Discounted Gift Trust

Investor Guide

For use in connection with the HSBC Onshore Investment Bond

INTERNAL

What’s in this guide

Contents

The purpose of this Guide is to explain how a Discounted Gift Trust can be used with the HSBC Onshore Investment Bond to help you reduce your potential liability to inheritance tax.

It is designed for investors working with their adviser who will guide them on the merits and suitability of this trust arrangement.

HSBC Life (UK) Limited does not give advice on trusts and investors are responsible for obtaining their own tax and legal advice before proceeding.

You should also read the following documents:

- HSBC Onshore Investment Bond – Key Features
- HSBC Onshore Investment Bond – product brochure
- HSBC Onshore Investment Bond Key Information Document and accompanying investment document(s)

Important note

The information contained in this Investor Guide is based on our understanding and interpretation of current UK tax law as at February 2020. Whilst every care has been taken to ensure accuracy, HSBC Life (UK) Limited cannot accept any responsibility for any action taken or refrained from being taken as a result of the information contained in this Guide. UK tax law is subject to change. The value of any tax advantages will depend on individual circumstances.

Why you should consider a Discounted Gift Trust

Increasing numbers of people are finding that their estates may be subject to inheritance tax. An estate for inheritance tax purposes comprise all the assets you own including your house, car, investments and personal possessions.

Inheritance tax on death is usually charged at the rate of 40% on your estate after all available reliefs and exemptions have been deducted. In addition, every person is entitled to a nil rate band of £325,000 which means inheritance tax on this sum is charged at 0%. Your estate may also be entitled to the residence nil rate band in respect of your main residence and if you meet the conditions for this to apply then your main residence will not be liable to inheritance tax.

If inheritance tax applies it can significantly reduce what you can pass onto your children. The Discounted Gift Trust can help mitigate your inheritance tax liability.

The Discounted Gift Trust allows you to make a monetary gift during your lifetime for inheritance tax purposes; part of that gift can be treated as a discount and falls outside your estate immediately for inheritance tax. The other part of the gift is treated as a transfer of value for inheritance tax and the inheritance tax treatment will depend on the type of trust used.

There are some significant reliefs and exemptions available most notably for gifts/bequests to a spouse or civil partner and the residence nil rate band. However, without careful planning your beneficiaries may still receive less than they otherwise might if the estate you leave them is reduced by a liability to inheritance tax.

Some people are, of course, able to consider giving away a substantial sum, either outright or via a Gift Trust which would have the effect of reducing this potential tax liability. For more information on Gift Trusts, please refer to the HSBC Gift Trust Investor Guide.

Others may be unable to give away any assets but would be prepared to create a trust with a loan which the trustees can then invest. Although a Loan Trust will not provide any immediate saving in inheritance tax, it will at least ensure that any growth on the investment made by the trustees will be outside your estate for inheritance tax purposes. For more information on Loan Trusts, please refer to the HSBC Loan Trust Guide.

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If, however, you have a lump sum to invest but are unable or unwilling to give up complete access to your capital, a Discounted Gift Trust in conjunction with the HSBC Onshore Investment Bond, will (subject to certain conditions being met) enable you to achieve an immediate reduction in your estate for inheritance tax purposes, whilst retaining access to a regular stream of capital payments to provide you with an income during your lifetime. Your adviser will advise you of the suitability of a Discounted Gift Trust but, generally, an investor for whom this trust arrangement would be appropriate will:

- have a net estate exceeding £325,000;
- have capital to invest;
- require access to this capital, but will be happy to restrict this access to a series of fixed regular payments; and
- be aged between 18 and 89 years old.

In order to obtain a discount on the value of the amount you transfer into trust, you need to be in reasonably good health. Having said that, less than perfect health should not be a bar to creating a trust of this kind, provided the implications for inheritance tax are understood and accepted

Benefits at a glance

What the trust offers

The Discounted Gift Trust is a lump sum investment, held under trust, which enables you to:

- achieve an immediate reduction in the value of your estate for inheritance tax purposes;
- further reduce any potential liability to inheritance tax if you survive for seven years from making the gift;
- receive fixed regular payments during your lifetime; and
- select trustees who will administer the trust and distribute any remaining trust fund to your beneficiaries after your death.

Please remember, however, that apart from the fixed regular payments, you will have no access to your investment once you have created the trust.

What the HSBC Onshore Investment Bond offers

- **Direct investment into funds** – The bond invests directly into collective investments such as open-ended investment companies (OEICs) and unit trusts, rather than mirror funds
- **Flexibility** – Your bond can be split into a maximum of 1,200 segments to allow tax planning flexibility
- **Transparent charging structure** – All transactions are undertaken through a cash account showing charges for investment, administration and advice
- **Comprehensive online facilities** for your adviser to set up and administer your bond
- **Simplified administration** – All transactions are undertaken though a cash account making it easy for your trustees to monitor and administer your bond
- **Value for money** – By linking to the actual funds offered by fund managers (rather than replicating those funds ourselves), we are able to offer a competitively priced proposition with minimal administration costs
- **Multi-life/multi-owner financial planning** – The ability to have combinations of up to 10 lives insured and 10 policy owners, gives flexibility that will be particularly attractive to trustees
- **Extensive range of withdrawal options** – Annual withdrawals can be set for up to 10% of the original investment and can be taken on a monthly, bi-monthly (every other month), quarterly, termly (every four months), half-yearly or yearly basis
- **Minimum age three months for a life insured** and 18 years for an applicant

The value of investments can fall as well as rise and you may not get back what you invested. For some investments this can also happen as a result of exchange rate fluctuations as shares and funds may have an exposure to overseas markets. HSBC Life (UK) Limited cannot be held responsible for the investment performance of your bond.

The value of any tax benefits described depends on your individual circumstances. Tax rules and rates may change in the future. HSBC Life (UK) Limited cannot be held responsible for any future changes in legislation.

For more details, please refer to the HSBC Onshore Investment Bond product brochure, Key Information Document and Key Features.

How the Discounted Gift Trust works

Depending on your requirements, you can choose between an absolute and a discretionary trust. For more details about the differences between these two types of trust please refer to page 7. Once you have created your trust, you will be known as the Settlor and the people who can benefit from your trust are the Beneficiaries.

Whichever trust you choose, your trust fund is notionally divided for inheritance tax purposes as follows:

The discount

HSBC calculate the discount when the Trust is established. If you die within seven years of the establishment date, HMRC will normally accept the discount without further enquiry. The discount value will have no value in your estate. Your right to receive the series of fixed payments from the trust for the remainder of your lifetime, the Settlor's Retained Right, is valuable and is deducted from the actual amount transferred into trust. In the event of your death, the value of these payments will fall to zero. In effect therefore the total value of the discounted payments are 'carved out' from the value of your estate.

We calculate the discount according to a variety of factors including your age, state of health, the level and frequency of payments you choose to take and rate of growth which meets HMRC guidelines. Generally, the longer your life expectancy, the more payments you can expect to receive and, therefore, the greater the value of the discount. Whilst your adviser has access to our standard discount tables which can be used as a guide, your actual discount will be based on our assessment of your life expectancy.

The gift

The remainder of the amount invested is the value of the gift for inheritance tax purposes. Depending on the type of trust you use, this gift will be either a potentially exempt transfer or a chargeable transfer for inheritance tax purposes.

The Settlor's Retained Right	**The Beneficiaries' Rights**
These are the series of fixed payments, out of the capital of the trust fund that you will receive during your lifetime. These payments will be made to you for the rest of your life, or until there is nothing left in the trust fund. We will value the discount based on the factors mentioned above.	This is the value of the trust fund after the death of the settlor.
The discount	**The gift**
The actuarial value of the Settlor's Retained Right equals the amount of the discount.	The gift will be the difference between the sum invested and the discount obtained by reference to the Settlor's Retained Right.

No transfer of value	The transfer of value
There will be no transfer of value in respect of the Settlor's Retained Right.	If the discretionary trust is used, the transfer of value (or gift) will be a chargeable lifetime transfer. This means the gift may attract an immediate inheritance tax charge. If the absolute trust is used, the transfer of value (or gift) will be a potentially exempt transfer. This means the gift does not immediately incur an Inheritance Tax charge and if you continue to live more than seven years after you've made the gift, it becomes fully exempt from Inheritance Tax.
The amount liable to inheritance tax	**The amount liable to inheritance tax**
There is no liability to inheritance tax on the value of the discount when the arrangement is made.	This is the amount that will be used to calculate any inheritance tax liability due on creation of the arrangement, or in event of the settlor's death within seven years of the transfer.

Paying the benefits

The trust will be administered by your chosen trustees who are responsible for distributing to the beneficiaries whatever is left in the trust fund after your death. As the settlor of the trust, you will automatically be a trustee, but it is essential that you appoint at least one other trustee who can deal with the trust after your death.

Joint arrangements

It is possible for the Discounted Gift Trust to be set up on a joint basis with your spouse or civil partner. In this case, the fixed regular payments will continue until death of the survivor. For inheritance tax purposes, each of you will be given an individual discount.

If each of you intends to create individual arrangements, your adviser will probably recommend that you exclude each other from your respective trusts. This can be accomplished by signing the appropriate box on the draft trust deed. Please refer to your adviser for guidance on this.

Your choice of trusts

A Discounted Gift Trust can be set up either as an absolute trust or a discretionary trust. When deciding which type of trust, you will need to consider:

- how much flexibility you wish to have in changing the beneficiaries at a later date;
- how much control you wish your trustees to have over the trust fund and how your chosen beneficiaries may benefit from it; and
- how the trust will be treated for inheritance tax purposes.

Your adviser will provide guidance on which trust will be most suitable for your circumstances, but the key differences are as follows:

Absolute trust

This trust can be used if you know exactly who should benefit from the trust fund after your death. When creating the trust, you must specify the beneficiary(ies) and, if more than one, the share of the trust fund to which they are each entitled. You cannot change your mind at a later date.

An advantage of this trust is that your absolute discounted gift will be treated as a potentially exempt transfer for inheritance tax purposes. This means that there will be no immediate tax charge and, provided that you survive for at least seven years after making the gift, the whole of your trust fund will be free from inheritance tax on your death.

A drawback is that you cannot change the beneficiary(ies) once the trust is established. If a beneficiary dies their share of the trust fund will pass to their heirs and you will have no control over who then benefits. In the event of a beneficiary's death, the value of their share of the trust fund (the bond less the value of the Settlor's retained rights) will form part of their estate and may be liable to IHT, but the trustees will not be able to release any funds to help with the increased liability on the remainder of the beneficiary's estate. Similarly, the beneficiary's personal representatives will not be able to claim the share to which they are entitled until after your death.

Also, a beneficiary's share of the trust fund could be at risk if he or she is involved in a marital break-up or a dispute with creditors. The trust fund could potentially be taken into account for any means-tested benefits to which a beneficiary might otherwise be entitled.

Discretionary trust

This trust may be chosen if you want to retain some flexibility over who will benefit.

No beneficiary will have a fixed right to anything; instead it will be up to the trustees to decide who will benefit, in what proportion and when the trust fund is to be distributed after the settlor's death. The trust deed sets out the classes of beneficiaries who can benefit and you can add named individuals to this list. It is normal to provide trustees with a letter outlining your wishes but, although they can take these into account, they are not bound to act in accordance with them.

As a result of the flexibility provided by a discretionary Discounted Gift Trust your discounted gift will be classed as a chargeable transfer with the following inheritance tax implications:

- there will be an immediate tax charge of 20% on any amount of the gift which, when added to any other chargeable transfers you have made in the past seven years, exceeds the nil rate band;
- there could be a further charge if you die within seven years of setting up the trust;
- inheritance tax will potentially be payable on every tenth anniversary of the trust and when any distributions are made.

For further details, please refer to the 'What about tax ?' section on page 14. Whichever trust is used, the value of the discount will not be taken into account when valuing your estate for inheritance tax purposes in the event of your death, provided the discount has been accepted by HM Revenue & Customs. Consequently, you will have achieved an immediate reduction in your potential inheritance tax liability when you create the trust. Also, you will achieve a further reduction on your survival for seven years, when the value of the discounted gift will fall outside your estate.

The DGT in action

Let's consider an example. Mary is a 75 year old widow. She has made no previous gifts for inheritance tax purposes and all her late husband's nil rate band was used on his death. Her main residence is fully covered by the residence nil rate band and this means there is no inheritance tax due in respect of it. The remainder of Mary's estate is worth £550,000 and is made up of shares, unit trusts, her possessions and £200,000 sitting on deposit earning very little interest.

Although she has substantial assets, Mary's income is insufficient for her needs and she regularly dips into her capital to fund holidays and other treats. She has been taking about £10,000 a year from her capital to supplement her income.

If Mary were to die her inheritance tax liability based on her £550,000 would be £90,000.

If Mary does not undertake inheritance tax mitigation then her two sons Peter and Paul will each receive a share of her main residence and £230,000 (£550,000-£90,000). HMRC will receive £90,000 of her estate.

Fortunately, she is prepared to consider mitigating her inheritance tax liability, provided she can retain access to yearly payments of £10,000.

On the advice of her adviser, she decides to transfer £200,000 held on cash deposit into a discretionary Discounted Gift Trust, with her two sons being her beneficiaries. She enjoys good health and following underwriting qualifies for a discount of £98,000 on this transfer. This discounted value falls outside of her estate immediately for inheritance tax purposes. The remaining £102,000 would be treated as a transfer of value for inheritance tax purposes and there will be no immediate inheritance tax charge and will fall outside her estate provided she lives seven years from the date of the gift.

The investment growth on the Bond inside the Discounted Gift Trust will not be part of her estate for inheritance tax purposes.

By placing the £200,000 held on cash deposit into the Discounted Gift Trust, Mary has reduced her estate from £550,000 to £350,000 and has reduced her inheritance tax liability on her estate. This means that her two sons will inherit a share of the main residence and although they will inherit less from her estate, they will benefit from the Discounted Gift Trust as beneficiaries.

The inheritance tax liability on Mary's estate of £350,000 would be £50,800. This means that HMRC would receive only £50,800 in inheritance tax rather than £90,000, a saving of £39,200.

From Mary's estate of £350,000, her two sons will each receive £149,600 and they will also benefit from the Discounted Gift Trust as beneficiaries. This means they could each receive £249,600 rather than £230,000, an additional £19,600 because of Mary using the Discounted Gift Trust to mitigate her inheritance tax liability.

Whichever trust Mary chooses, all the investment growth on the Bond will be outside her estate for inheritance tax purposes.

If she chooses an absolute trust, the discounted gift will fall outside her estate provided she survives for seven years from the date of creating the trust. In the event of Mary’s death within seven years, any inheritance tax liability on the discounted gift will be covered by the nil rate band available to her estate at that time.

If she chooses a discretionary trust, there will be no immediate inheritance tax charge as her discounted gift is below the nil rate band and the discounted gift will fall outside her estate provided she survives for seven years from the date of creating the trust. Whilst the trust fund will be assessed for periodic charges at each tenth anniversary to which she survives and for exit charges when payment is made to her beneficiaries following her death, it is unlikely that the trust will attract any inheritance tax charge if its value remains below the nil rate band available at the time of each assessment.

Please note that this example is provided for illustration only and should not be used as a guide for any particular course of action. The tax implications will vary according to individual circumstances and you will need to consider your personal tax situation in detail with your adviser before proceeding.

Creating your Discounted Gift Trust

Your adviser will explain how to complete the trust documentation as well as the application process. In outline though the application process is as follows. First you should obtain details of the discount which applies by completing a statement of health form. Next you should apply for the bond; once the bond application is successful you should set up the trust and place the bond into the trust.

The value of the gift you are making will fall outside your estate provided you survive for seven years from creating the trust. For further information on this, please refer to the 'What about tax' section page 14.

Depending upon your requirements, you can choose between an absolute and a discretionary trust. For more details about the differences between these two types of trust please refer to the 'Your choice of trusts' section on page 7 and 'About your beneficiaries' section on page 12.

Whichever version you choose, any growth on the Bond will be held for the benefit of your beneficiaries outside your estate, thereby reducing your potential inheritance tax liability.

As the sole settlor of the trust you must appoint at least one additional trustee to act with you in administering the trust for the benefit of your chosen beneficiaries.

If both you and your spouse (or civil partner) are creating a joint arrangement, there is no actual requirement to appoint an additional trustee at outset. However, it will be necessary for you to appoint an additional trustee at some point, in order to ensure that there are at least two trustees remaining in the event of your death or the death of your spouse (or civil partner). Appointing an additional trustee at outset is generally considered prudent.

Taking your regular payments

Convenient payment options

You can choose between monthly, bi-monthly (every other month), quarterly, termly (every four months), half-yearly or yearly options for your regular payments. Once selected, your regular payments are fixed and will continue throughout your lifetime unless, of course, the value of the Bond falls to nil, when your income will cease.

You can choose any level of payment up to 10% per year of the amount you invest. Please also remember that the value of the bond will reduce if the amount withdrawn exceeds the rate at which the bond grows.

As explained in the next section, there may also be income tax implications where repayments exceed 5% each year.

Income tax treatment

You can arrange to receive regular payments of up to 5% of the original investment every year without any immediate income tax charge. Any part of this allowance which is unused can be carried forward; so you can potentially defer any higher or additional rate income tax liability until 100% of the original investment has been withdrawn, or the bond comes to an end.

Any amount over the available 5% allowance is usually added to your income and so may be subject to income tax. If this increases your income above £100,000 then your personal allowance may be reduced.

Because we pay corporation tax on any income and capital gains realised on the underlying investments in the Bond, basic rate income tax is treated as already paid on this investment. We calculate the underlying tax charge daily and collect a monthly tax deduction from the Bond to account for this. As a result, tax administration is simplified for the trustees and any liability you face will be restricted to higher or additional rate income tax.

The Bond will be issued as a series of separate but identical policies, each of which is treated independently of the others. This segmentation gives your trustees considerable flexibility to undertake strategies which can minimise any income tax liability arising from any gains made.

For more details on the tax treatment please refer to pages 14 and 15 as well as to the HSBC Onshore Investment Bond product brochure. Please also note that though it is possible to “top-up” the HSBC Onshore Investment Bond by paying additional premiums, this is not possible where the bond is held within a Discounted Gift Trust.

Investing the trust fund

A Discounted Gift Trust is a long term arrangement, so it is essential that the widest investment choice is available. With the HSBC Onshore Investment Bond you and your trustees can access the expertise of investment managers across a range of fund management groups. Your adviser will be able to give you and your co-trustees details of the current fund range.

Building the portfolio

The initial investment will be allocated to the bond and held in a cash account which forms part of the investment portfolio and is used to debit the cost of fund purchases and credit the proceeds from fund sales.

Once the trust fund is allocated to the bond you and your co-trustees can then build a portfolio from a choice of collective investments such as Open Ended Investment Companies (OEICs) and unit trusts. Other than the minimum investment levels which apply to each asset held in your portfolio, there are no restrictions on how the investment can be spread.

The cash account can also be used to hold monies awaiting investment or as a cash shelter in times of market volatility.

Trading free from capital gains tax

Subject to the minimum investment levels, you and your co-trustees also have complete flexibility to move monies between funds and, because the trust fund is held within the bond, it is possible to trade between funds without incurring any charge to capital gains tax.

About your trustees

Choosing your trustees

As previously mentioned, as the person who created the trust, the settlor, you will automatically be a trustee but you will need to appoint at least one other trustee to act with you.

If both you and your spouse (or civil partner) are creating a joint arrangement, there is no actual requirement to appoint an additional trustee at outset. However, it will be necessary for you to appoint an additional trustee at some point, in order to ensure that there are at least two trustees remaining in the event of your death or the death of your spouse (or civil partner). Appointing an additional trustee at outset is generally considered prudent.

A trustee must be someone you can rely on to act in accordance with your wishes, so you should choose your trustee(s) with care.

You can appoint anyone to be a trustee provided they are over the age of 18 years and have full mental capacity. There must be at least two trustees to administer the trust. If you wish, you can appoint a Beneficiary under the trust as trustee.

You may prefer to appoint a professional trustee, such as your solicitor but please bear in mind professional trustees are permitted to charge for their services. If the only asset within the trust is the Bond and if a withdrawal is made from the Bond to pay the fees of a professional trustee, this will have an impact on the annual allowance available for chargeable event purposes. Please refer to the 'What about tax? Section on pages 15 and 16.

During your lifetime, you will be able to appoint new or additional trustees. In the event of your death or incapacity, this power will pass to your trustees. You will also have the power to remove a trustee provided at least one trustee (other than yourself) remains after the dismissal.

Trustees' roles, responsibilities and accounting

The role of the trustees is to manage the trust assets in accordance with the terms of the trust deed.

Whilst the only asset held in your trust is the HSBC Onshore Investment Bond, your trustees will have little to do to administer the trust fund. In particular, they will not need to complete trustee tax returns.

Whilst the only asset in your trust is the HSBC Offshore Investment Bond, your trustees will have little to do to administer the trust fund. There is a requirement to notify the H M Revenue & Customs if the Trustees have a tax liability or the value of the discounted gift is greater than 80% of the nil rate band, and to report the termination of the trust whenever that occurs, but they should not need to complete trustee tax returns.

About your beneficiaries

Choosing your beneficiaries

The choice of who should benefit from your trust in the event of your death rests, of course, with you and your trustees. Anyone, other than the settlor of the trust, can be beneficiary. Although you are entitled to the regular payments specified when you create the trust, you cannot benefit from the trust in any other way. Whether or not the beneficiaries are fixed at the outset and how a beneficiary will be treated for tax and other purposes will depend on whether you have created an absolute or discretionary trust.

Absolute beneficiaries

Under an absolute trust, you will name those you wish to benefit and the shares they should take. Once you have made this choice, however, you cannot change your mind. In the event of your death, the trustees will be able to pay the appropriate share of the trust fund to any adult beneficiaries. Where there are minor beneficiaries, the trustees will usually have to retain the trust fund until each beneficiary reaches age 18 (16 in Scotland).

Discretionary beneficiaries

Under a discretionary trust, the beneficiaries are described as a class of individuals such as your children, grandchildren, nieces, nephews, your spouse or surviving spouse (unless you created the trust as joint settlors or deliberately excluded your spouse) and the spouse or surviving spouse of any of your beneficiaries. A full description of your discretionary beneficiaries will be found in Clause 2.2 of your trust.

A discretionary beneficiary does not have an automatic right to anything under the trust – they only have the right to be considered by the trustees. The trustees can exclude a beneficiary and you can add to the class of beneficiaries during your lifetime.

You may wish to write a letter to your trustees explaining how you would like your trust fund to be distributed. Although your trustees will usually take your wishes into account, they cannot be bound by them and, ultimately, the decision about who receives what and when will rest with them.

What happens if someone dies?

If someone associated with the trust dies, the trustees should notify us as soon as possible. We need to know if:

- the settlor dies;
- a trustee dies; or
- a life insured dies.

What happens if the settlor dies?

If a single (or surviving) settlor of an absolute trust dies, the trustees must advise us to stop making the regular withdrawals. The trustees will then be able to distribute the trust fund to the beneficiary(ies).

If the single (or surviving) settlor of a discretionary trust dies, the trustees must advise us to stop making the regular withdrawals. The trustees will then be able either to maintain the trust fund or distribute it to the beneficiaries, possibly in accordance with the settlor's letter of wishes.

If one settlor of a joint trust dies, the withdrawals will continue to the survivor for the remainder of his or her life.

What happens if a trustee dies?

If a trustee dies, the remaining trustees must advise us of this and provide evidence in the form of a copy of the Death Certificate.

If, following the death of a trustee, only one trustee remains, the settlor or the surviving trustee should appoint a new trustee to act with them. We can provide a suitable deed for this purpose.

What happens if a life insured dies?

If one of the lives insured dies but is survived by other lives insured, there will be no effect on the arrangement and the Bond will continue.

If, as a result of the death of the last life insured, a claim is paid under the Bond during your lifetime, your trustees may need to reinvest the fund in another investment in order to continue making the regular payments to which you are entitled.

If the last surviving life insured dies after the death of the settlor (or survivor), the trustees can claim the proceeds. Whether they distribute these or retain them will depend on whether the trust is absolute or discretionary and the circumstances of the beneficiaries.

What happens if a beneficiary dies?

If a beneficiary of an absolute trust dies, the value of the trust fund, less the value of the Settlor's Retained Right, will be included in the beneficiary's estate for inheritance tax purposes. The heirs of that beneficiary will not, however, be able to benefit from the trust fund until after the death of the settlor (or the survivor). There is also the risk that, if you die within seven years of creating the trust and a beneficiary has predeceased you, the trust fund will form part of both your estate and the beneficiary's estate for inheritance tax purposes. The trustees of your trust could be liable to pay inheritance tax as a result of the beneficiary's death.

If a beneficiary of a discretionary trust dies, there will be no inheritance tax implications for the beneficiary's estate in relation to the Discounted Gift Trust.

What about tax?

Inheritance tax

There are a number of occasions when a liability to inheritance tax may arise and these are summarised in the following table:

	Type of Discounted Gift Trust	
Event	**Absolute**	**Discretionary**
Creation	Potentially Exempt Transfer (PET)	Chargeable Lifetime Transfer (CLT) but may be covered by Nil Rate Band (NRB)
Who pays the tax?	n/a.	The tax will usually be paid by the trustees. If the settlor pays the tax, the gift must be grossed up.
Death of the settlor within seven years	May be covered by NRB	If the CLT is not covered by the NRB and tax at the lifetime rate is paid, a further tax liability is possible but taper relief may assist. If any PET which was made before the CLT becomes chargeable, this may create a further tax liability.
Who pays the tax?	The beneficiary	The trustees
First and subsequent tenth anniversary	n/a	There will be a possible periodic charge, at a maximum of 6% on the value of trust fund in excess of available trust NRB. This will be a maximum of 6% of the discounted value of the trust fund. However, it will be nil where there were no chargeable transfers in the seven years prior to the creation of the trust and the value of the trust is less than the NRB at this time.
Who pays the tax?	n/a	The trustees
Payment to a beneficiary	n/a	An exit charge may be possible. Exit charges may apply each time money is paid out of the trust to your beneficiaries. An exit charge is usually based on the previous periodic tax charge.
Who pays the tax?	n/a	The trustees

Income tax

The Discounted Gift Trust has been designed for use with the HSBC Onshore Investment Bond. As a series of life insurance policies, gains arising under a bond are taxable to income tax under the chargeable event regime. Under that regime, a liability to income tax can only arise if a chargeable event occurs, there is a chargeable event gain and there is a chargeable person to whom the gain can be attributed.

A chargeable event will arise on the death of the last life insured under the policy, assignment or part assignment of the policy for money or money's worth, maturity of the policy, surrender in full of the policy or when certain part surrenders are made under the policy. Your adviser will be able to explain how any liability is arrived at.

The following table illustrates the tax implications for the three most common events:

	Event		
Income tax implication	**Withdrawals within 5% allowance**	**Withdrawals greater than 5% allowance**	**Full surrender**
Is there a chargeable event?	No	Yes	Yea
Is there a chargeable event gain?	No	Yes, on excess above 5%	Yes, on any gain realised

Who is liable for the tax?

With an absolute trust, any gain is assessed on the beneficiary, regardless of age. The only exception is where the beneficiary is the minor (unmarried) child of the person who created the trust, in which case any gain in excess of £100 will be assessed on the parent.

With discretionary trusts, the person who is liable for the tax will depend upon the circumstances at the time, as illustrated in the following table:

Discretionary DGT	**Who is liable for the tax?**
	The person who created the trust, if alive and UK resident, failing whom
	UK resident trustees, failing whom
	a UK resident beneficiary when receiving a benefit from the trust

Under a discounted gift trust, the Settlor's Retained Rights are held on absolute trust for the settlor. Consequently, the settlor will be liable to any income tax due in relation to a chargeable gain during his life.

The rate of tax payable

The rate of tax payable will depend on whom the liability falls. As the person who created the trust you will be taxed at your highest marginal rate. You will receive a credit for basic rate tax in consideration of the tax paid by HSBC Life on the underlying investments within the Bond.

Where UK resident trustees are liable, the rate of tax is 45% and they also receive a credit for basic rate tax of 20%.

Where a beneficiary is liable, the tax paid will depend on their personal income tax position and, as above, a credit for basic rate tax will be available.

Capital gains tax

Capital gains tax does not generally apply to investment bonds and there should be no charge to the trustees provided they are the original owners of the bond. No liability to capital gains tax will arise when fund switches are made within the Bond.

Pre-owned assets tax

Pre-owned asset tax rules are aimed at discouraging certain inheritance tax planning arrangements by imposing an income tax charge. However, HMRC has confirmed in guidance notes that pre-owned asset tax does not apply to Discounted Gift Trusts.

Gifts with reservation of benefit

A gift with reservation can occur where you continue to enjoy a benefit from an asset. These rules do not apply to a Discounted Gift Trust because two separate rights are created. Your right, as the settlor, is to regular payments from the trust fund, the amount of which are determined at outset and cannot be varied. Your beneficiaries' rights are to the remainder of the trust fund, on your death, to which you have no access during your lifetime.

HSBC Life (UK) Limited

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Issued by HSBC Life (UK) Limited
Customer information: Administration Office, PO Box 1053, St Albans, Hertfordshire AL1 9QG

INV1717 220-1028