The Discretionary Gift Trust

Adviser guide

Adviser Solutions

Fidelity INTERNATIONAL

Contents

IMPORTANT NOTE:
Fidelity Adviser Solutions cannot give advice regarding the legal or tax effects of the Fidelity Adviser Solutions, and will not accept responsibility for any loss occurring from their use. Investors are strongly recommended to seek independent legal advice before completing the trust deed to ensure the Trust meets their needs. Once established, trusts may be difficult to unwind and gifting money or assets into certain trusts will mean you cease to have access to the money or assets.

1 The Discretionary Gift Trust – objectives and suitability

The aim of the draft Discretionary Gift Trust deed is to facilitate effective lifetime inheritance tax (IHT) planning. Potential users of the Discretionary Gift Trust could be:

- new investors contemplating investment in unit trusts, OEICs and/or SICAVs, or already holding such investments, either on the platform or off the platform (in this guide such investments are referred to as "investment funds"*); or
- those investing in, or holding, one or more of the single premium life assurance investment bonds (here called "Bonds") offered via Fidelity Adviser Solutions.

The investor using the Discretionary Gift Trust is called the Settlor. By using the Discretionary Gift Trust with cash intended for an investment, Bonds or a holding in investment funds, the Settlor(s) will be making a gift.

When the gift is of cash, the Trustees will collectively apply for the intended investment(s).

When the intended investment is a Bond, the Trustees will normally make an application for a policy on the lives of the Settlor(s) and/or some of the Beneficiaries on a joint or multiple lives last survivor basis.

The Trust is "discretionary", which means that there is no need to decide at outset which Beneficiary is entitled to receive what. Instead there are several classes of Beneficiary and the Trustees have discretion as to which Beneficiary should receive what, how much and when.

When an asset is made subject to a Discretionary Gift Trust, the gift will be a chargeable lifetime transfer for inheritance tax purposes to the extent that the cash invested (or the market value of the existing investment) exceeds the Settlor's available inheritance tax annual (£3,000) exemption. However, provided the value of the gift is below the Settlor's available inheritance tax nil rate band, no actual inheritance tax charge need arise when the investment is made (see Section 5 for further details).

To ensure that the Discretionary Gift Trust is effective for inheritance tax purposes, the Settlor cannot benefit from the trust assets in any circumstances.

The Settlor can choose whether to include his or her spouse, or registered civil partner, as one of the Beneficiaries. Although this would have no adverse inheritance tax implications, it has important income tax implications. These are covered along with details of the UK tax implications of the Discretionary Gift Trust in Section 5 of this guide.

As well as the important tax benefits, the asset that is subject to the Discretionary Gift Trust will not be an asset of the Settlor's estate for probate purposes which means that, in the event of the Settlor's death, the Trustees can carry on dealing with the investment, without waiting for probate on the Settlor's estate.

To ensure that the asset does not form part of the Settlor's estate for probate purposes, the legal ownership of the investment must be with a person or persons other than the Settlor on his or her death. Therefore, this benefit will only be secured if there is at least one Trustee who survives the Settlor. To satisfy this requirement, under the Discretionary Gift Trust, the Settlor is automatically one of the Trustees and further Trustees are appointed in the trust deed. If any of the additional Trustees retires or dies before the Settlor, a further Trustee(s) should be appointed.

The power of appointing Trustees vests in the Settlor(s) (whilst alive) and then the Trustees. If no additional Trustees are appointed, or they have been appointed and resigned, died or been removed, so that there is no surviving Trustee on the death of the Settlor, the Trust will nevertheless continue to exist.

The personal representatives of the deceased Settlor will assume the role of Trustee under the Trust. This means that, although the trust investments will not be part of the Settlor's estate for inheritance tax or probate purposes, securing probate to the Settlor's estate will still be necessary to ensure that the personal representatives can act as Trustee under the Trust. Clearly then, it is very important that additional Trustees are appointed who are likely to survive the Settlor, so as to ensure that any delays in being able to deal with the trust investments are avoided.

Provided the legal and tax implications of the Discretionary Gift Trust are acceptable to the Settlor, the Trust can be used regardless of whether the gift is to be made by one Settlor or two jointly, e.g. when cash is coming from a joint account of a couple or existing Bonds or investment funds are owned jointly. For inheritance tax purposes, each of the joint Settlors is then treated as a separate Settlor who has created a separate settlement.

2 The Discretionary Gift Trust and inheritance tax planning

Following the changes to the inheritance tax treatment of trusts in March 2006, lifetime inheritance tax planning has been made considerably more difficult. Until 21 March 2006, most lifetime gifts were treated as potentially exempt transfers (PETs) for inheritance tax; now most lifetime gifts into trust are treated as chargeable lifetime transfers. Only outright gifts to individuals and gifts into bare (absolute) trusts, or into trusts for the disabled, are still treated as PETs.

All other gifts to trusts are now treated as chargeable lifetime transfers. However, provided the gift, together with the Settlor's cumulative total of chargeable lifetime transfers in the previous 7 years, does not exceed the inheritance tax nil rate band for the current tax year there will be no tax to pay when the Trust is established.

Other charges to tax may also arise in respect of Discretionary Trusts (see Section 5 for further details), but, again, provided the value of the trust fund is below a certain level, there will be no tax to pay.

To ensure that the Settlor makes an effective gift for inheritance tax purposes, the Settlor must not retain any benefit (actual or prospective) under the Trust. This is the case with the Discretionary Gift Trust, as the Settlor is specifically excluded. The Trust is expressed as being irrevocable, and the only persons who can benefit are those individuals identified as Beneficiaries in the trust deed. The Discretionary Gift Trust is therefore effective for inheritance tax purposes.

The Settlor's spouse may be included as a Beneficiary, if the Settlor so desires, and this, by itself, will not have any adverse inheritance tax implications. However, great care should be exercised if any payments are to be made from the Trust to the Settlor's spouse during the Settlor's lifetime. If, in these circumstances, the Settlor were to enjoy a direct or indirect benefit (for example if the funds were used for common family expenses), the whole Trust could fall within the inheritance tax gift with reservation of benefit provisions, thus making the Trust ineffective for inheritance tax purposes.

*References to the income and capital gains taxation of 'investment funds' in this guide do not apply to offshore funds which do not hold HMRC reporting fund status. Offshore income and gains arising from such funds are taxed under the income tax regime.

Where an investor does require some beneficial access to his or her investment, the Discretionary Gift Trust should not be used. Where an investor is happy that his or her choice of Beneficiary is certain and would prefer to secure PET treatment for his or her gift, the Discretionary Gift Trust will not be suitable but a different type of trust may be. Other trust wordings are available from Fidelity Adviser Solutions for the consideration of professional advisers.

3 The Discretionary Gift Trust – income tax and capital gains tax planning

As the income tax and CGT rules for Discretionary Trusts are quite complex, and depend on who the Beneficiaries of the Trust are, it is important that Settlors are aware of the potential implications before they create the Trust, and choose their Beneficiaries accordingly. Further details of the tax rules are given in Section 5 but the following key principles should be noted.

Income Tax

- For income tax purposes, what matters is whether the Settlor's spouse (or registered civil partner) is included as a Beneficiary – if this is the case, then all trust income is assessed on the Settlor.
- Where the Settlor is assessed it does not absolve the Trustees from being assessed on the same income in the first place. If the Settlor pays a rate of tax lower than the rate of tax for the Trustees, he or she can recover any overpaid tax from HM Revenue & Customs. However, the Settlor must pay to the trustees any tax repayment obtained.

Capital gains tax

Tax on capital gains (CGT) is assessed on the trustees. Trustees have their own annual exemption (normally equal to one half of the personal exemption but reduced in cases where the settlor has created more than one trust), after which they pay CGT at the rates applicable to trust.

4 The Discretionary Gift Trust provisions in detail

For tax purposes, the Discretionary Gift Trust is a discretionary trust. The Trust gives the Trustees power to appoint benefits under the Trust among a wide class of Beneficiaries. No Beneficiary is entitled to any benefit until the Trustees so decide – the ultimate Default Beneficiaries named in the Trust will benefit only if no other appointment has been made by the end of the trust period which is 125 years.

The following is a summary of the key provisions as they appear in the draft Discretionary Gift Trust deed.

Part 1 – Execution of the deed and trust declaration
The deed is executed by the Settlor and the named additional Trustees.

Alternative provisions are applied depending on whether a new investment is contemplated or an existing investment is being transferred to the Trustees. The details of the assets being transferred to the Trust are specified in the Schedule.

Part 2 – Definitions
In this part of the Trust deed the terms used throughout the Trust are defined to avoid repetition. The most important definitions are those of the Discretionary Beneficiaries and the Default Beneficiaries.

The **Discretionary Beneficiaries** are those in favour of whom the Trustees may make appointments of benefits. They include the widow, widower or surviving registered civil partner of the Settlor, the children and the remoter issue of the Settlor, their spouses, the brothers and sisters of the Settlor, and their issue, anybody who would benefit from the estate of the Settlor on the Settlor's death, any person nominated in writing to the Trustees by the Settlor, as well as any charity. The Settlor can add any other individual not covered by the standard wording.

The Settlor can choose whether to include his or her spouse, or registered civil partner, which will have important income tax implications if the investments of the Trust are investment funds – see Section 3 above. In the case of joint Settlors, if the spouse or registered civil partner is already a Settlor, he or she cannot, by definition, be a Beneficiary. The class of Discretionary Beneficiaries is therefore very wide and can be added to by the Settlor – all that is necessary is a written notification to the Trustees. However, the Settlor him or herself cannot be added to the class at any time.

The **Default Beneficiaries** are the individuals who will benefit if the power of appointment is not exercised by the Trustees by the end of the trust period (i.e. 125 years from the time the Trust is created). They are named by the Settlor in the trust deed. At least one person must always be named and, if more than one is named, the shares in which they are to benefit must be stated. This is necessary to ensure the Trust is valid. It is essential that, where more than one Default Beneficiary is appointed, the cumulative shares add up to exactly 100%, else adverse tax consequences may arise to the Trust.

Part 3 – Principal trust terms
In this part **the power of appointment** is defined as well as **the default entitlement** if the power of appointment is not exercised.

As previously indicated, the power to appoint capital and income under the Trust is vested in the Trustees. The power is exercisable at the Trustees' discretion and includes the power to appoint further trusts in favour of Beneficiaries.

The Trustees have power to accumulate any trust income throughout the duration of the trust period of 125 years. The Trustees may need to consider opening a trust bank account if investment income is received.

In default of appointment by the end of the trust period the Default Beneficiaries will benefit.

There is also a special provision dealing with any potential conflict of interest. In many cases, the Trustees of the Trust would be family members who would also be Beneficiaries under the Trust. If an appointment of benefits were to be exercised in favour of a Beneficiary who is also a Trustee then a suspicion of conflict of interest could arise. For this reason, there is a provision in this Trust which states that if a Beneficiary is also one of the Trustees, the Trustees can only make an appointment in favour of that Beneficiary if there is at least one other Trustee who does not benefit directly or indirectly from the appointment being made.

Should there be a desire to appoint benefits in favour of the Settlor's spouse, or registered civil partner (who has been included as a Beneficiary) whilst the Settlor is alive, and the Settlor's spouse is a Trustee, he or she could not be a party to this decision and would have to resign before the appointment was made. It should be appreciated that an appointment to the Settlor's spouse whilst the Settlor is alive may give rise to adverse inheritance tax implications.

The Trustees have wide powers included in the Trust to advance capital from the trust fund to Beneficiaries and to make loans to Beneficiaries.

Part 4 – Administrative powers
The Trustees have wide administrative powers to deal with the trust fund and to reinvest the proceeds of any investment in any way they wish. They also have the power to borrow funds, to make payments to parents or guardians of minor Beneficiaries and to delegate certain powers.

Part 5 – Appointment, dismissal, retirement, and remuneration of Trustees
The Trust contains comprehensive provisions applying to the Trustees.

The power to appoint new or additional Trustees is vested in the Settlor during his lifetime and after his death in the Trustees. The Settlor also has power to dismiss any Trustee, provided at least one Trustee, other than the Settlor, remains after such a dismissal.

There is no power to dismiss a Trustee after the death of the Settlor, and it must be remembered that Trustees under this trust subject to the law of England must act unanimously.

If two persons are joint Settlors, they exercise their powers jointly during their joint lives and, after the death of the first of them, the survivor exercises the Settlor's powers alone.

There are also powers dealing with the retirement of Trustees and corporate trustees.

Professional Trustees are permitted by the trust deed to charge normal professional fees.

Part 6 – Further trust provisions
These mainly deal with the Trustees' liability in relation to the Trust. The liability of individual Trustees is limited so that they will not be held liable for any loss to the trust fund, provided they act in good faith. Trustees who are paid for their services are also liable for negligence. The Trustees are permitted to take part in transactions and Trustees' decisions in which they have a personal interest.

Part 7 – The Governing Law
The Trust is governed by the law of England.

5 The UK tax implications of the Discretionary Gift Trust

In the following section, it is assumed that the Settlor, the Beneficiaries and the Trustees of the Trust are UK resident and domiciled. Special rules apply where this is not the case and appropriate professional advice should be sought. This section is only intended to provide a brief guide to taxation and precise taxation treatment will depend on types of trust investments and the tax circumstances applicable to an individual trust arrangement.

Inheritance Tax

Establishment of the Trust

- For inheritance tax purposes a transfer of value (a gift) takes place at the time the Trust is created, and if further amounts are added to the Trust.
- Where there are two Settlors, each is treated as making a gift in proportion to the amounts actually transferred.
- When a new investment is to be made subject to trust with cash given to the Trustees, the value transferred will be the cash gift.
- When an existing Bond is made subject to trust, the value of the gift will be the value of the Bond or the amount of the premium originally paid, if greater.
- When existing investment funds are made subject to trust, the value of the gift will be the value of the shares or units at the time of the gift. The inheritance tax implications will be otherwise as set out above.
- If the amount of the transfer exceeds the Settlor's available inheritance tax annual exemption, currently £3,000 for each Settlor (£6,000 maximum for each Settlor if the exemption for the previous tax year has not been fully used), it will be a chargeable lifetime transfer for inheritance tax purposes. This means that a potential liability to inheritance tax, at the lifetime rate of 20%, may arise immediately if the value of the gift plus the value of all other chargeable lifetime transfers made by the Settlor in the previous 7 years, exceeds the inheritance tax nil rate band available at the time the Trust is established. A further tax liability (a further 20%) on the gift could arise if the Settlor (or, where appropriate, either of the Settlors) dies within 7 years of making the transfer although inheritance tax taper relief will be available if the Settlor survives for at least 3 years. On the Settlor's death within 7 years of making the gift, the full value of the gift will also be taken into account in determining the inheritance tax liability on the Settlor's estate.

Additions to the Trust by the Settlor

- Any additional premium paid by the Settlor into a Bond or any additional amount paid to an investment fund held by the Trust will be a further gift and the tax implications will be as described above for the initial gift.
- Additional investments into the Trust can also have an impact on the periodic and exit charges (see below).Death of a Beneficiary.
- As no Beneficiary is actually entitled, or deemed to be entitled, to anything until the Trustees make an appointment, the death of a Beneficiary has no inheritance tax implications for this Trust.

Death of the Settlor

- On the death of the Settlor (or, where appropriate, either of the Settlors), the value of the trust investments will be outside the Settlor's estate for inheritance tax purposes. There may however be further inheritance tax consequences on death within 7 years as described above.

Inheritance tax whilst the Trust is in existence
As this is a discretionary trust, this means that special inheritance tax charging rules apply. Under these rules there may be inheritance tax charges:

- on every ten-year anniversary of the trust – "the Periodic Charge"; and
- whenever property leaves the trust (e.g. when capital is advanced to a Beneficiary) – "the Exit Charge".

The Periodic Charge
Periodic charges at ten-yearly intervals may be applied to the value of the assets in the Trust. The rate of inheritance tax charged will be determined based on an assumed transfer by an assumed transferor. This will mean that it will be necessary to take account of:

- the value of the property in the Trust on the ten-year anniversary and any sums paid out of the Trust in the 10 years prior to the anniversary (the assumed transfer); and
- the Settlor's cumulative total immediately before he or she made the Trust, including any transfers to related settlements and same-day additions (the cumulative total of the assumed transferor).

Any excess amount over the then inheritance tax nil rate band applicable to the trust will suffer a periodic charge to inheritance tax at an effective rate of 6%.

Example

Nick creates a Discretionary Gift Trust in November 2017 by investing £300,000 in an OEIC with Fidelity Adviser Solutions. He has made no chargeable transfers in the previous 7 years. No payments are made out of the Trust in the first 10 years. In November 2027 the trust fund (i.e. the value of the shares in the account) is worth £450,000 and the inheritance tax nil rate band applicable to the trust is £400,000. The inheritance tax charge will be calculated as £50,000 @ 6% = £3,000. This equates to 0.66% of the total value of the trust fund.

The Exit Charge

Exit charges will be based on the value of property leaving the trust or being appointed absolutely to a Beneficiary. The calculation process can be complex and in addition to taking account of the actual values within and the exiting trust may also need to take account of related settlements and same-day additions. The maximum rate of charge is currently 6% (as for the periodic charge) but will often be lower or nil.

Simplistically, exit charges within the first 10 years will be nil if the value of the initial chargeable lifetime transfer (before applying any inheritance tax exemptions or reliefs) going into the Trust (including the cumulative total of the Settlor's chargeable transfers in the seven years prior to creating the Trust and the value of any added property) is below the IHT nil rate band available to the trust at the time of the property leaving the Trust. If an exit charge does arise, it will increase according to the number of quarters that have expired since the Trust was created.

The amount of any exit charge occurring after the first 10 years will depend on the rate of tax charged at the last ten-year anniversary periodic charge (if any) and the length of time (in quarters) that the property has been in the Trust since the last periodic charge. Simplistically, if there was no charge at the previous ten-year anniversary, (and there has been no added property) there will be no exit charge.

Joint Settlors

If there are joint Settlors who have contributed the Trust is effectively treated as two separate trusts, each settled by one Settlor, in proportion to the amounts settled for all inheritance tax purposes. Inheritance tax calculations are then applied to each of the settlements. So for example if each Settlor originally contributed equally to the trust, the trust fund would effectively be divided in two equal parts for the purposes of calculating the ten-year periodic charge and any exit charge.

Capital Gains Tax

Creation of the Trust

When existing investment funds are transferred to the Discretionary Gift Trust, this will be a disposal for CGT purposes. The gain will be calculated in the usual way and, subject to the Settlor's available CGT annual exemption taxed at the tax rate applicable to individuals for taxation on capital gains.

However, as the transfer to a discretionary trust is also a chargeable lifetime transfer for inheritance tax purposes, any chargeable gain can be held-over, i.e. deferred, until a subsequent disposal by the Trustees. Hold-over relief is not available if the Settlor's spouse, registered civil partner and/or dependent children can benefit from the Trust. The rules for Hold-over Relief can be complicated and individual advice should be sought relevant to the circumstances.

There are no CGT implications if a Bond is transferred to a trust, unless the transferor is not the original owner of the Bond and the Bond had been acquired for a monetary value.

Trust capital gains

- Tax on capital gains (CGT) is assessed on the trustees. Trustees have their own annual exemption (normally equal to one half of the personal exemption but reduced in cases where the settlor has created more than one trust), after which they pay CGT at the rates applicable to trust.
- Hold-over Relief may be available to allow the trustees to transfer assets to beneficiaries – or other trustees in certain circumstances – without paying Capital Gains Tax. The recipient usually pays the tax when they sell or transfer the asset. The rules for Hold-over Relief can be complicated and individual advice should be sought relevant to the circumstances.

Income Tax

The income tax implications of the Trust depend on whether the asset held by the Trustees is a Bond or investment funds.

Chargeable event gains under a Bond

- **During the Settlor's lifetime or in the tax year in which the Settlor's death occurs**

  For income tax purposes, any chargeable event gains arising under the Bond will be assessed on the Settlor provided the Settlor is, or was, UK tax resident during the tax year. If there are joint Settlors, each will be assessed on the gain in proportion to the amounts he or she actually transferred into the Trust.

  If the Settlor becomes non-UK resident any chargeable event gains arising in a tax year following that in which the Settlor moved abroad will be assessed on the UK resident Trustees at the rate of tax for trusts, less a 20% tax credit if the Bond was issued by a UK insurance company. If there are no UK resident Trustees, special rules exist to tax UK ordinarily resident Beneficiaries when they receive benefits from the Trust – specialist advice should be sought if this applies.

- **After the end of the tax year in which the Settlor's death occ**

  Following the Settlor's death, any chargeable event gains arising in a tax year after that in which the Settlor died will be assessed on UK resident Trustees at the rate of tax for trusts. A 20% tax credit will apply if the Bond was issued by a UK life assurance company.

  If the Trustees are non-UK residents, there are special rules to tax UK Beneficiaries when they receive benefits – specialist advice should be sought if this applies.

Income arising to the Trustees from investments in investment funds

If the spouse or registered civil partner, of the Settlor is excluded from benefit under the Trust, then for income tax purposes, the Trustees are assessed to income tax on any trust income at the relevant rate applicable to trusts according to the type of income.

Where income is to be distributed to a Beneficiary, the Trustees must first have paid the relevant income tax on it.

The Beneficiary will be taxed on the income received from the Trust, grossed up to take account of any tax credit in respect of tax paid by the Trustees. Where the Beneficiary pays a rate of tax lower than the rate of tax for the Trustees, a tax reclaim may be made.

If the Beneficiaries include the Settlor's minor, unmarried children, who are not in a registered civil partnership, and any income actually paid to such a child, or for his or her benefit, will be assessed to tax on the Settlor, if this income, and income from all other gifts the Settlor has made to or for the benefit of that child, exceeds £100 gross in a tax year. The £100 p.a. gross limit is per Settlor, per child, per tax year.

If the spouse, or registered civil partner, of the Settlor is **included** as a Discretionary Beneficiary, all trust income will be treated as income of the Settlor. However, the Trustees will still be liable at the trust rates. If the Settlor pays a rate of tax lower than the rate of tax for the Trustees, he or she can reclaim any excess tax paid by the Trustees. However, the Settlor must pay to the trustees any tax repayment obtained.

6 Notifying HMRC about a discretionary trust

Income tax and capital gains tax

HMRC operates an online Trusts Registration Service for trustees. This has replaced the previous paper based 41G(Trust) form and the ad hoc process for trustees to notify changes in their circumstances. Also, trustees must ensure and confirm the Trust Register is accurate and up to date, guaranteeing their obligations under Money Laundering Directives are complied with. Any new trusts with a UK tax consequence will be required to use the registration service to obtain a unique taxpayer reference (UTR). The requirement to register online includes those trusts that have already registered with HMRC using the 41G(Trust) form. Trustees must update the register each year that the trust generates a UK tax consequence.

You should consult the relevant guidance from HMRC for details concerning the requirement to register and report your individual trust as appropriate to the circumstances of that trust.

Inheritance Tax

HMRC Inheritance Tax – does not automatically need to know when a new trust is set up, but they do need to know when a trust incurs an Inheritance Tax charge or if the intital transfer in or periodic valuations or exit amounts exceeds certain limits. There are differing rules dependent upon the type of asset being transferred and reference should be made to the guidance notes issued by HMRC.

7 Further information

This guide should be read in conjunction with the literature available for the relevant investment contracts to be held within the Discretionary Gift Trust.

Tax rates and allowances quoted are those for the tax year to 5 April 2025.

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