INHERITANCE TAX PLANNING – DISCOUNTED GIFT TRUST

PURPOSE

To provide an immediate and longer term inheritance tax (IHT) saving while generating a regular stream of tax efficient income.

DESCRIPTION

One of the dilemmas associated with Inheritance Tax Planning is deciding how to 'give away' capital to your chosen beneficiaries in order to mitigate Inheritance Tax, but still retain sufficient to live on.

Therefore, the concept of the discounted gift plan was created. This allows a UK domicile person to make a gift, while retaining access to a regular income during their lifetime.

This gift will be Inheritance Tax efficient in three ways. Firstly, because an immediate amount gifted into the plan (the discount) will fall outside the Settlor's estate. Secondly, because after seven years the whole amount invested will fall outside of the estate, and finally, because any growth within the plan will be outside of the estate with immediate effect.

Once monies are placed into a discounted gift plan the capital is no longer accessible to the Settlor (creator of the Trust). The discounted gift plan is therefore not suitable for persons who may require full, immediate or unrestricted access to the capital invested. It also may not be suitable for persons whose income needs are likely to vary significantly in the future, or for persons who are not in good health.

The underlying investment of the Discounted Gift plan is a single premium life assurance bond. An investment in a non-income producing asset such as a life assurance bond means that the trust administration is minimised. The trustees are entitled to draw up to 5% of the initial investment each year, without any tax charge at that time, for up to 20 years and this provides a very convenient method for the trustees to finance the Settlor's entitlement to the capital payments under the trust. Please note that the level of income set at outset in most contracts cannot be amended.

The immediate discount is calculated taking into consideration sex, health, life expectancy and the level of income that is selected.
A higher income would produce a higher immediate discount; however this also increases the possibility of capital erosion within the bond investment and may give rise to a chargeable gain. This discount is subject to underwriting clarification which may mean the level of discount may be reduced or removed completely.

The actual gift into trust itself will be exempt from IHT if it is below the Nil Rate Band threshold (currently £300,000). The gift will be a Nil Rate Band Reducer that in effect will reduce the individuals Nil Rate Band entitlements by the amount gifted until after seven whole years from the date of the gift.

EFFECTS

• An immediate amount gifted into the plan (the discount) will fall outside the Settlor's estate immediately, subject to medical underwriting.
• After seven years all monies will be outside the estate.
• Any growth will be outside the estate immediately. This gift will therefore help reduce the pace in which an estate's liability to inheritance tax (IHT) will grow.
• An income has to be provided from the Trust.

CASE STUDY

Mr & Mrs Simons are both age 68 and have an estate worth £800,000. The main Beneficiaries of their estate are their three children. They are concerned about their estate's liability to IHT and their own financial independence into retirement. Having taken certain other steps to mitigate the IHT problem they are keen to explore other possible solutions. Having taken into consideration their own future needs and requirements they have estimated that they can afford to gift £100,000 from their estate immediately leaving them with other liquid resources to fund foreseen and future unforeseen expenditure. However, for their own financial security they wish to have an entitlement to an income from the discounted gift plan.

Therefore, they have decided to invest £100,000 into a discounted gift plan with themselves and family solicitor as the Trustees, and their three children the sole Beneficiaries. This will allow them to keep control over monies and have the ability to alter or add (Grandchildren) Beneficiaries in the future. They will also withdraw 3% from the trust rising with RPI each year, giving them £250 per month.

On the level of income selected then £60,000 (subject to underwriting) will immediately go outside of the estate resulting in an IHT saving of £24,000 and the remaining £40,000 will form the Chargeable Lifetime Transfer part of the investment that will be outside your estate in seven years creating a further IHT saving of £16,000.

After ten years the discounted gift plan is worth £125,000, and has generated an income of over £35,000. All these monies are sheltered from IHT resulting in a total saving of £50,000.

Following the second death 20 years from the plan's creation, the bond was worth £175,000 and the children decided to leave monies within the trust rather than add to their own estate's and split the income three way's each year.

Five years later, with the bond worth £200,000, they decide to collapse the trust and distribute the proceeds without liability to IHT.

For further information please call 0845 0551970 or go to www.henwoodcourt.com