WAY Investment Services Limited

How much does a discount cost?

Discounted Gift Trusts (DGTs) have been a popular option in estate planning for many years, but the COVID-19 crisis has presented some new reasons to test their suitability.

A key upside to DGTs is that through the discount, they offer a (potentially) immediate way to reduce an IHT liability – which may be tempting for people who feel they have left their planning a bit on the late side. The discount is based on age and life expectancy, and needs to be supported by medical evidence. The problem is that in the current climate, GPs have enough on their hands. Responding to requests for medical file reports is unlikely to be much of a priority, as is carrying out medical examinations to support any applications. Indeed, anecdotal reports suggest that getting such policies underwritten in the current climate is problematic, if not impossible. Any delay in IHT delay planning could be devastating, as the client might not survive the seven year inter-vivos period.

Even if the medical evidence is obtained, caution needs to be applied in assessing suitability. The discount comes at a cost: in flexibility. Clients with DGTs are compelled to take regular reversions with no flexibility to increase, decrease or defer them for twenty years*. In other words, taking a fixed amount of income from the plan no matter what changes or crises happen within a family or to the wider world. This can lead to all sorts of unwanted scenarios. For example; effectively crystallising losses during stock market downturns, taking a greater income than is needed, or not being able to access funds that are needed either by the client themselves or to support their family. On this latter point, such funds could be absolutely vital at the moment if there has been a loss of income or family members have been furloughed. In any case a discount may turn out to be a red herring, as with a client with life expectancy above seven years it may be rendered useless.

Whatever else we have learnt through this crisis, we have all had to adapt to extraordinary changing circumstances. The WAY Flexible Inheritor Plans have been designed with flexibility in mind. Unlike a DGT, reversions can be deferred by the trustees in whole or part if not needed. Whilst there is no discount given, any investment growth is immediately outside the estate, as is the original gift after the inter-vivos period expires. In addition, trustees can also distribute capital or, more significantly, make loans to the beneficiaries at any time.

If a client were to die without putting planning in place, they may miss out or have a substantially reduced Residents Nil Rate Band (RNRB) available. Where net RNRB-assessable estates are above £2m, placing money into a WAY Flexible Inheritor Plan will immediately reduce the value of the estate towards the £2m taper threshold, or may bring it below that figure and thus benefit from the full RNRB (assuming the other RNRB qualification criteria are met).

Financial planning is so often a balancing act. There are advantages and disadvantages of every financial product. It is always worth assessing whether the amount of flexibility in a product is appropriate for the client. And when it comes to discounts, remember that everything has a price.

*Based on, typical, 5% p.a. tax-deferred withdrawals.

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