

IHT planning using Gift, Loan & Discounted Gift Trusts

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Learning Objectives

By the end of this session you will be able to:

Describe the current IHT landscape and why receipts are rising

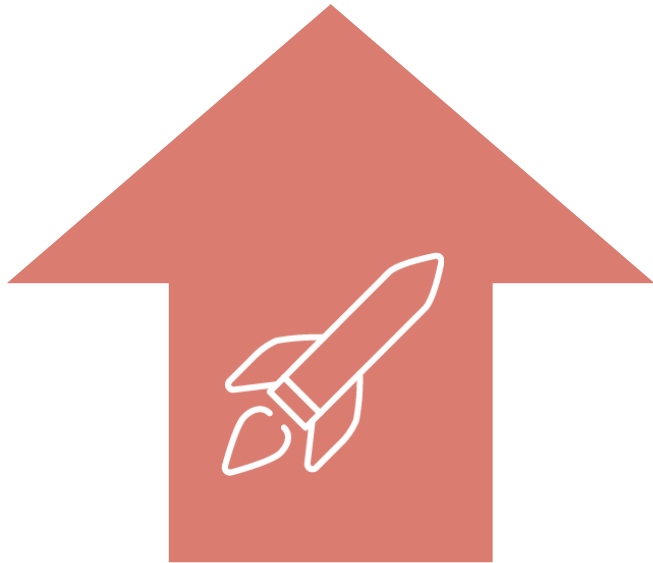
Explain how trusts can be used to overcome objections to gifting and reduce a person's IHT liability

Describe the operation of Gift, Loan and Discounted Gift Trusts

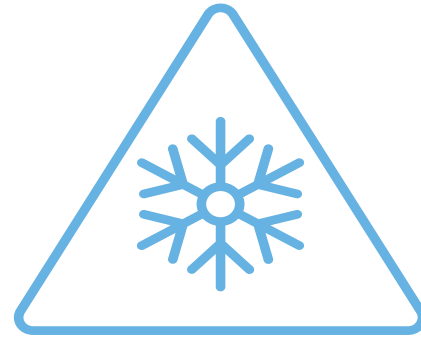


IHT landscape

Inheritance Tax



OBR forecast that IHT will raise
£7.5 billion on 2024/25



NRB frozen at £325k since
2009/10 and to remain frozen
until April 2028

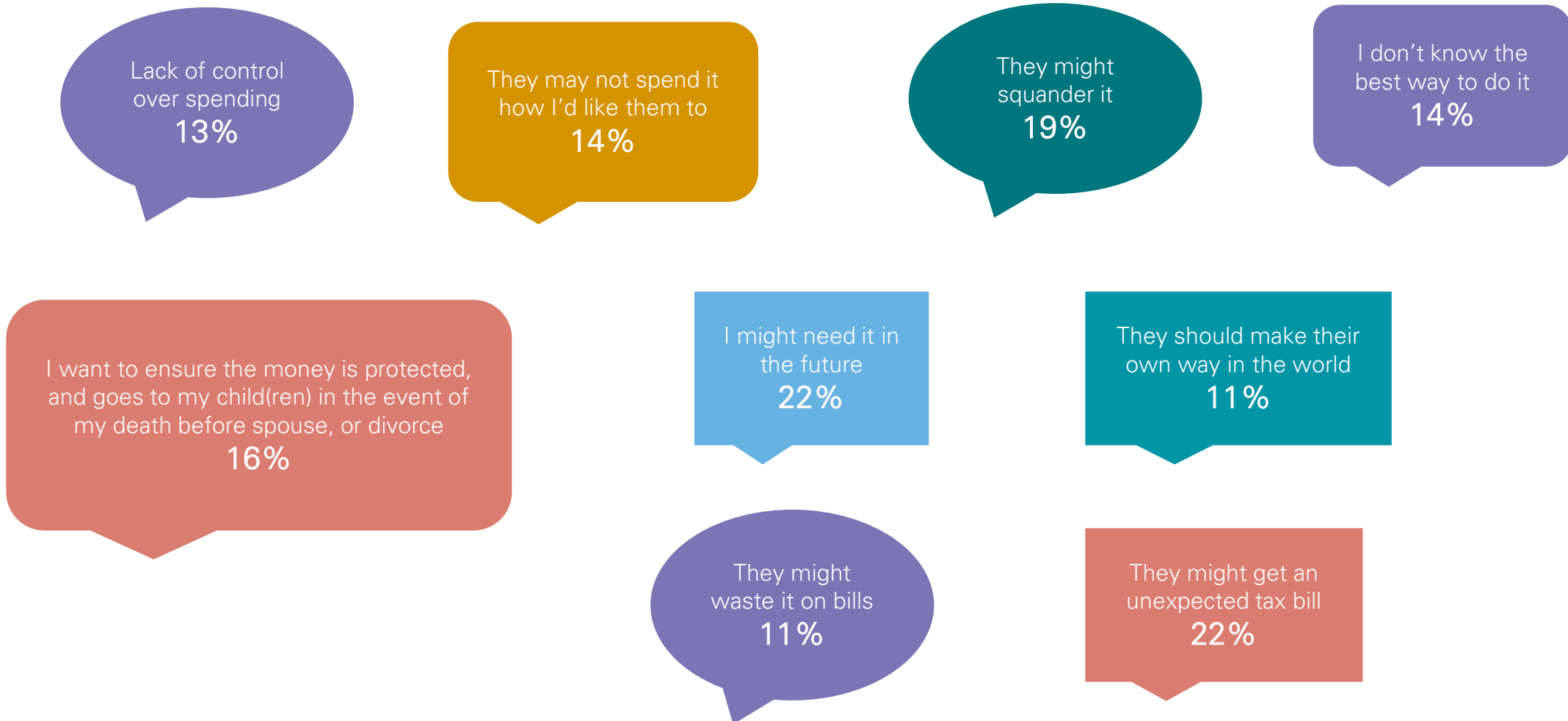


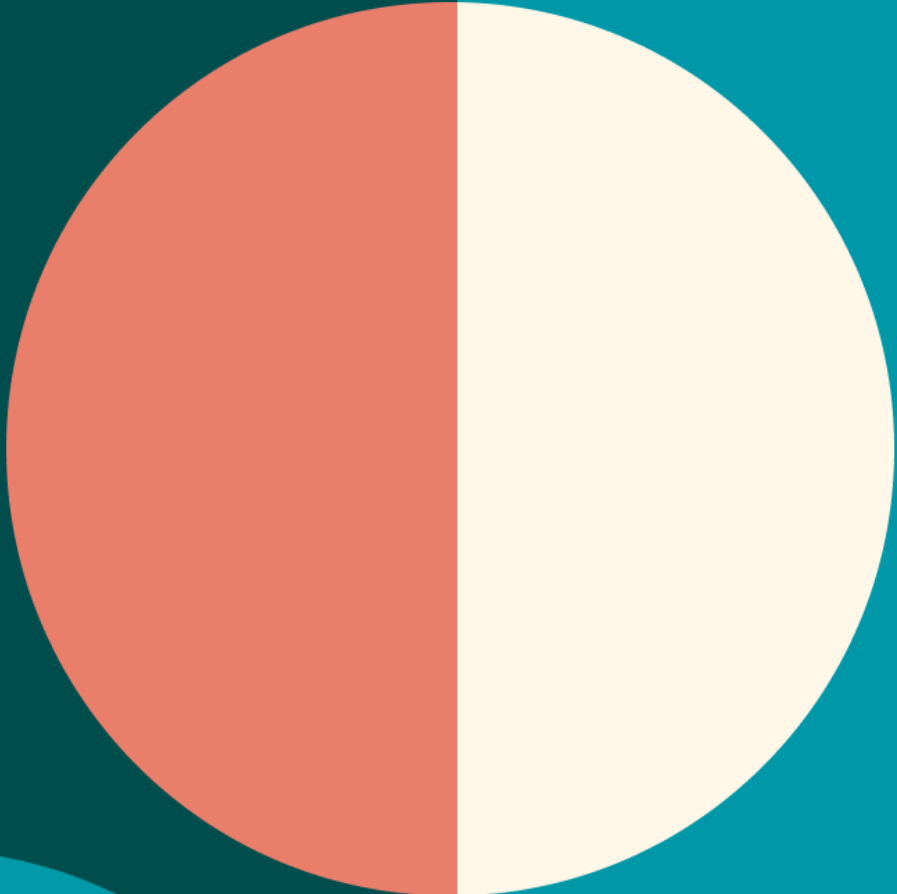
Residence NRB frozen at
£175k since 2020/21 and to
remain frozen until April 2028



House prices have risen by
more than 70% between
2009 and 2022

Why don't clients gift?



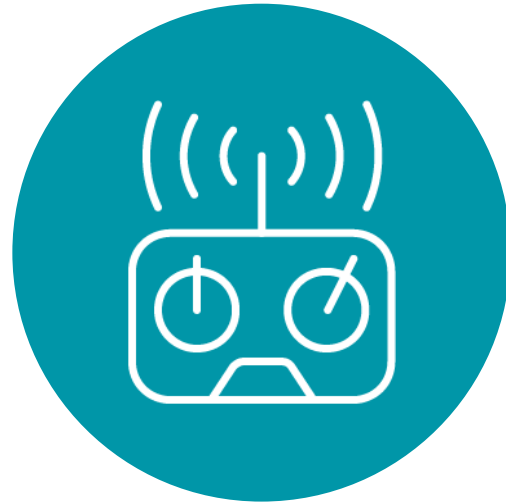


What trust can
help overcome
objections to
gifting?

3 key pillars to selecting the right trust



Access

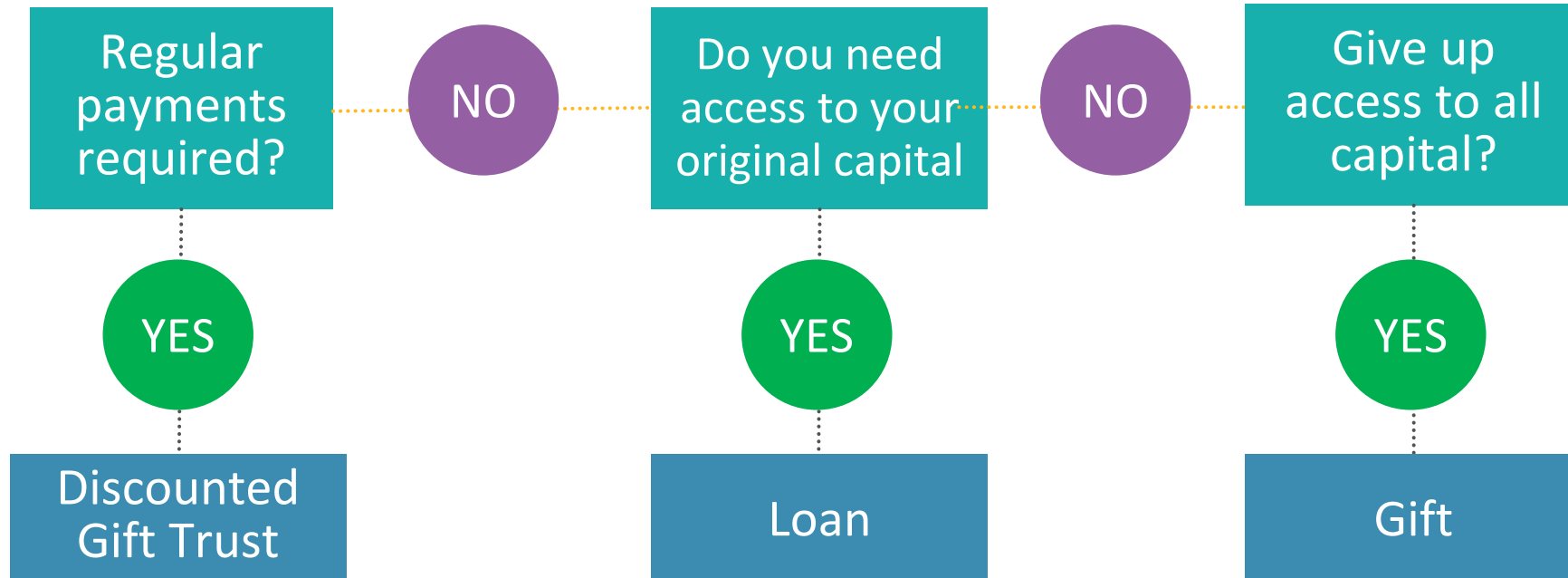


Control



Tax

Access



Access - Settlor cannot get trust fund back

HMRC internal manual

Trusts, Settlements and Estates Manual

TSEM6353 - Legal Background to Trusts and Estates: Settlor decides to cancel a trust

A settlor can revoke a trust, if the original trust document allows this action. The trust is fully valid. It only comes to an end when the settlor fully revokes it.

If the settlor has no power to revoke the trust he must get court approval to cancel the trust. He must satisfy the court that he made the trust as a result of

- fraud, or
- undue influence, or
- mistake.

In these circumstances the trust would be void from its creation.

These situations have different tax consequences.

Control



Absolute (bare)

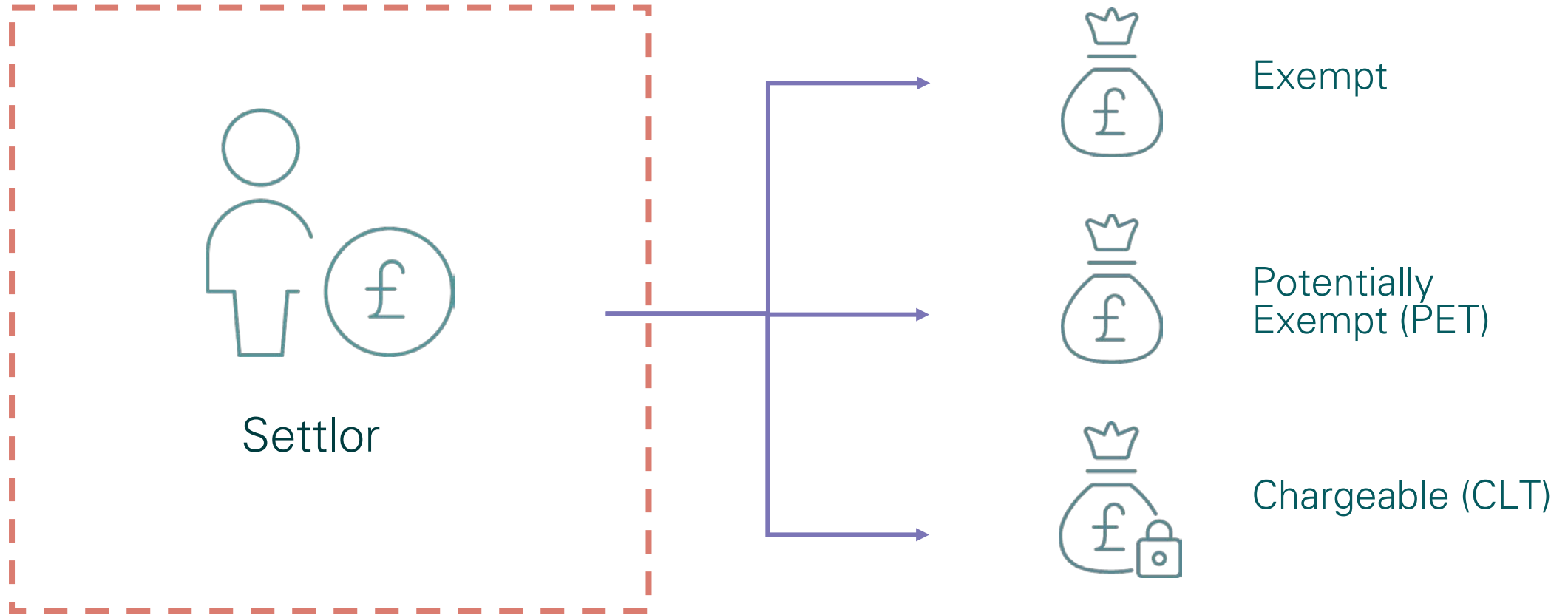
- Beneficiaries fixed at outset
- Trustees control on distribution restricted
- Trust fund in the beneficiary's estate



Discretionary

- Range of beneficiaries
- Trustees have full control over distribution
- Trust fund not in beneficiary's estate

Tax



Tax



Absolute (bare)

- PET (unlimited) for Gift Trust & DGT only
- 7 years before outside settlor's estate
- Trust fund in the beneficiary's estate
- Simple tax regime



Discretionary

- CLT (restrictive) for Gift Trust & DGT only
- 7 years before outside settlor's estate
- Trust fund not in the beneficiary's estate
- Complex tax relevant property regime

Taxation of investments held by trustees also needs to be considered



Gift Trust

Gift Trust



No Access required



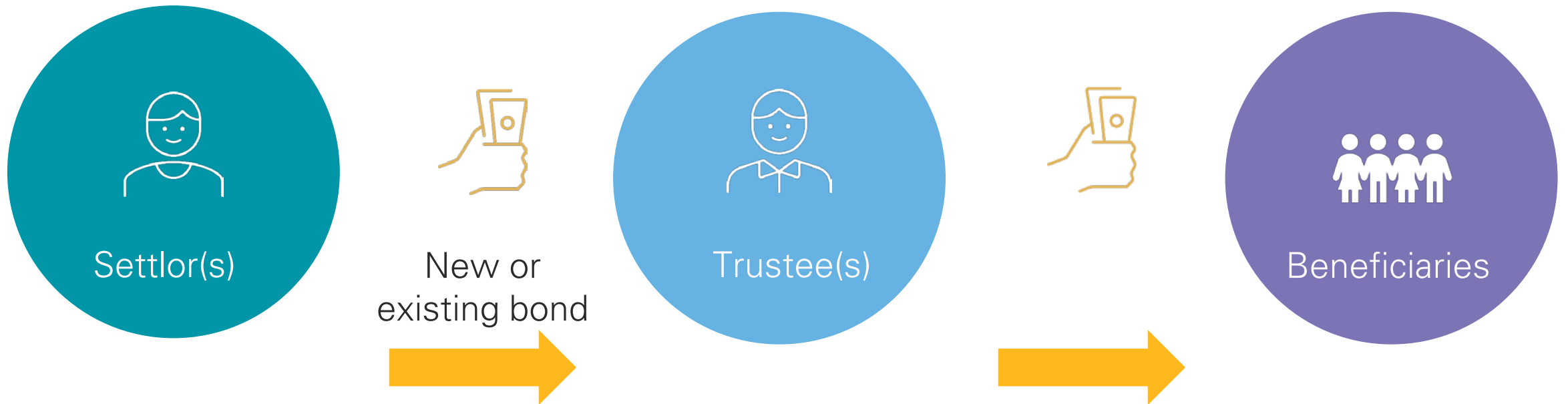
Absolute

Trustees at the order of beneficiary when they attain age 18 (16 in Scotland)

Discretionary

Trustees can make distributions at their discretion

Gift Trust – How is it set up?



Gift Trust – administration

Bond

Distribution to beneficiaries

- Regular withdrawals
- Ad hoc withdrawals
- Tax deferral if withdrawals within 5% tax deferred allowance
- Segment assignment to transfer liability for gains to discretionary beneficiaries



Gift Trust – Key Points



Key Point
Bare – beneficiary unless parental settlement rule applies.
Discretionary – Settlor/Trustee/Beneficiary?

Key Point
Bare – PET (7-year clock)
Discretionary – CLT (7-year clock)
Growth – immediately outside estate

Key Point
The only way to provide trustees with full control over distribution of the trust fund to beneficiaries

Key Point
The settlor is excluded from benefitting (directly or indirectly)

Key Point
The trustees can use the trust fund for the beneficiaries from day 1

Key Point
Generally, only suitable for minor beneficiaries who will take control at age 18 or 16 in Scotland

Non-bare trust bond gain - Who is liable?

Is settlor alive and UK resident?



- Settlor is assessed on the gain
- Top slicing relief may apply
- Statutory right of recovery

No? Then look to the trustees

Is the trust UK resident?



- Trustees are assessed on the gain
- Trustee rates apply
- Top slicing relief does not apply

No? Then look to the beneficiary

Is the beneficiary UK resident?

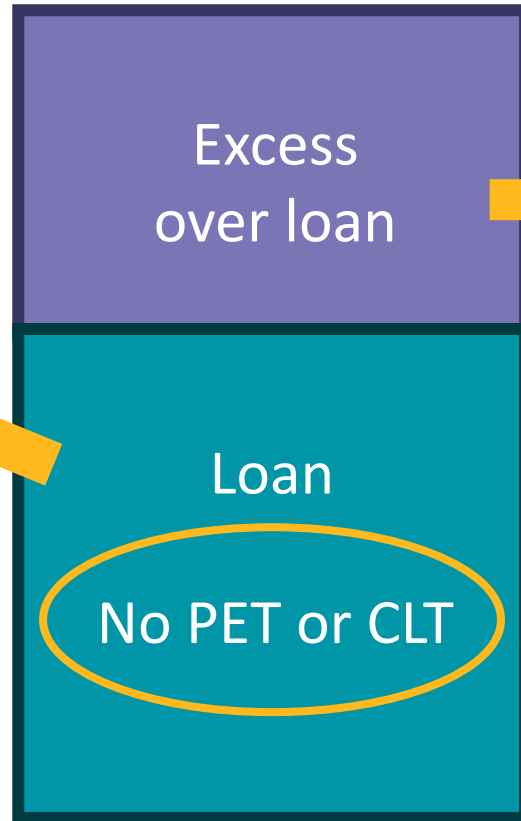


- If beneficiary is UK resident they will be assessed on the gain.



Loan Trust

Loan Trust



Requires access to original capital only

- Regular withdrawals
- Ad hoc withdrawals
- Repayment in full
- No access to trust fund

Absolute and Discretionary

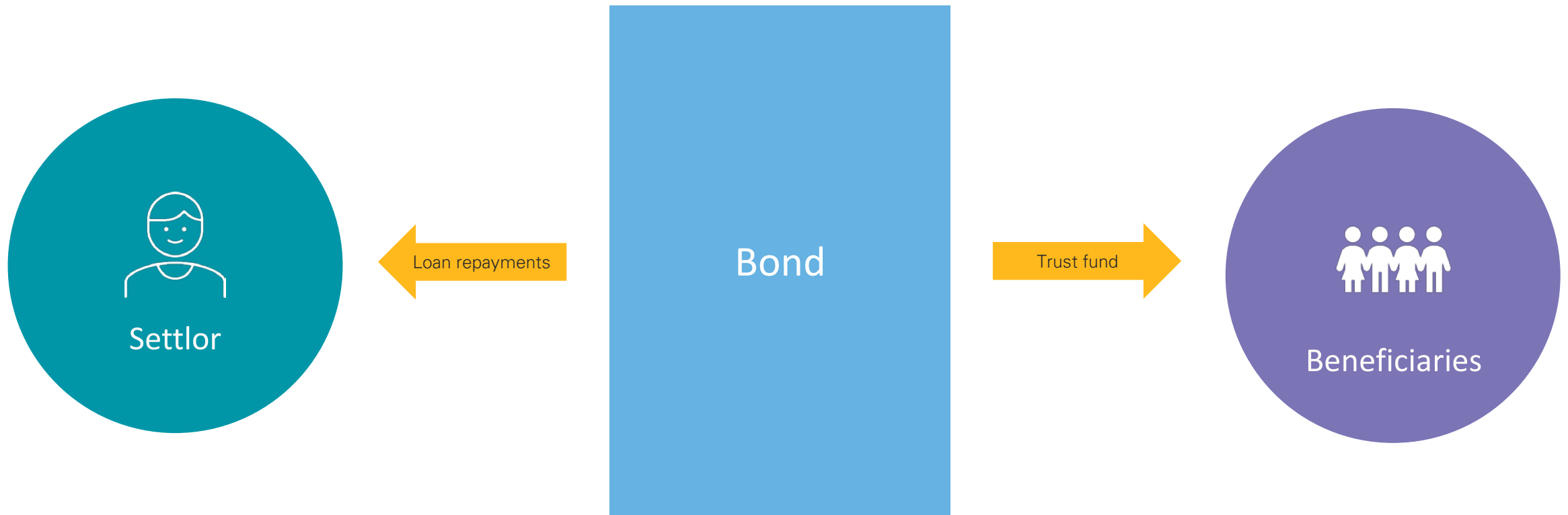
Trustees can distribute excess over outstanding loan

Prudent to retain buffer

Loan Trust – How is it set up?

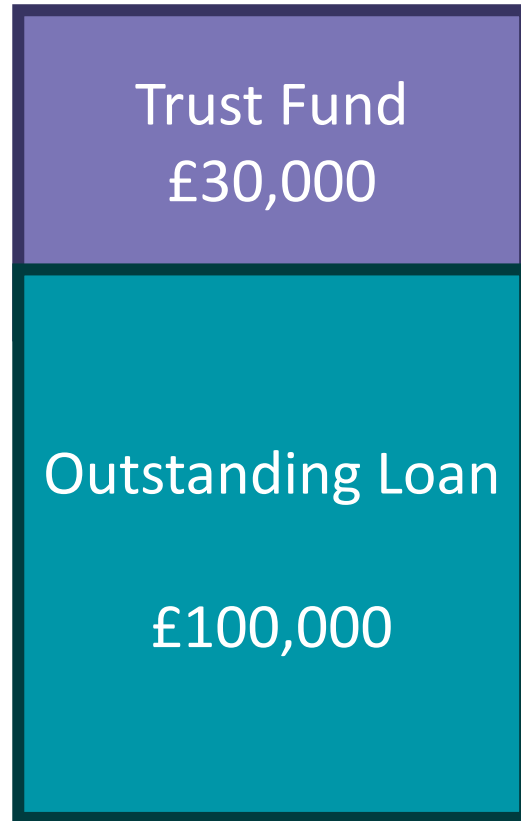
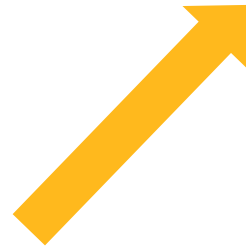


Loan Trust – administration



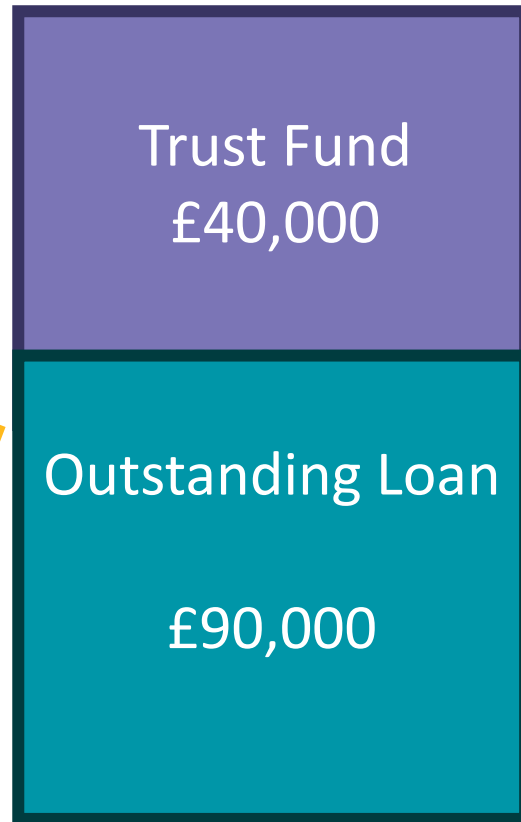
Normal chargeable event rules apply to withdrawals by trustees to repay loan and payments to beneficiaries

Waiving the loan during lifetime



- Roy wants to waive £10,000
- No annual exemption available

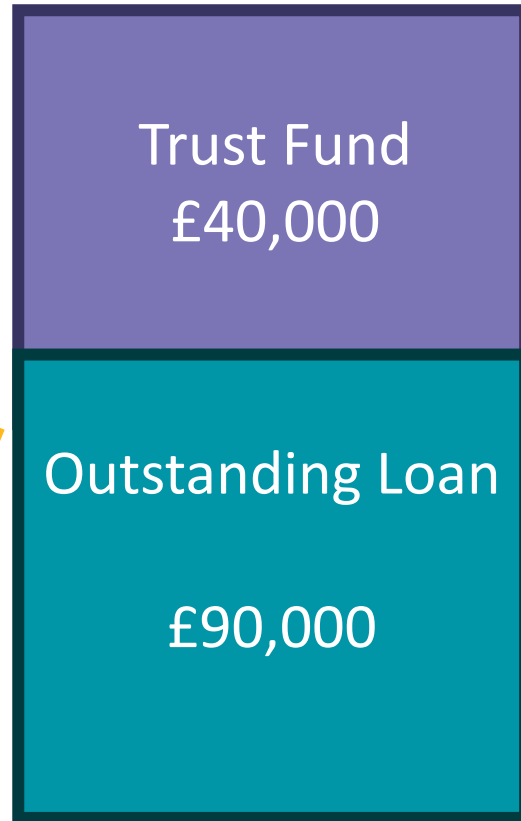
Waiving the loan during lifetime



- Roy's loan reduces by £10,000
- PET or CLT of £10,000

- Trust fund increases by £10,000

The loan on death



- £90,000 in Roy's estate
- Loan repayment to executor?
- Pass loan to estate beneficiaries?
- Chargeable event implications?

Waiving the loan on death



- Option on trust deed at outset?
- Make provision in will?
- Waiving loan will use nil rate band



- Trust fund increases by £90,000
- Trustees can distribute to trust beneficiaries without probate
- Trustees can assign segments to beneficiaries (chargeable event planning)

Loan Trust – Key Points



Key Point
Bare – beneficiary unless parental settlement rule applies.
Discretionary – Settlor/Trustee/Beneficiary?

Key Point
No PET or CLT when lending to trustees
Waiving loan during lifetime PET or CLT?
Growth immediately outside the estate

Key Point
The only way to provide trustees with full control over distribution of the trust fund to beneficiaries

Key Point
The settlor is restricted to repayment of loan capital amount only. No access to trust fund.

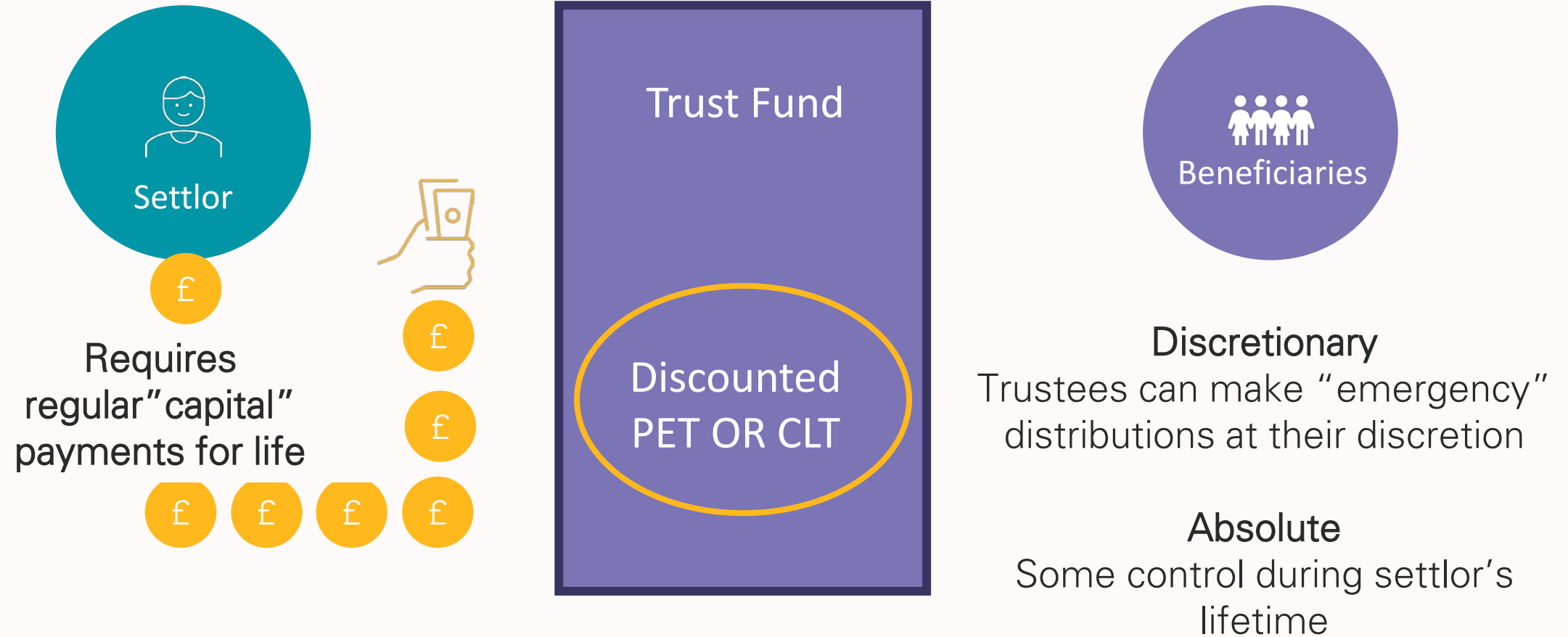
Key Point
Trustees should take care distributing trust funds to beneficiaries while there's still an outstanding loan

Key Point
Beneficiaries entitled when they reach the age of majority, but care is required when distributing to beneficiary while there's still an outstanding loan

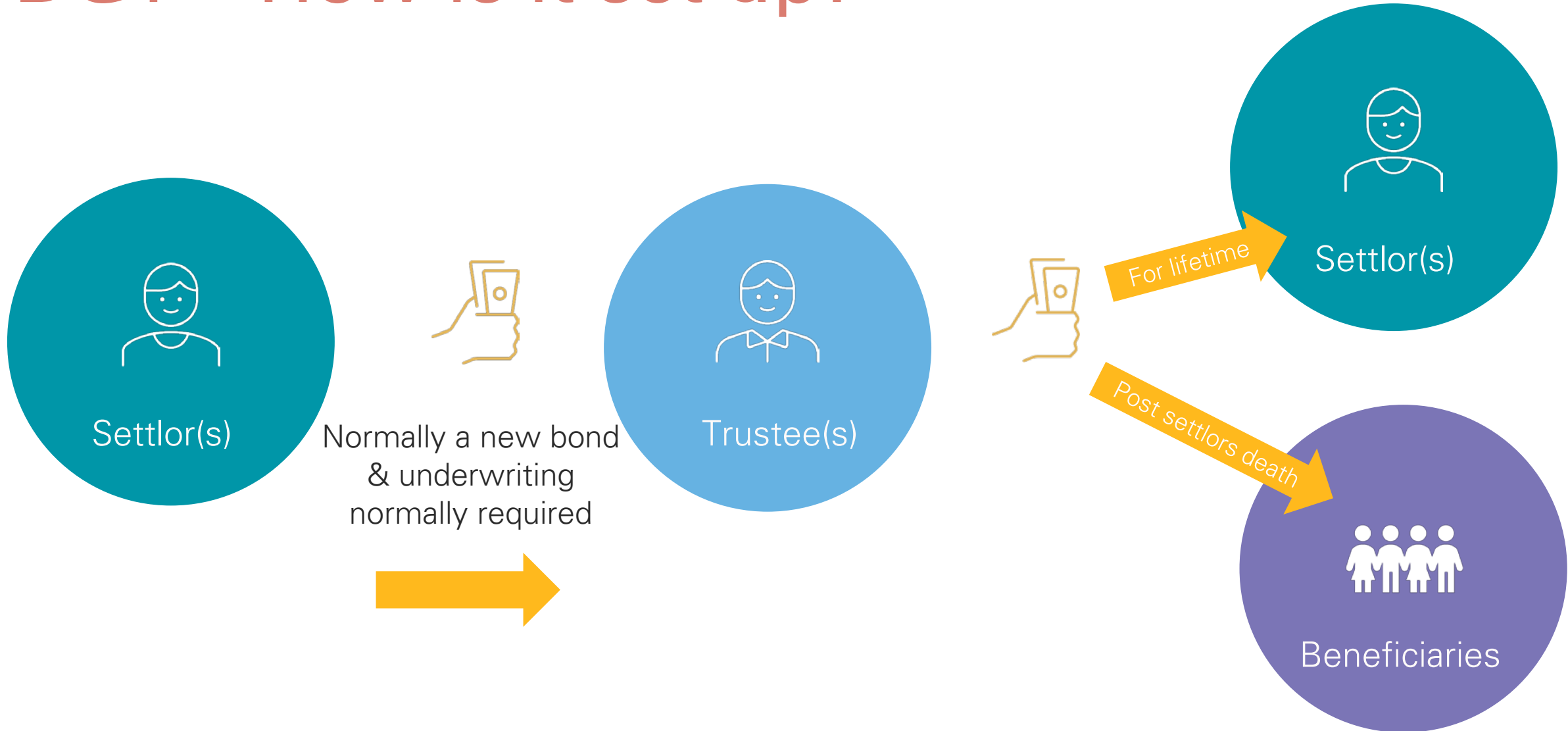


Discounted Gift Trust

Discounted Gift Trust

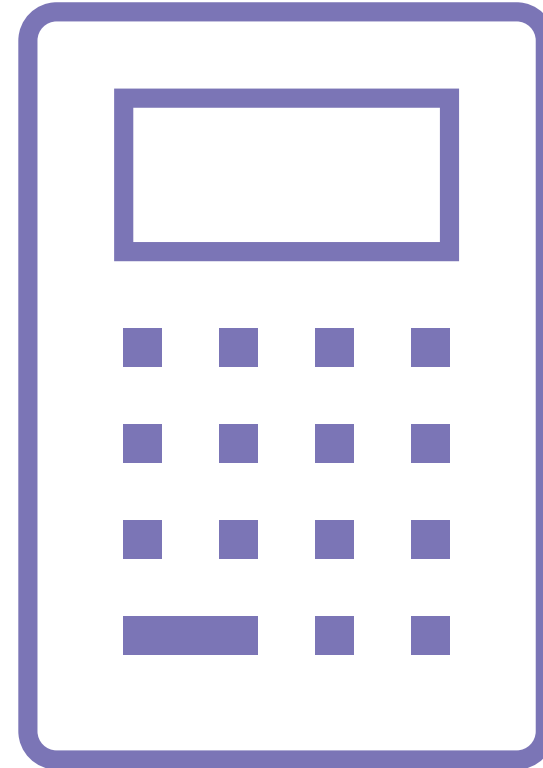


DGT – How is it set up?



The discount (broadly)

- Tom is gifting £100,000 and needs £4,000 p.a.
- Underwriters assess life expectancy to be 10 yrs
- Retained Rights – $10 \times £4,000 = £40,000$
- Discount - $£40,000 / £100,000 = 40\%$
- Transfer of Value (gift) = £60,000



DGT discount calculator

PIB/Discounted Gift Trust - Discount Estimator tool

built by M&G

Product type ?	<input type="radio"/> DGT <input checked="" type="radio"/> PIB	Investment amount ?	<input type="text" value="£ 300000"/>
Tax basis ?	<input type="radio"/> Onshore <input checked="" type="radio"/> Offshore		
Regular withdrawal amount ?	<input type="text" value="£ 650"/>	Withdrawals frequency ?	<input type="text" value="Monthly"/>
No of settlors ?	<input type="text" value="1 Settlor"/>		
Settlor 1 age next birthday ?	<input type="text" value="70"/>		

Discount results

Estimated discount %

25.77%

Estimated gift

£222,700

£77,300 reduction 40% = £30,920 IHT saving

DGT discount calculator

PIB/Discounted Gift Trust - Discount Estimator tool

built by M&G

Product type ?	<input type="radio"/> DGT <input checked="" type="radio"/> PIB	Investment amount ?	£ 300000
Tax basis ?	<input type="radio"/> Onshore <input checked="" type="radio"/> Offshore		
Regular withdrawal amount ?	£ 1875	Withdrawals frequency ?	Monthly
No of settlors ?	1 Settlor		
Settlor 1 age next birthday ?	70		
		Reset to defaults	View results

Discount results

Estimated discount % 71.37%

Estimated gift £85,900

£214,100 reduction x 40% = 85,640 IHT saving

When a larger discount isn't better

	DGT with £650 per month withdrawals	DGT with £1,875 per month withdrawal
Value in estate 7 complete years after making the gift into DGT	£0	£102,900
Value in estate 15 complete years after making the gift into DGT	£0	£220,500

DGTs – Key Points



Key Point

Bare – settlor liable if event triggered by withdrawals to meet settlor's rights
Discretionary – Settlor/Trustee/Beneficiary?

Key Point

PET or CLT might be "discounted"
PET or CLT outside estate after 7 years
Growth – immediately outside estate
Discount can apply 10-year anniversary

Key Point

The only way to provide trustees with full control over distribution of the trust fund to beneficiaries

Key Point

Restricted to fixed payments based on need for capital (not discount) & payable until death. No access to trust fund.

Key Point

Normally after settlor's death or emergency during settlor's lifetime and settlor's rights can be maintained

Key Point

Beneficiaries entitled when they reach the age of majority but a small degree of control while the settlor is still alive



Planning Considerations

Access – Case Study

John & Mary are each looking to gift £150k to address their IHT liability. Neither require access while living, but Mary is slightly concerned she'll have enough money should John die first.

From an "access" perspective which of the following options might be suitable?

Joint Settlor
Discretionary
Gift Trust ❌

2 x Single Settlor
Discretionary
Gift Trusts ✅

John – Gift Trust
Mary - Loan Trust ?

Control – Case Study

Maria (widow) gifts £325k into discretionary gift trust but still has a further £175k she wants to gift. She doesn't want her adult children to benefit yet and doesn't want to incur an entry charge.

From a "control" perspective which of the following options might be suitable?

Absolute Gift Trust as it will avoid an entry charge ❌

Discretionary Gift Trust as she has two nil rate bands ❌

Discretionary Loan Trust ✅

Tax – Case Study

Naya wants to reduce her estate by placing £250k into trust. She expects to have excess income from her final salary pension until death.

From a “tax” perspective if she unexpectedly dies after 8 years which of the following trusts would be the most IHT efficient?

DGT with an immediate discount of 50%



Gift Trust



Loan Trust



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Describe the operation of Gift, Loan and Discounted Gift Trusts

QUESTION TIME



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Last Updated: 5 Jan 24 | 10 min read

LTA Abolition - New allowances: LSA & LSDBA →

Last Updated: 3 Jan 24 | 10 min read

LTA Abolition - Pension Commencement Lump Sums (PCLS) →

Last Updated: 3 Jan 24 | 6 min read

LTA Abolition - Lifetime benefits →

Les recommends

Lifetime Allowance - Abolition from 2024 →

Tax Year End Hub →

6 Apr 23 | 20 min read

Interaction of tax relief and annual allowance →

Events and CPD

15 Feb 24 | 90 min watch

The 7 steps to achieving

Last Updated: 1 Feb 24 | 90 min

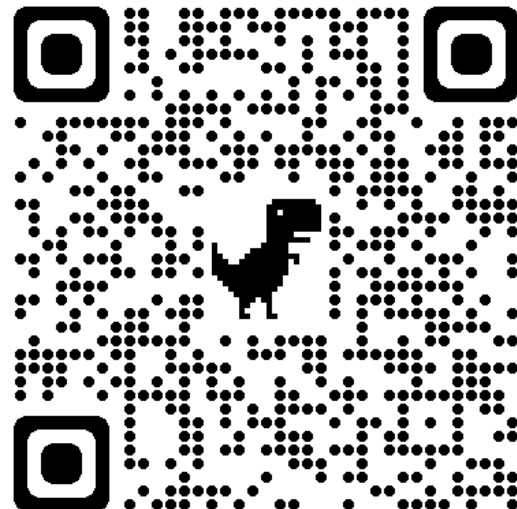
The BIG LTA question – v

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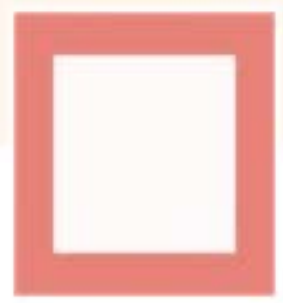
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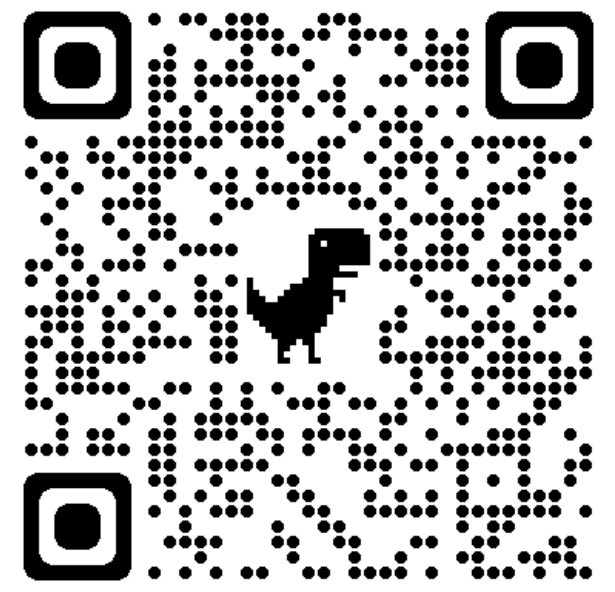


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