested in a London & Colonial Bond; and
- do not need to retain access to the Bond for your own benefit 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 GIFT TRUST NOT BE USED?

The Discretionary Gift Trust should not be used if you wish to retain access to the Bond or part of it for your own benefit or if you wish to make an outright immediate gift and retain no flexibility or control (subsequent to the gift) over its final destination. In such circumstances, other London & Colonial trusts may be suitable and you should ask your financial adviser for more information.

4. HOW IS THE DISCRETIONARY GIFT TRUST ESTABLISHED?

The Discretionary Gift Trust can be used with either an existing Bond, which you own outright, or with cash that is available for investment. In the latter case you give a cheque payable to London & Colonial to the Trustees and the application for the Bond will be made by all the Trustees. Where a new Bond is being effected by the Trustees, the Bond should be effected on a joint lives last survivor basis on the lives of some of your Beneficiaries. If an existing Bond is being transferred to the trust, the deed incorporates a legal assignment of the Bond to all the Trustees.



The trust is established by the Settlor and the additional trustees completing the Discretionary Gift Trust deed. At least one Trustee must be appointed in addition to the Settlor who is automatically a Trustee.

The reason for appointing an additional trustee is that without additional trustees there will be a delay in securing access to the Bond benefits should this be necessary following the death of the last surviving or only Trustee.

Once the existing Bond is made subject to trust or the new Bond is issued to the Trustees, any subsequent dealings with the Bond will be between the Trustees (as the legal owners) and London & Colonial.

5. KEY PROVISIONS OF THE DISCRETIONARY GIFT TRUST

- 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 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.
- An appointment of benefit to the Settlor's spouse during the Settlor's lifetime should be approached with extreme caution because if the Settlor were to enjoy even 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(s) cannot benefit from the trust 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 (in the unlikely event of no appointment having been 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 where the Bond proceeds are not to be distributed immediately for the benefit of Beneficiaries. For example, if the intended Beneficiaries are minor children, it may well be that the Trustees would wish to only occasionally distribute benefits yet keep most of the trust fund invested.

6. THE LAW OF THE TRUST

The Discretionary Gift Trust is governed by the law of England and Wales . However, it can also be used in Scotland or Northern Ireland as there is nothing in the laws of those countries which would preclude its use. In particular, the objectives of the Discretionary Gift Trust as indicated above, including the freedom from inheritance tax, will be achieved in all parts of the UK.

7. THE TRUSTEES

The Settlor (or both of them in joint cases) is/are automatically appointed as the initial Trustee(s) and additional trustees are appointed in the trust deed. Further trustees can be appointed later on if necessary.

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

The Trustees must act unanimously and so it is important that the Settlor chooses the additional trustees carefully.

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.



8. THE TAX IMPLICATIONS OF THE DISCRETIONARY GIFT TRUST

(1) INHERITANCE TAX (IHT)

(a) Establishment of the trust

- For IHT purposes a transfer of value (a gift) takes place at the time the trust is created. The transfer will be a chargeable lifetime transfer (CLT).
- Where there are two Settlers, each is treated as making a gift equal to the proportion of value each contributes to the trust.
- When the trust is set up with cash, the value of the gift will be obvious.
- When an existing Bond is made subject to trust, the value of the gift will be the value of the Bond (or the initial premium paid if greater less any part surrenders less an allowance for any decrease in the value of units since allocation at inception of the Bond).
- If the value of the gift exceeds the available annual exemption, currently £3,000 for each Settlor (£6,000 maximum for each Settlor if the exemption for the previous tax year has not been used), it will be a CLT. This means that a potential liability to IHT at 20% may immediately arise if the value of the gift plus the value of all other CLTs made by the Settlor in the seven years immediately preceding the establishment of the trust exceeds the nil rate band at the time the latest gift is made. A further tax liability (a further 20%) on the gift could arise if the Settlor dies within 7 years of making the transfer although taper relief will be available if the Settlor survives for at least 3 years. On the Settlor's death within seven years of making the gift the full value of the gift when made will also be taken into account in determining the inheritance tax liability on the Settlor's estate.

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 in the following circumstances:-

- (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) Payment of additional premiums by the Settlor

Any additional investment made into a Bond by the Settlor will be a further gift and the tax implications will be as described above for the initial transfer. Additional investments into the trust can also have an impact on the periodic and exit charges (see below).

(c) 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.
- Inheritance tax could be a factor where the value of the original gift to the trust (after deduction of any annual exemption(s)) causes the Settlor to exceed his available nil rate band and the Settlor dies within 7 years of creating the trust. In these cases tax equal to 20% of the amount of the gift that exceeds the nil rate band would have been paid when the gift was made. A further tax liability of 20% on the gift could arise if the Settlor dies within 7 years of making the transfer although taper relief will be available to reduce the tax payable if the Settlor survives the gift by at least 3 years.
- If the value of the original gift is within the available nil rate band no liability will arise on the gift itself. However, the nil rate band available to determine the liability arising on the Settlor's estate on his death will be correspondingly reduced.
- 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.
- If the Settlor is survived by another life assured under the Bond, the Bond will continue unaffected by the Settlor's death.

(d) 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. The rate of inheritance tax charged will be determined on the basis of 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 CLTs 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 (maximum 20%). 30% of that rate is taken and that is the rate that will be applied to the value of the trust property.

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%.

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 obtain 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.

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.

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 HM Revenue & Customs 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 have contributed 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. Provided each Settlor originally contributed equally to the trust, the trust fund would effectively be divided in two 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, the Beneficiaries and the Trustees are UK resident and UK domiciled - special rules apply where this is not so).

(i) 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 proportion of the gain based on the proportion of his contribution. Please refer to the London & Colonial Offshore Open Bond literature for further 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 available to the Trustees, the charge to tax will be 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 and irrevocable

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 payment, 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 which may be advantageous if the Beneficiary is not a higher rate taxpayer.

(ii) Payments to Beneficiaries

- If the Trustees make an encashment of or withdrawal from the Bond to make a payment to Beneficiaries, 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 or the death of a Trustee have no tax implications.

(3) CAPITAL GAINS TAX

No capital gains tax should arise in relation to any dealings with a Bond held subject to the 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.