

Discounted Gift Trust

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Inheritance tax planning

The Discounted Gift Trust uses an onshore or offshore investment bond, which are types of investment products. Please remember that the value of an investment can go down as well as up and you may get back less than you have put in.

Inheritance tax (IHT) might be called 'the voluntary tax' as there are ways you could reduce it.

Inheritance tax – a tax on personal wealth

IHT is paid if a person's estate (their property, money, possessions and in some cases, gifts) is worth more than a certain amount when they die. This is called the "Inheritance Tax threshold".

The IHT threshold is expected to remain unchanged at £325,000 until April 2021.

In addition, the Government introduced a 'main residence nil-rate band' from the 2017/2018 tax year starting at £100,000, increasing to £175,000 in the 2020/2021 tax year. There will be a tapered withdrawal for estates with a net value of more than £2 million.

This will be available if the deceased's residential property, which has been his or her residence, and is included in the estate, is left to one or more direct descendants on death.

Any unused IHT nil-rate band can be transferred to a surviving spouse or civil partner on your death. This means that the nil-rate band that is available when the surviving spouse or civil partner dies will be increased by the proportion of the nil-rate band that was unused. The main residence nil-rate band will also be transferable where the second spouse or civil partner of a couple dies after 5 April 2017 irrespective of when the first of the couple died.

IHT is charged on the value of your estate above the available nil-rate band at a flat rate of 40% (or 36% if you leave at least 10% of the net value to a charity).

Why use a trust?

Using trustees within a discretionary structure provides flexibility and control and enables those trustees to select which beneficiaries are to benefit and when those benefits are to be provided. There are different types of trust and they vary in relation to how they can be used.

A tax you can legally plan to reduce

Accountants have been known to call IHT 'the voluntary tax' as there are ways you could reduce it. A few simple steps and a little planning could save HM Revenue & Customs (HMRC) potentially becoming your largest single beneficiary.

With the IHT nil-rate band set at £325,000 for tax year 2019/2020 and the average UK property £230,776*, even an average household with some savings, life assurance and property could potentially come within its reach.

* landregistry.data.gov.uk/app/ukhpi
December 2018

This brochure is based on our understanding of current taxation, legislation and HMRC practice, all of which are liable to change without notice. The impact of taxation (and any tax reliefs) depends on individual circumstances.

What can the Discounted Gift Trust do for you?

In this document, we refer specifically to the Discounted Gift Trust. This is a trust that can be used where you want to put a lump sum into trust for your beneficiaries, while retaining the right to a regular payment.

If you wish to know more about trusts, you should speak to a Financial Adviser, a tax expert or a solicitor.

What are the benefits?

The Discounted Gift Trust offers you:

- Tax-efficient regular payments during your lifetime
- The opportunity at outset to choose your payment level and its frequency
- Capital for your family or chosen beneficiaries after your death
- The potential for an immediate reduction in the IHT liability on your estate
- A choice of investment bonds from Prudential and Prudential International
- Diverse investments within these bonds, helping to spread the risk
- Single or joint settlor arrangements
 - if you choose single settlor, then the payment into the trust must come solely from you
 - if you choose joint settlor, then the payment into the trust must be from both of you, for example, joint bank account

The people you choose to be the beneficiaries of the trust may receive:

- Modest amounts of capital, at the trustees' discretion, to help cope with "emergency situations" during your lifetime. The tax consequences of these payments can be complex and substantial. The trustees should seek advice from a financial adviser before exercising this option
- The remaining fund in the trust after your death when the trustees decide

Who is it suitable for?

It may be suitable if you:

- want the potential for immediate and future IHT reduction
- are likely to survive seven years
- want fixed regular payments
- are in reasonable health

It may not be suitable if:

- you are unlikely to have an IHT liability
- you are older than 90 next birthday
- you might change your mind about when you want payments or how much you want back from the trust

Choice of trusts and inheritance tax

The Discounted Gift Trust can be written as either a discretionary trust or an absolute trust, so you can decide which better suits your circumstances.

Discretionary trust

A discretionary trust provides your trustees with the flexibility on who can benefit from the trust assets. If you are currently unsure how you want the trust assets to be distributed, please speak to your financial adviser for more information.

However, depending on the amount you put into the trust, there may be IHT charges during your lifetime as well as at your death. These are explained across the next section. There are also potential requirements to provide details of the trust to HMRC at specified times.

Ongoing Trustee Advice

Prudential will facilitate ongoing adviser charges for advice given to the trustees. In view of the fact that the trustees are not party to the bond application form, the ongoing adviser charge instruction section on the application form must be left blank. Instead, the trustees will need to complete the adviser charge instruction form PIPF10048.

Where Prudential facilitate payment of ongoing trustee advice, then this will be funded by withdrawals from the bond and will impact on the 5% tax deferred allowance. This will not, however, impact on the discount calculation, as that is based on the settlor's payment stream.

Trustees should not pay for ongoing advice given to the settlor as that could be regarded as a reservation of benefit with adverse tax consequences.

For the avoidance of doubt, set up advice charges are the responsibility of the settlor not the trustees, and if Prudential facilitates payment then both the premium invested and the gift into trust will be the lower (net) amount. The trustees do not therefore pay set up advice charges.

For more information, speak to your Financial Adviser.

Inheritance tax

There will be an immediate tax charge if the value of your gift into the trust, together with any other chargeable transfers you have made in the previous seven years, is more than the nil-rate band (£325,000 per individual for the 2019/2020 tax year). An example of a chargeable transfer would be another gift into a discretionary trust or a gift to a company. If there are two of you setting up the trust, you will each have your own nil-rate band.

The immediate tax charge is 20% of the amount above the nil-rate band.

There may also be a periodic charge every ten years. This will be a maximum of 6% of the value of the trust fund, but is likely to be less in many cases. If the trust fund is worth less than the nil-rate band at that time, and you hadn't made any other chargeable transfers in the seven years before setting up your Discounted Gift Trust, the periodic charge would be zero.

Both the immediate and the periodic charges will be based on the "calculated" (discounted) value of the trust fund. This is explained in the section "The discount" on page 7. Where two people set up the trust, the charges will be assessed individually, based on each person's discounted gift and nil-rate band.

The value of the trust fund is not included within the estates of your beneficiaries.

Inheritance tax – on death

If you die within seven years of setting up your trust, the immediate tax charge will be recalculated using the full IHT rate of 40%.

Inheritance tax – exit charges

When money is paid out of the trust to your beneficiaries, either while you are alive or after your death, there may be an exit charge. This is based on the previous periodic charge (or the charge when the trust was set up, if there hasn't yet been a periodic charge), but takes into account the nil-rate band at the time.

If the previous charge was nil, the exit charge will also be nil, even if the value of the trust fund has grown. Where there is an exit charge, the maximum rate that will apply is currently 6%.

Your regular payments are not subject to any exit charge.

Absolute trust

With the absolute trust, you must select both the beneficiaries and their share of the trust fund at the time you set up the trust. The important point to remember about an absolute trust is that you cannot change the beneficiaries or their share of the trust fund once the trust has been set up.

If you are sure of how you want the trust assets to be distributed, this could be the appropriate choice for you.

All capital growth on the trust investment will be immediately outside your estate. The trust itself will not be subject to any periodic or exit IHT charges, although each beneficiary's share of the trust fund will be treated as forming part of their estate.

Currently, details of an absolute trust do not need to be reported to HMRC.

Inheritance tax – survival for seven years

The gift you make into the trust is called a potentially exempt transfer (PET). If you survive for seven years after making the gift it becomes an exempt transfer. This means that the whole of the trust fund, including any capital growth, will be free of IHT at your death.

Inheritance tax – death within seven years

If you die within seven years of setting up your Discounted Gift Trust, your gift becomes a chargeable transfer, which means that there may be an IHT liability. However, this will normally be less than if you hadn't set up a trust, because the value of the gift may be discounted. This is explained in the section "The discount" on page 7.

How does the trust work?

During your lifetime

Discretionary trust version

You apply for your chosen bond asking that it be issued to your trustees. You set up the trust deciding the level and frequency of your payments.

Absolute trust version

You invest a sum of money into your chosen bond, decide the payments you would like from it and then gift the bond to the trust.

Once you have chosen which version of the trust you would like to be written, Discretionary or Absolute, you can then choose how often you would like payments made. This could be:

- monthly,
- quarterly,
- half-yearly, or
- yearly.

Once you have chosen your level of payments, they will be fixed for the rest of your life so it is important to consider carefully how much you might need both now and in the future.

These payments will then be made throughout your life.

If you are setting up the trust with your spouse or civil partner, the payments will be split between you while you are both alive. After the first death, they will be paid to the survivor for the rest of their lifetime.

Following your death your trustees administer the trust fund for the benefit of the beneficiaries. Where you have used the Absolute version the beneficiaries are entitled to receive the trust fund on demand. Where the Discretionary version is used the trust can continue and the trustees can use the fund to benefit the beneficiaries as they see fit.

However, with single settlor trust arrangements, great care is needed if any money is paid to your spouse or civil partner while you are alive. If you were to benefit, directly or indirectly, it would remove the IHT benefits of the trust.

The discount

Because you are entitled to regular payments, the value of your initial gift may be discounted for IHT purposes. This means that the potential IHT liability on your estate may be immediately reduced when you set up the trust.

The discount takes into account the payments you could expect to receive during the rest of your lifetime. This will obviously depend on the level of payments you choose to take – the higher these are, the smaller the amount of money you are actually giving away.

It will also depend on factors such as your age and state of health.

The longer your life expectancy, the more payments you could expect to get, so the discount is likely to be larger. On the other hand, if you are in poor health at the start, the discount may be small and there could even be no discount at all. Your gift is then reduced by the amount of any applicable discount. If you set up the trust with your spouse or civil partner, the total discount will be apportioned between you according to each person's age, state of health and so on.

The discount is important because it is used to determine the value of your gift for certain IHT charges that may arise (see the section "Choice of trusts and inheritance tax" on page 5 for more information). We will give you an indication of the value when you set up your trust, based on medical evidence we have received. It's important to remember the amount of discount we show can change as a result of a review by HMRC or by random sampling. If this were to happen, it would give rise to a further IHT liability.

After your death

After your death, or the second death if it is a joint arrangement, it is possible for the trust to continue, in which case the trustees can make payments to the beneficiaries as and when they see fit.

In the case of a discretionary trust, it is up to the trustees (within the rules of the trust) to decide who to pay the money to. We provide a Statement of Wishes, which you can complete to give an indication of how you would like the trust money to be distributed. This is not binding in any way, but it can provide valuable guidance for your trustees if they are uncertain what you would have wanted.

The Discounted Gift Trust in action

This is just an example designed to represent a typical situation and does not relate to any particular individual. You should not consider this as financial advice or a recommendation of a particular course of action. You should consider your own circumstances fully and may wish to consult a Financial Adviser to help you make a decision. There may be a charge for their advice.

Mrs Brown is a widow, aged 60. When Mr Brown died his IHT nil-rate band was used in full so there was nothing left to transfer to his widow. Mrs Brown has an estate valued at £525,000, which is above her IHT nil-rate band of £325,000, so there is a potential IHT liability should she die. This would be charged at 40% on the £200,000 that is above the nil-rate band, giving a bill of £80,000. There is no residence nil-rate band available.

Mrs Brown currently gets payments from her capital which she relies on. However, she is happy to give away £200,000, as long as she can continue to get payments from it of £10,000 a year. So she puts £200,000 into an investment bond under the Discounted Gift Trust and opts to have annual payments of £10,000, paid quarterly. Her chosen beneficiaries are her two children.

As Mrs Brown is in good health, the discounted value of her gift is calculated to be £67,531. As the remainder of her estate is worth £325,000, which is just covered by the current nil-rate band, it is only the discounted gift that will now be liable for IHT should she die within seven years of making the gift. At 40%, the potential liability is £27,012 instead of the £80,000 it was before – an immediate reduction of £52,988.

Mrs Brown's quarterly payments of £2,500 will continue to be paid for the rest of her life. At her death, the trustees can pay out the remaining capital in the investment bond to her children.

Depending on what kind of trust Mrs Brown chooses, there may be some additional IHT charges, although these are likely to be much less than if she had not set up the trust. More information is given in the section "Choice of trusts and inheritance tax" on page 5.

Income tax

Any income tax liability will depend on the product you have chosen. Please see the relevant client guide, or speak to your Financial Adviser.

Who pays the income tax?

This depends on which type of trust you have chosen.

Absolute trust

Where there is a gain on a surrender or part surrender of the bond an income tax charge arises. Where the gain arises during the settlor's lifetime or in the tax year of death, then the tax position is not clear. We are currently awaiting confirmation from HMRC. Where the gain arises in the tax year after death, then the named beneficiary should be taxable.

Discretionary trust

If you are alive and resident in the UK when an income tax liability arises, or it occurs in the tax year in which you die, it will be treated as part of your income and you will have to pay any tax due. You may recover the tax from the trustees. If it arises after your death (other than in the tax year in which you die), or when you are not resident in the UK, the tax charge will be assessed against UK resident trustees.

Where assessed against UK resident trustees, basic rate applies on gains up to £1,000, where this hasn't already been set against other non-savings income. Otherwise, the tax rate applicable to trusts is currently 45% (tax year 2019/2020) and this will apply in full for a Prudential International bond. For a Prudential bond, the charge takes into account the tax already paid within the bond, regarded as equivalent to 20%, so the trustees will pay the difference between this and the 45% trust rate. The charge will actually be met from the trust fund, rather than by the trustees personally.

You can find out more about the bonds, their charges and tax position in the Key Features document. For more information on the bonds available, see the section "Choose the product" on page 10.

How to set up your trust

Choose the product

The Discounted Gift Trust gives you the following investment options to choose from:

- Prudential Investment Plan
- Prudential Onshore Portfolio Bond
- Prudential International Investment Bond
- Prudential International Investment Portfolio

Prudential Investment Plan and Prudential Onshore Portfolio Bond are Prudential's onshore bonds.

Prudential International Investment Bond and Prudential International Investment Portfolio are Prudential International bonds.

As international bonds, they provide the potential for tax-efficient growth. There is no tax suffered within the fund other than any irrecoverable withholding tax.

Please remember that investing in a bond means the investment can go down as well as up and is not guaranteed. The capital will be at risk and the returns to the trust beneficiaries may be less than the full amount invested.

Tax rules and regulations may change in the future. This item is valid as at March 2019. Your tax position depends on your own personal circumstances.

Further information on your investment choices is given in the guides for each of the bonds available.

Choose the trust

- Absolute: the beneficiaries and their shares of the trust fund are fixed at outset.
- Discretionary: there is flexibility over who benefits, by how much and when.

Choosing your beneficiaries

When you set up your trust, you can specify whom you would like as your beneficiaries.

If you choose an absolute trust, you will also need to specify their shares of the trust fund.

For a discretionary trust, there is a "standard" list, which includes your spouse or civil partner (as long as they are not a joint settlor), your children and any further descendants, and you can add anyone else. The trustees will have discretion over who will benefit from the trust and in what shares, but they may take into account your Statement of Wishes if you have completed one.

Choosing the trustees

The trustees are the people who will manage the trust and have control over the investment. As the settlor, you will automatically be a trustee. If you are setting up the trust jointly, both of you will be trustees. There should be at least two individual trustees or a corporate trustee and you can appoint further trustees if you wish.

The trustees cannot make any changes to your payments, which they must continue to pay to you throughout your life. With a discretionary trust, however, they will have considerable freedom to decide who else is to benefit from the trust, which could continue for some time after your death. So it is important to choose the trustees carefully, so that you can feel comfortable that they will take your wishes into account.

Choose the amount and frequency of regular payments

It is not possible to change the amount or the frequency once the trust is set up, so it is important you give careful consideration to this.

Further information

Your Financial Adviser will give you a personal illustration for each bond within your Discounted Gift Trust, together with a Key Features document describing in more detail how your chosen bond works.

Important notes

Anyone thinking of using the Discounted Gift Trust, or doing anything under the provisions of the trust, must seek and rely on the advice of a suitable tax and trust practitioner. You should take appropriate professional advice before going ahead and the trust declaration form accompanying this brochure is provided for your consideration and use on this understanding.

This is very important for a number of reasons.

- This trust will not be suitable in all cases. Other forms of tax and trust planning may be more suitable in individual circumstances.
- Creating a trust can have tax as well as legal consequences.
- Once a trust has been created it cannot be revoked.

- The trustees have special duties to the settlor(s) and beneficiaries and the misuse of a trust power by a trustee can make him or her personally liable for resulting losses.
- Situations that may involve international or cross-border legal and taxation issues can be extremely complex.
- Tax and trust law can be open to differing interpretations.

Every care has been taken as to accuracy, but it must be appreciated that Prudential, Prudential International and their representatives cannot accept responsibility for loss, however caused, suffered by any person who has acted or refrained from acting as a result of the material published in this brochure or with the use of accompanying trust instruments. Investors must consult their own professional advisers for advice on their own circumstances.

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