

# Discounted gift trust reporting requirements

**For advisers only.  
Not for use with customers.**

For UK Inheritance Tax (IHT) purposes, a lifetime transfer that is not to an individual is almost always a chargeable lifetime transfer (CLT). Since 2006 transfers into most lifetime trusts such as a discretionary discounted gift trust (DGT) by a UK domiciled or “deemed” UK domiciled individual is a CLT. There are certain circumstances where CLTs need to be reported to HM Revenue and Customs (HMRC).

There will always be a requirement to report the creation of a discretionary trust to HMRC where the creation of the trust triggers an immediate IHT liability. An IHT liability will arise where the value of the CLT into the trust exceeds the settlor’s available nil rate band (NRB) at the time of transfer. Where the Settlor’s available NRB is exceeded, the excess amount is subject to an IHT charge at lifetime rates of 20% and this results in the trust being reportable to HMRC.

**Note:** If the IHT entry charge is paid by the settlor the rate is grossed up and a rate of 25% is applied as the tax payment is deemed to be a further gift by the settlor.

Even where no charge is triggered, a report may still have to be made to HMRC. The purpose of this guide is to identify those situations where the establishment of a discretionary trust needs to be reported, specifically in the context of a DGT.

## What are the current rules for reporting chargeable transfers?

It is the settlor’s responsibility (with appropriate tax advice) to report and pay any tax due on the CLT. However, the trustees can take on this responsibility on behalf of the settlor.

It is not necessary to deliver a return where there is an **excepted transfer**. Where the CLT is made on or after 6 April 2007, it is an excepted transfer where:

- The transfer value is attributed **to cash or quoted shares and securities**, and the aggregate of the value of the transfer together with chargeable transfers in the previous 7 years does not exceed the IHT NRB; or

- The aggregate of the value of the transfer together with chargeable transfers in the previous 7 years does **not exceed 80% of the NRB** and the value of the value transferred by the current transfer (ignoring any reliefs such as business property relief or agricultural property relief) does not exceed the available net NRB.

## Guidance from HMRC

HMRC take the view in their guidance note **IHTM06105 – Excepted transfers and terminations – value transferred attributable to insurance linked products** that for insurance linked products, the value transferred will be attributed to cash, if:

*‘the client makes a transfer of cash to an insurance company and the insurance product and trust documentation are all completed at the same time and the policy is placed into trust at outset.’*

Therefore, where this is the case and the premium paid to the insurance company for an insurance based product does not exceed the NRB (including any other CLTs in the last 7 years), no report is required to be made to HMRC.

However, if the insurance linked product is already in existence, which is then placed into trust, this is treated as a **transfer other than cash/quoted shares and securities**, then the 80% of the NRB limit should apply instead for CLT reporting purposes (i.e. £325,000 x 80% = £260,000).

As a result, even if the amount of the transfer is within the client’s available NRB, if it exceeds £260,000 (including CLTs in the last 7 years), a report will need to be made to HMRC.

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In the context of a DGT, HMRC have confirmed that the value transferred is the amount computed **after the available discount** has been deducted and not the amount of the transfer into the trust.

#### *Example*

If after successful medical underwriting there was a 50% discount on a £500,000 investment into an insurance based product using a DGT, the CLT for IHT would be £500,000 x 50% = £250,000.

The following are two scenarios which highlight when a transfer may be an excepted transfer:

#### **Scenario 1 - [A New Policy]:**

Susan Knight is 70 years of age and wishes to invest £700,000 into a DGT. Susan has not made any CLTs in the past seven years.

Susan wishes to take capital repayments from her trust based on 5% per annum of her initial investment, payable on a monthly basis in arrears.

Susan completes an application for an insurance based product in conjunction with the DGT and sends this to FPIL. After her life has been successfully underwritten, her policy is automatically issued under trust and the value of her gift for IHT purposes is deemed to be £319,035.

As the policy was not in existence and the transfer consists of cash only, the transfer will be an excepted transfer. This is because the discounted value of Susan's gift is below the current NRB of £325,000 and she has made no other CLTs within the past seven years. As a result, the establishment of the trust does not need to be reported. Furthermore, the creation of the trust does not trigger an immediate IHT charge.

#### **Scenario 2 - [An Existing Policy]:**

This case is different as the Settlor completes the DGT Settlement Deed with the intention of assigning an existing policy into the trust. As the transfer does not consist entirely of cash/quoted shares or securities, i.e. a life insurance policy, it is not just a case of whether the gift is below the settlor's available NRB:

Robert Jenkins has held a single premium policy with FPIL for approximately five years. The policy was established with an initial premium of £350,000. Robert is concerned about his future IHT liability and after taking advice from his financial adviser, he decides to place his policy under the DGT. Robert has not made any CLTs in the previous seven years.

Robert completes the DGT deed and sends this together with his medical questionnaire to FPIL. Underwriting confirm that Robert is deemed to be in good health and that in their opinion, a discount of 38.7% would apply. The discount is based on his age of 75 and a capital repayment rate of 5% per annum paid monthly in arrears. The calculation of the discount would be based on 5% of his total premiums paid and not the surrender value of the policy. This is essential to ensure that withdrawals are kept within the cumulative 5% rule for chargeable event purposes. However, once the discount has been calculated, it is then applied to the surrender value of the policy as of the date it is transferred into the trust. The current surrender value of Robert's policy is £370,000 which means that after you apply the discount, the value of his discounted gift into the trust would be £226,810.

Since this figure is below 80% of Robert's available NRB, the establishment of the trust does not need to be reported to HMRC. Furthermore, there is no immediate charge to IHT.

#### **Reporting deadlines**

Where a CLT is not an excepted transfer, it must be reported to HMRC.

For a lifetime transfer the IHT return is strictly not required until 12 months after the end of the month in which the transfer takes place. However, interest on overdue tax, if applicable, runs from earlier dates, so returns should be submitted accordingly.

The normal deadline for payment of IHT on CLTs is:

- 30 April (in the following year) where the CLT occurs between 6 April and 30 September; or
- 6 months after the end of the month in which the transfer took place where the CLT occurs between 1 October and 5 April.

HMRC charge interest on any IHT not paid by the due date and care should be taken when the tax is due for payment before the deadline of the tax return.

#### **Important notes**

For financial advisers only. Not to be distributed to, nor relied on by, retail clients.

Finally, please note that every care has been taken to ensure that the information provided is correct and in accordance with our understanding of current law and HMRC practice. You should note however, that we cannot take upon the role of an individual taxation adviser and independent confirmation should be obtained before acting or refraining from acting upon the information given. The law and HMRC practice are subject to change.