INCOME FOR EXISTING DGT

This guide is intended to assist you with completing Section F(ii) (Settlor's Rights) of a Discounted Gift Trust (DGT) where an existing policy[1] is being transferred into the Trust. It will also explain what information is required to generate an accurate illustration for your client.

IMPORTANT

All Settlors of a DGT must be underwritten to determine their life expectancy. If the client is unable to be underwritten we will be unable to accept the DGT.

The underwriting decision is only valid for a short period. Therefore, it is important that if the client wishes to proceed with the DGT that the trust deed is dated and submitted as soon as possible after receiving the underwriting decision and final illustration.

Any final illustration that we provide will remain valid for a period of 30 days. During this time, the trust deed must be dated and sent to us. If we do not receive a copy of the trust during this period, a new illustration may be required due to policy values changing.

Value for determining income

Where an existing policy is transferred into trust, the settlor's income paid from the trust is not based on the amount of premiums paid. Instead, the calculation looks at the initial value.

The initial value is the value of the policy segments (already in existence) and/or the value of any sum of money or other assets at the time (date trust is dated) they are transferred to the Trust Fund.

Dating the deed/selecting income percentage

Care is required when completing **Section F** of the trust deed to ensure that the level of income specified is actually the amount that will be generated.

The settlor's income that is completed in Section F (ii) must be a percentage of the total amount gifted (initial value) and not the premiums paid. This can be calculated as follows:

Annual income required / initial value = **settlor's income as a percentage of the total amount gifted.**

F. THE SETTLOR'S RIGHTS

i) The following rights are retained by the Settlor(s) and held by the Trustees for the Settlor absolutely, or where there are two Settlors are held for the Settlors in equal shares absolutely.

ii) There shall be paid to the settlor(s) capital repayments every Trust Year based upon ______ % of the Initial Value being either:

⚠ Whilst we can assist with the completion of the trust deed, we are unable to undertake specific policy tax calculations.

1 An existing policy is any policy that has already been issued.

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Example 1 – Income set up correctly

Client A invested £200,000 into a PIMS policy in 2018. On 1 January 2022, the policy is valued £650,000 (initial value).

The client would like to setup a DGT and receive an annual income based on 5% of the premiums paid. This level of income has been chosen by the adviser so the client stays within the UK tax-deferred allowance.

The adviser contacts us and requests an illustration showing an annual income of £10,000[2]. We convert the annual cash amount into a percentage of the initial value and provide an illustration. The annual withdrawal is 1.54% (£10,000 ⁄ £650,000) of the initial value.

On 14 January 2022, the adviser submits the trust deed to our office. The deed is dated 1 January 2022 and the fee in Section F (ii) is input as 1.54%. This will provide the required income of £10,000 per annum.

If the deed was dated 14 January 2022 then the 1.54% fee may no longer provide the required income of £10,000 per annum, depending on how much the policy value has changed.

If the income were input as 5% on the trust deed, the level of income provided would be £32,500 (£650,000 × 5%) per annum which is £22,500 more than required.

Example 2 – Income set up incorrectly

Client B invested £200,000 into a single premium policy in 2018.

The client would now like to setup a DGT and receive an income of 5% that will take advantage of the tax deferred withdrawal allowance offered by the policy.

The trust deed is completed and an income of 5% is selected in Section F(ii). The trust is dated 1 January 2022 when the value is £365,000. Therefore, the initial value is £365,000.

When the trust is created, the income is setup as £18,250 (£365,000 × 5%) per annum, instead of the required £10,000 (£200,000 × 5%). This is because the income is based on 5% of the initial value (£365,000) and not 5% of the premium (£200,000).

Instead of paying an income of 5% of the premium, the trust is actually paying an income of 9.12% (£18,250 ⁄ £200,000) of the premium.

Without sufficient cumulative tax deferred allowance, this will result in a UK chargeable event each year.

How can we help?

We can provide illustrations that demonstrate the potential discount the client could achieve by using the DGT.

To assist with providing a more accurate illustration for an existing policy we require:

1) the **annual cash amount** required for income payments

2) the frequency of the payments

3) any escalation of payments

4) any deferral of income payments.

What will the illustration show?

- **Assumed start date**: this is the date that the trust is expected to be dated
- **Total payment amount**: this is the initial value and what drives the settlor's income
- **Withdrawal percentage of the total amount gifted**: this is the percentage figure that should be input into Section F (ii) of the trust deed.

IMPORTANT NOTES

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

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[2] The adviser has calculated and taken into account the available 5% tax deferred allowance.