canada life™

Discounted Gift Trusts Q & A

A discounted gift trust (DGT) allows a client to put a lump sum into trust for their chosen beneficiaries, while retaining the right to regular fixed capital payments. It uses the principle of carving out the settlor's entitlement to the regular fixed capital payments so that this part of the investment is not a gift for inheritance tax purposes. These payments will cease on death or when the fund is exhausted.

Below is a list of questions, with the answers, which we are frequently asked. If you have any further questions regarding Canada Life's discounted gift trusts please contact your account manager in the first instance. Alternatively please contact the ican Technical Services team or refer to our website: **https://www.canadalife.co.uk/estate-planning/discounted-gift-trust/**

Question	Response
Discount	
Why is the term 'discounted' used?	The term 'discounted' is used because the amount the settlor gives away on establishing the trust is less than the amount actually invested into the investment bond. This is because the settlor is entitled to regular capital payments and the current value of that future entitlement is 'carved out' and not given away. Hence the settlor's ability to continue to receive the regular capital payments allows for an immediate reduction in the value of their estate for inheritance tax (IHT) purposes – known as the 'discount'.
Why is there a discount on the value of the gift?	The gift for IHT purposes is determined by the loss to the estate. As the settlor retains rights to regular capital payments which cannot be stopped or changed by the trustees, there will be a discount on the value of the gift.
How is the discount calculated?	At outset, the settlor requests a series of regular capital payments payable for their lifetime, or until the fund is exhausted. The product provider medically underwrites the settlor in order to establish their life expectancy based on their state of health and lifestyle. Using their age, or rated age, the provider calculates the market value of the 'income' stream being provided to the settlor – the capital someone would pay to buy the regular capital payments. The younger and healthier the settlor, the higher the market value of the income stream, as payments could potentially continue for longer; which therefore will give a larger discount. If the settlor is older or in poor health then the payments may not continue for as long and, therefore, the market value is lower and the discount is smaller.

Question	Response
Discount	
Why is no discount available for clients over the age of 90?	HMRC's view is that the market value of the rights to regular capital payments ('income' stream) for a client over 90 would be nominal as no buyer would be willing to purchase these rights.
Gift with reservation of benefits	
Why does this not fall within the gift with reservation of benefits (GWR) provisions?	The settlor is not giving away the rights to the regular capital payments and is expressly excluded from benefiting from the remainder of the trust fund. This is confirmed in HMRC's IHT Manual at IHTM20424.
Why can't the settlor and/or their spouse/civil partner be a life assured?	We are of the view that, if they are lives assured, gift with a reservation rules (GWR) within paragraph 7, Schedule 20 Finance Act 1986 would apply. Consequently, as the benefits payable to the beneficiaries will vary by reference to the settlor's entitlement, the GWR rules would apply if the settlor and/or their spouse/civil partner were lives assured.
Trust	
Can the settlor be a trustee?	Yes and under Canada Life's DGT, the settlor is automatically a trustee.
How many trustees do we need in total?	For a Canada Life DGT there must be a minimum of two trustees at all times.
Is a professional trustee required?	No, although one can be appointed if the client wishes.
What are the duties of the trustees?	The primary duty of the trustees, whilst the settlor is alive, is to pay the regular capital payments every time the settlor survives to each payment date. After the death of the settlor, the trustees must consider all the beneficiaries in their dealings with the assets of the trust. Throughout the lifetime of the trust, they will need to hold regular reviews and take proper advice concerning the funds in which the bond is invested
Tax	
Does the settlor's entitlement to the regular capital payments have a value on their death?	No. The settlor is only entitled to the regular capital payments on survival to selected dates. As the trustees have no obligation to continue payments after the death of the settlor, the right to these payments is worthless.

Question	Response
Tax	
What is the tax situation if the client has been taking 5% each year and is still alive after 20 years and continues to receive 5% each year?	Under chargeable event rules, when the tax deferred allowance has been exhausted, any subsequent payments are treated as a chargeable gain assessable to income tax. If the investment bond is an onshore policy, the gain will have a 20% non-repayable tax credit.
Income	
Do the regular capital payments have to be paid whether the client wants them or not?	Yes. The capital payments must be set at outset and cannot be varied or cancelled. This is because the discount is based on the actuarial value of the future payments.
Can the settlor cancel or vary the regular capital payments after the trust has been set up?	No. As the discount is based on the settlor receiving the regular capital payments, they cannot be cancelled or varied.
Are the regular capital payments added back into the periodic charge calculations?	No. The value of the trust fund at each ten-yearly anniversary will be the value of the bond less the recalculated discount taking into account any rating imposed at outset.
General	
What happens if the bond is surrendered during the settlor's lifetime?	Under a Canada Life DGT the bond cannot be surrendered during the settlor's lifetime, as the settlor's right to receive the regular capital payments is carved-out in the policy provisions.
What are the options when the settlor dies?	The regular capital payments will cease but the investment bond will continue, with the trustees managing the bond for the beneficiaries. The bond can continue until the death of the lives assured or it could be surrendered or assigned.
As it is an investment bond in trust, will it still be outside the settlor's estate for the means test carried out to determine the settlor's entitlement to long-term care costs?	The value of the trust is not in the settlor's estate; however, the regular capital payments that the settlor receives will be included for the purposes of the means test.
Is the settlor able to access the whole trust fund?	No. The settlor is only entitled to benefit from the regular capital payments.

Question	Response
Pre-Owned Assets Tax	
Why is this not affected by pre-owned assets tax (POAT)?	The settlor's rights to the regular capital payments are held subject to a bare trust and as such are not within the definition of 'settlement' for the purposes of the pre-owned assets legislation and outside the scope of paragraph 8, Schedule 15, Finance Act 2004. In addition, the settlor is excluded from all other benefits under the trust and so this schedule does not apply. This is confirmed in HMRC's IHT Manual at IHTM44112.
DOTAS	
Are DGTs subject to the Disclosure of Tax Avoidance Schemes regulations (DOTAS)?	Regulation 5 of The Inheritance Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2017 makes it clear that arrangements are excepted from being disclosed if they are substantially the same as arrangements entered into before 1 April 2018 which accorded with established practice of which HMRC had indicated their acceptance. HMRC's acceptance is contained in IHTM20421 to IHTM20427 of their IHT Manual.

This document is based on Canada Life's understandings of applicable legislation, law and current HM Revenue & Customs practice as at December 2023. It is provided solely for general consideration. The information regarding taxation is based on our understanding of current legislation, which may be altered and depends upon the individual financial circumstances of the investor. We recommend that investors take their own professional tax advice.

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