

# Discounted Gift Trust: Bare Trust

## Tax Notes

Note: All references are to Acts of the UK Parliament

### Background

Under the Discounted Trust Account Bare Trust arrangement, you will take out a specially designed life insurance policy (the 'Policy'), with either Canada Life Limited, Canada Life International Limited or Canada Life International Assurance (Ireland) DAC (referred to together as the 'Company'). You decide the level of regular withdrawals you wish to take from the Policy. This right to regular withdrawals will rest with you for life or until the Policy is worthless, and cannot be defeated (the 'retained right'). You then gift the remaining rights conferred by the Policy (the 'gifted rights') to the beneficiaries named in the trust deed of which you cannot be one. The legal title to the Policy will be held by the trustees that you appoint.

### Practical implications

All trustees must sign any instructions given to the Company, including instructions regarding the switching of investment funds held within the Policy (unless a Fund Adviser has been appointed) or a trustee resolution for fund variation (T26)\* has been completed.

\* cannot be used for a Canada Life Limited policy

### Inheritance tax considerations

#### Gift with reservation of benefit

The assignment of the gifted rights into the trust should not constitute a gift with reservation of benefit by you, since you will, by the terms of the trust deed, be expressly excluded from being able to benefit from the gifted rights. Neither you or your spouse/registered civil partner will be a life assured under the Policy, so that the arrangements are not considered to be a gift with reservation of benefit by virtue of paragraph 7, Schedule 20, Finance Act 1986.

### Initial gift

The bare trust is not a settlement for inheritance tax (IHT) purposes.

The assignment of the gifted rights into the bare trust will therefore be a potentially exempt transfer ('PET') for inheritance tax ('IHT') purposes. Because the retained right cannot be defeated by the trustees, there will be a discount on the value of the PET. The Company will underwrite each applicant to provide an indication of the discount available.

The value of the PET will be the market value, for IHT purposes, of the Policy on the date of the assignment of the gifted rights, less the actuarial value of the retained right on that date. The result will represent the reduction in your estate at the date of the assignment of the gifted rights.

Should you survive seven years from making the PET, the transfer becomes fully exempt from IHT.

However, if you die within seven years of making the PET, the transfer becomes fully chargeable and may be liable to IHT. Any tax payable (assuming that part or all of the PET does not fall within your IHT nil rate band) will be reduced by taper relief if you die more than three years after the date of the chargeable transfer. Taper relief has the effect of reducing the rate of IHT payable from 40% to 8%, depending when you die within the seven year period.

## Income tax considerations

The assignment of the gifted rights into the bare trust is not 'for money or money's worth', and is therefore not a chargeable event for income tax purposes.

The premium payment into the Policy gives you the right to take regular withdrawals from the Policy. If you want to avoid a charge to income tax on those regular withdrawals you should take no more than 5% a year of the premium paid.

The allowance is cumulative and any unused allowance may be carried forward for use in subsequent years. Effectively the legislation allows for the return of the original premium tax-deferred but no more quickly than one-twentieth of the premium each year.

However, you should note that any payment made by us to a professional adviser which is treated as an adviser charge will also count towards this 5% allowance.

So a charge to income tax will arise if the aggregate of your withdrawals and any adviser charge payments made in a policy year exceed 5% of the premium paid by you.

Any surrender of the Policy after your death is a chargeable event and a chargeable gain will arise if a profit has been made. A profit will occur if the surrender value plus all sums withdrawn from the Policy exceeds the premium paid. The liability for the income tax falls principally on the beneficiaries of the bare trust. However, there is a risk that HMRC could look to the trustees for the income tax if it was not paid by any of the beneficiaries. This will need to be paid from trust assets.

The payment of a death benefit is also a chargeable event and a chargeable gain will arise if the surrender value of the Policy immediately before the death of the last life assured, plus all sums withdrawn from the Policy, exceeds the premium paid.

Finally, following the decision of the Special Commissioner, Dr Brice, in *Sugden v. Kent (Inspector of Taxes) [2001] STC (SCD) 158*, your entitlement to, and the payment of, the regular withdrawals should not amount to an annuity.

## Pre-owned asset tax considerations

The retained right and gifted rights are held on bare trusts and as such are not within the definition of 'settlement' for the purposes of the Pre-Owned Asset Tax legislation and outside the scope of paragraph 8, Schedule 15, Finance Act 2004.



**This document is based on Canada Life's understandings of applicable legislation, law and current HM Revenue & Customs practice as at October 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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