

Nucleus adviser guide

Nucleus Onshore Bond Bare Discounted Gift Trust

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Nucleus Onshore Bond Bare Discounted Gift Trust

The Nucleus Onshore Bond Bare Discounted Gift Trust: an overview

The Nucleus Onshore Bond Bare Discounted Gift Trust is an arrangement designed for individuals who wish to reduce their potential inheritance tax (IHT) liability, whilst securing a regular stream of specified cash payments into the future.

The onshore bond bare discounted gift trust provides:

- the potential for an immediate reduction in the donor's taxable estate for IHT purposes, subject to underwriting
- regular tax efficient withdrawals to the donor(s), which cannot be defeated by the beneficiaries
- for a gift that will be outside the donor's estate after 7 years
- for investment growth to be outside of the donor's taxable estate from day one
- peace of mind for the donor in knowing that those intended to benefit from the gift will do so

The impact of IHT

IHT is becoming increasingly important for many people. With the basic IHT threshold at £325,000 and the additional residence nil rate band at £175,000 (for those who can claim it) currently frozen, an increasing number of estates are caught paying IHT.

Note: For married couples and civil partners, if all the assets of the first one to die pass to their spouse, the unused nil rate band can be transferred to the surviving spouse.

Using lifetime gifts to reduce IHT liability

One effective way to mitigate the tax charge is by making lifetime gifts. Lifetime gifts that are potentially exempt transfers (PET) do not give rise to a tax liability when they are made. And, if the donor survives for a full seven years from the date of gifting, the property will be outside the estate for IHT purposes.

A common problem with gifting is that it needs to be affordable for the donor as in most cases they will need to give up access to the capital and any income produced.

Another problem with making lifetime gifts is the type of trust the gift is given to and the tax regime which applies. If the gift does not qualify as a potentially exempt transfer (PET), this will be a chargeable lifetime transfer (CLT) and an immediate IHT liability may arise if the value of the gift is above the prevailing nil rate band.

The Nucleus Onshore Bond Bare Discounted Gift Trust is able to offer many investors a potential solution to these problems. Before considering the arrangement, it is very important to have an understanding of how it operates. It should never be used by a client without taking appropriate tax and legal advice.

The IHT benefits of the onshore bond bare discounted gift trust

This arrangement allows a client (known as the donor) to place an investment in trust that will be free of IHT after seven years. It also means that if the donor dies within seven years, only a part of the value of the initial investment (subject to underwriting) is added back to the estate for IHT calculation. This part of the investment is known as the 'discounted gift'.

The discounted gift

The discounted gift becomes relevant if the donor fails to survive for seven years from the date of making of the gift.

Although the assets have been gifted, the donor retains the right to receive regular payments from the bond held under the trust. The amount of the payments is determined at the outset, and can be up to a maximum of 5% a year (for up to 20 years) of the original value of the investment. The total sum of these regular payments is converted to a capital value, which is known as the 'donor's retained rights'.

This part of the fund is not added back to the donor's estate on death (even if death occurs within seven years). This is because the donor's right to regular payments ceases on his or her death, and so this right is not regarded as having an actual value at the time of death.

The remainder of the initial investment is known as the discounted gift or gifted benefits for the beneficiary(ies). This part does have a value for tax purposes, and is added back to the donor's estate if death occurs at any time during the initial seven year period.

At the end of seven years, the entire investment is outside the scope of IHT and does not have any impact on the donor's estate.

The benefits of the onshore bond bare discounted gift trust

The onshore bond bare discounted gift trust allows the donor:

- to make a tax-efficient gift of assets into trust for the absolute benefit of named beneficiaries
- to potentially immediately reduce the value of their estate for IHT purposes, subject to underwriting
- to ensure that any growth on the original gift will immediately be free from IHT
- to enjoy tax efficient withdrawals
- to avoid probate delays on death.

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Suitability of the onshore bond bare discounted gift trust

The onshore bond bare discounted gift trust may be suitable for a client with a potential IHT liability on death, who would like to reduce the value of his or her estate, but still needs some access to the money they invested via regular tax efficient withdrawals.

The investor should know who should benefit from the trust assets after his or her death, and the proportion by which they should benefit.

If this does not match with your client's wants and needs, then there may be more appropriate trust solutions that you could consider. The clients should take appropriate professional advice before proceeding.

Note that the onshore bond bare discounted gift trust is not suitable for investors who may require full, immediate or unrestricted access to the capital invested. It also may not be suitable for clients whose requirements for tax efficient withdrawals will vary during the term of the trust. You should also ensure your clients are aware of the potential impact of chargeable event gains from partial surrenders depending on their life expectancy and the level of withdrawal, including any ongoing adviser fees.

How does the onshore bond bare discounted gift trust work?

The onshore bond bare discounted gift trust has two main parts; a single premium onshore bond and a bare trust.

The onshore bond

Initially, the donor applies for a single premium unit linked life assurance bond. Under the bond policy conditions, the donor is entitled to fixed withdrawals for the rest of his or her life, or until the fund is depleted.

The bond is usually effected on the lives assured of the beneficiaries named on the deed.

The bare trust

Once the bond commences, the donor immediately transfers it into a bare trust, which is drafted to retain his or her entitlement to withdrawals. The trustees appointed under the new trust become the legal owners of the bond.

The beneficiaries and their shares must be named at the commencement of the trust, and there is no flexibility whatsoever to make changes at a later date. It is very important that the donor is absolutely certain at the outset that these are the people he or she really intends to ultimately benefit from the trust.

During the lifetime of the trust, the trustees will regularly withdraw funds from the life assurance bond to finance the donor's entitlement to payments. Certain assumptions are made at the outset in order to calculate a notional capital value for the payments. This part of the plan becomes known as the 'donor's retained rights'.

The balance of the investment is the discounted gift, which, together with any future growth, becomes known as the 'gifted benefits for the beneficiaries'.

Is there a cooling-off period?

The donor will have a 30-day right to cancel the bond once the policy has commenced. Further details can be found in the key features document for the Nucleus Onshore Bond.

The right to cancel does not cover the creation of the trust, as this is a separate legal document and is not covered by the cancellation rules.

What are the charges?

For the underwriting, an initial consultation fee of £150 is charged which covers the time spent in underwriting and establishing the level of discount available (joint donors each pay a fee of £150). A separate cheque for this fee must be supplied at the time of the application, and should be made payable to the bond provider, Countrywide Assured.

Please refer to the key features document for the Nucleus Onshore Bond for charges which are specific to the selected bond.

How is the discount determined?

The value of the donor's fund is calculated from assumptions made using the donor's age, state of health and the amount and frequency of capital payments he or she is entitled to.

The difference between the value of the donors' retained rights and the amount of the initial investment is the discounted gift. The discounted gift is treated as a transfer of value for IHT purposes, and is a potentially exempt transfer (PET). This means that if the donor survives for seven years from the date of the gift, no tax liability will arise on the value of the gift.

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What basis of underwriting is used?

The donor is required to complete a medical questionnaire at the outset. The donor's life expectancy is underwritten by a specialist underwriting services company, MorganAsh, before the bond and the trust is established. The client may be required to attend a medical appointment with his or her General Practitioner or with a convenient independent medical practitioner. MorganAsh will not be able to underwrite the case until they are in receipt of all the medical information required.

Subject to the parties being satisfied with the value of the discounted gift, the investment and the trust can then proceed and the donor receives a personalised discount certificate from Countrywide Assured.

Please note: HMRC can challenge the value of the discount and it is for the client and their trustees to determine this value in consultation with their professional advisers before the trust and bond are created.

Joint donors

Where husband and wife or civil partners gift as joint donors, each is treated as making a gift of 50% of the total investments in the onshore bond. HMRC has issued guidance on how the discounts are calculated for joint settlors in the Inheritance Tax Manual, please see <https://www.gov.uk/hmrcinternal-manuals/inheritance-tax-manual/ihm20654>

For joint donors, the investment monies can be paid from either a joint account or individual accounts (provided that 50% of the monies originate from each donor's individual account).

Where the trust is created by a husband and wife or civil partners and one (or both) are not "long-term residents" there are tax implications and specialist tax advice should be obtained.

Can a husband and wife or civil partners each set up their own trust?

A husband and wife or civil partners can set up separate arrangements if they want to. This could be useful if they wanted to appoint different named beneficiaries, for example if they want to benefit children from previous marriages.

In this case 50% of the combined regular withdrawals would cease on first death, whereas where there are joint donors, payments would continue at the same level.

Who can act as trustee?

The donor is automatically appointed as trustee. He or she should appoint additional trustees, which can be done through the trust deed at the outset. A maximum of three additional trustees can be appointed under the draft Nucleus Onshore Bond Bare Discounted Gift Trust.

For ease of administration, it is always preferable to have a minimum of two trustees (including the donor). Nucleus can supply a specimen deed for the appointment of new trustees by the donor.

Who are the named beneficiaries?

The named beneficiaries are those who will ultimately benefit from the trust. Once a beneficiary has been named and their share expressed at the outset of the trust, there is no flexibility for the donor or the trustees to change this.

It is recommended that independent legal advice is sought if you wish to include minors as beneficiaries of the trust.

The donor's spouse or civil partner cannot be named as a beneficiary, as this may defeat the tax planning purpose of the arrangement.

If however, the named beneficiaries decide after the death of the donor that they don't require any benefit from the trust, it may be possible to assign the bond to others. The beneficiaries should seek tax advice before doing so.

IHT implications for beneficiaries

Should a named beneficiary die, a proportionate share of the trust assets will form part of his or her estate for IHT purposes. The value includes the beneficiary's interest in the beneficiaries' fund.

This could give rise to an IHT liability if the deceased beneficiary's total estate exceeds the nil rate band at the time of death.

A beneficiary should make provision in his or her will for their share of the trust fund, so that their executors are aware of the asset and have clear instructions on who is entitled to benefit from the policy.

There will be no IHT implications where the policy is left to the beneficiary's spouse or civil partner, as the gift is covered by the spousal exemption, however, specialist advice must be sought for a spouse or civil partner who is not a "long-term resident".

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How is the donor provided with withdrawals?

The level of capital payments and the frequency are chosen by the donor at the outset of the trust. The donor can specify a fixed amount for the payments or a fixed percentage of the initial investment. The maximum annual payment to the donor is 5% of the initial investment, which can be paid over a 20-year period and is effectively a return of capital.

The payments can be made monthly, quarterly, half-yearly or yearly. The trustees can arrange for withdrawals to be paid to the trust bank account.

Please note that ongoing adviser fees will be taken from the 5% tax deferred allowance and exceeding this allowance could give rise to a chargeable event which may have income tax considerations. These should be understood before proceeding so the parties involved know who would be liable for the income tax depending on the circumstances involved.

Can the donor change the level of withdrawals?

Once the trust is established, the donor cannot make any changes to the level or frequency of payments, as this may affect the benefits of using the arrangement.

Can the withdrawals continue to be paid to the donor's spouse after his or her death?

Where just one party settles the trust, payments will not continue to a surviving spouse. However, if husband and wife are joint donors, the full level of payment will continue to be made to the survivor for his or her lifetime, or until the fund is depleted.

Can the donor surrender the right to withdrawals?

The donor would have to continue receiving the fixed regular payments under the terms of the trust. If the withdrawals are not needed to support the donor's standard of living, he or she may decide to gift away the cash received (specialist advice should be sought).

Can additional capital be added to the bond?

It is not possible to add any further capital to an existing onshore bond bare discounted gift trust, although a new arrangement could be started with a fresh lump sum investment. Specialist advice should be taken to consider the tax effects of making a new gift into a trust.

Can the trustees or the beneficiaries surrender the bond during the donor's lifetime?

The trustees, rather than the beneficiaries, are the legal owners of the policy and are the decision makers. However, as the donor is entitled to withdrawals from the bond, encashing the policy would defeat the donor's specific interest, which the trustees are not allowed to do.

If the donor and beneficiaries collectively agree that they wish to terminate the trust, specialist legal advice should be sought.

What happens following the death of the donor?

Following the donor's death (or the second death for joint donors), the specific right to withdrawals ceases and the whole of the bond investment is held on bare trust for the benefit of the named beneficiaries. The trustees must decide whether to continue the trust for the beneficiaries, to surrender the bond and distribute the proceeds proportionately to the beneficiaries or to assign the bond proportionately to the beneficiaries.

If the beneficiaries have sufficient capital and do not require access to the trust fund, the policy can be assigned by the beneficiaries (after it has been assigned to them by the trustees).

Assignment by way of gift of the bond does not trigger a chargeable event, but it is a PET from the beneficiaries, who should take appropriate tax advice on any implications.

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Income tax implications on surrender

As the donor has an entitlement to receive withdrawals from the bond, the trustees should not try to surrender the bond during his or her lifetime.

After the donor's death, surrendering the policy gives rise to a chargeable event and any gain may be subject to income tax assessed on the beneficiary proportionately to the amount they benefit from the trust. The gain is added to the individual's income to calculate any tax payable. A basic rate tax credit will apply as the bond is an onshore bond, which means that a liability will only arise if the beneficiary is a higher rate (40%) or additional rate (45%) taxpayer. Personal tax allowances and top slicing relief may be available, and the normal rules for chargeable event gains apply.

Why is the onshore bond bare discounted gift trust not subject to the gift with reservation of benefit or pre-owned asset tax rules?

The gift with reservation rules do not apply, as the donor's entitlement to withdrawals is effectively carved out from the fund at the outset and he or she does not retain any rights over the remaining beneficiaries' fund.

Does the onshore bond bare discounted gift trust need to be registered with HMRC?

All UK expressed trusts need to be registered on the UK trust registration service by the trustees. It is their responsibility to ensure the trust is correctly registered, proof of registration is provided and the record is kept up to date.

Important note

This document is provided strictly for general consideration only. Any action taken or refrained from in connection with the Nucleus Draft Onshore Bond Bare Discounted Gift Trust must be preceded by discussion with your legal and other professional advisers. Accordingly, neither Nucleus nor any associated or affiliated company nor any of their representatives, officials or employees can accept any responsibility for any loss occasioned as a result of the use of the Nucleus Draft Onshore Bond Bare Discounted Gift Trust in any circumstances whatsoever except as provided by law.



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