Trust Range

Discounted Gift Trust reporting requirements

For financial advisers only

For Inheritance Tax (IHT) purposes, a lifetime gift into a discretionary trust by a UK domiciled or "deemed" UK domiciled individual is called a chargeable transfer. There are certain circumstances where chargeable transfers need to be reported to Her Majesty's 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 chargeable transfer into the trust, together with the value of any chargeable transfers made by the same person within the previous 7 years, exceeds the nil rate band at the time of transfer. Where the Settlor's available nil rate band is exceeded, the excess amount is subject to an IHT charge of 20% (2012/2013) and this results in the trust being reportable to HMRC.

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

What are the current rules for reporting chargeable transfers?

HMRC use specific terminology when they are describing the reporting requirements for discretionary trusts. The two important definitions to understand are as follows:

- A **chargeable transfer** is the value transferred **after** reliefs such as business property relief or agricultural property relief have been deducted.
- The **value transferred by the transfer of value** is the value of the transfer before any deductions for reliefs are made.

In the context of Discounted Gift Trusts, HMRC have confirmed that the "value transferred by the transfer of value" is the amount computed after the discount has been taken into account.

Whether or not the establishment of a discretionary trust is reportable depends upon the nature of the asset being transferred. There are 2 tests to determine if the transfer is reportable.

Test 1

Where the chargeable transfer consists entirely of **cash** or **quoted shares** or **securities**, a report needs only to be made:

- where the chargeable transfer exceeds the Settlor's available nil rate band – that is to say the nil rate band at the time of the transfer less any other chargeable transfers made by the Settlor in the previous 7 years.

A chargeable transfer below this limit is referred to as an **excepted transfer** and does not have to be reported.

Test 2

Where the chargeable transfer does not consist entirely of cash or quoted shares or securities, it needs to clear two hurdles in order to be an **excepted transfer** and thus escape the reporting requirement.

- First, the chargeable transfer itself must not exceed 80% of the Settlor's available nil rate band.
- Secondly, the value transferred by the transfer of value in which the chargeable transfer is included must not exceed the Settlor's available nil rate band.

It is clear to see that a chargeable transfer into a trust may pass the first point by not exceeding 80% of the Settlor's available nil rate band. However, it is possible that the chargeable transfer may fail on the second point. This would be because the actual value of the transfer before any applicable reliefs were deducted, may have been in excess of the Settlor's available nil rate band.

Guidance from HMRC

HMRC have issued guidance notes regarding the reporting requirements for Discounted Gift Trusts in the shape of **IHTM06105 – Excepted transfers and terminations – value transferred attributable to insurance linked products**.

In this note they confirm that where the transaction concerned involves an insurance linked product, the question of whether or not the transfer is attributable to cash – and will qualify as an excepted transfer up to the nil rate band – will depend on the circumstances of the transaction.

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They confirm that the value transferred will be attributable to cash if the transferor makes a transfer where he pays an amount in cash (or by cheque/bank transfer) and he then needs to take no further action to complete the transfer (and cannot stop any further steps required to complete the transfer from taking place). This will usually be the case when the insurance product and related trust documentation are all completed at the same time and the product placed in trust from the outset. Where however, the transferor purchases an insurance product, which he then places in trust, this is clearly a transfer of an asset other than cash and the 80% limit would apply.

Which test is used for the Discounted Gift trust?

It depends.

One potential scenario will fall under Test 1 and two potential scenarios will fall under Test 2.

Test 1

It is our opinion that the only scenario which would pass this test is where the application for the Discounted Gift Trust is completed and the Settlor (or both Settlors in the case of a joint application) is found to be insurable after their life has been successfully underwritten. The policy will then automatically be issued under the trust with no further intervention from the Settlor.

Example

Susan Knight is 70 years of age and wishes to invest £700,000 into a Discounted Gift Trust. Susan has not made any chargeable transfers 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 offshore bond in conjunction with the Discounted Gift Trust and sends this to RL360°. 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.

Since the discounted value of Susan's gift is below the current nil rate band of £325,000 (2012/2013) and she has made no other chargeable transfers within the past seven years, the establishment of the trust does not need to be reported. Furthermore, the creation of the trust does not trigger an immediate IHT charge.

Test 2

Scenario 1

This test would apply where the Discounted Gift Trust is completed but the Settlor (or one or both where there are joint settlors) is found to be uninsurable and is therefore asked to sign a disclaimer to confirm whether or not they still wish to proceed with placing their policy under the trust. Test 2 applies here because at this point the Settlor has the option of not proceeding with the arrangement.

Example

John Moore is 82 years of age and wishes to invest £300,000 into a Discounted Gift Trust. John has not made any chargeable transfers in the previous seven years.

John submits an application for an offshore bond in conjunction with a Discounted Gift Trust to RL360°. Unfortunately John's health is such that RL360° cannot offer any discount. However John still wishes to proceed with the trust and so at the request of RL360°, he signs a disclaimer acknowledging that no discount will apply to his gift into the trust. The policy is then issued and placed under trust.

Since John's gift cannot benefit from any discount, the value of his gift for Inheritance Tax purposes remains at £300,000. This exceeds 80% of the current (and John's available) nil rate band and therefore the establishment of the trust would need to be reported to HMRC even though no IHT charge is triggered.

Scenario 2

Test 2 will also apply where the Settlor completes the Discounted Gift Trust Settlement Deed with the intention of assigning an existing policy into the trust.

Example

Robert Jenkins has held a single premium policy with RL360° 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 Discounted Gift Trust. Robert has not made any chargeable transfers in the previous seven years.

Robert completes the Discounted Gift Trust deed and sends this together with his medical questionnaire to RL360°. 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 nil rate band, 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 chargeable transfer is not an excepted transfer, it must be reported to HMRC within 12 months of the date of the gift, using form IHT 100 and Supplementary Event Form IHT100a. Supplementary Event Form IHT 100a asks for further information regarding the event HMRC are being informed about (in this case a Lifetime Transfer).

If form IHT100 Inheritance Tax account is being completed for the first time, it is a requirement to also apply for an Inheritance Tax reference number before the form IHT100 is sent in or any tax is paid. It is necessary to apply for a reference number using the form IHT422. When HMRC receive the request, they send a unique reference number by post. This number should be quoted in any calls or correspondence made with HMRC and it should be used in relation to any future payments made on the trust.

It is also a requirement that form D34 is completed since a life policy is involved in the transaction. Lastly, since the life policy is a foreign asset, the form D39 must also be completed.

All of these forms can be found on the HMRC website.

Where should the completed forms be sent?

All completed IHT100 Inheritance Tax Account forms should be sent to:

HMRC Trusts & Estates
Trusts
Ferrers House
PO Box 38
Castle Meadow Road
Nottingham
NG2 1BB

Trustees have up to one year following a chargeable event to report it to HMRC using the IHT100 form, however tax may be due before this time so it is advisable they act quickly after a chargeable event occurs.

What are the deadlines for any tax due?

At the time of writing (1 July 2012), the tax deadlines are as follows. However, it would be necessary to check with HMRC to ensure that at the time of the chargeable transfer, these dates remain current.

Chargeable Event Tax date	Tax due
January	31 July
February	31 August
March	30 September
1 – 5 April	31 October
6 – 30 April	30 April (next year)
May – October	30 April (next year)
November	31 May (next year)
December	30 June (next year)

HMRC charge interest on any IHT not paid by the due date.

Note that, except for gifts made in the period 6–30 April, the due date for payment of tax is before the deadline for reporting the gift.

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 (as at 1 July 2012). 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.

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