VitalityLife

Client guide to trusts

Contents

About this document

At VitalityLife we recognise that trusts can seem complicated and the laws around them daunting. This guide is to help you understand the benefits of putting your plan into a trust and to explain the key details as simply as possible.

What is a trust?

A trust is a legal arrangement that allows you to gift something (like a life assurance plan) to someone, without giving them total control and legal ownership of it.

There are three parties involved in a trust:

- **Donor (absolute trust)/Settlor (discretionary trust)** - When you gift your life assurance plan into a trust, you're known as 'the donor/settlor'.
- **Trustees –** These are the people responsible for looking after the gift and they are bound by the terms and conditions of the trust deed. Under VitalityLife's trusts you are automatically a trustee, and you should name at least one other person to help you look after the gift. The trustees become the legal owners.
- **Beneficiary –** These are the people who will get the money from the trust. As they are not responsible for looking after the trust, VitalityLife will not deal directly with them. This is why it is recommended that at least one other trustee is appointed.

Why use a trust?

Some of the reasons that a trust might be used are:

Avoid probate

Remember that the trustees are the people responsible for looking after the trust. So, provided there are trustees alive when a death benefit is paid, VitalityLife can simply pay those trustees on production of your death certificate, any signed documentation required and proof of identity. As a grant of probate (confirmation in Scotland) is not required, any payments made from trusts are normally paid quicker.

Better control

You can make sure that the death benefit goes to the right people by naming them as a beneficiary(ies). Please refer to the "What is an absolute trust" and "What is a discretionary trust" sections to understand the way the death benefit is distributed under each trust.

Tax planning

By placing your plan into trust, the death benefit will not be part of your estate. This helps to reduce any potential inheritance tax (IHT) liability you may have.

When you should not use a trust

Here are some examples of when you shouldn't use a trust:

- If you wish the death benefit to be included in your estate and go to the beneficiary(ies) of your will or the rules relating to intestacy. Intestacy refers to the order in which your estate is shared out if you die without a will.
- If you are going to use your plan as security for a loan
- If your plan is to be used for business protection. In this case a different type of trust would be more suitable. Please speak to your adviser for more details.

What is an absolute trust (also known as a bare or fixed trust)?

When you set up this type of trust, you name who you want to receive any death benefit. If you name more than one person, you also decide the share they will receive. The sole duty of the trustee(s) is to make sure that the person(s) you have named receives their share of the payment. You cannot change your mind about the person(s) you name to receive the payment after you have created the trust. If they die before you, the trustee(s)'s sole duty is to pay any money to the deceased beneficiary's estate. So, you need to be happy that if the person dies their estate will benefit.

You should not use an absolute trust if you think that the beneficiary(ies) may need to change in the future. In this instance, a discretionary trust would be more suitable.

What is a discretionary trust?

Under this type of trust there is a list of individual people, or groups of people, who could benefit. It's the trustee(s) who decides who will benefit from any death benefit, by how much and when. You, as the settlor, can offer guidance to the trustee(s) on who you would like to receive any money. However, it is ultimately the trustee(s)'s decision. A person is only entitled to benefit from any money once the trustee(s) decides to pay them. There are quite a few situations where this can be helpful. For example, where a person you want to benefit is going through a divorce or bankruptcy, the trustee(s) can delay giving them some money until after the divorce has been finalised or they have been discharged from bankruptcy, which helps to protect their pay-out.

You should not use a discretionary trust if you want to make an outright gift to a beneficiary(ies) and will not need to change this in the future. In this instance, an absolute trust would be more suitable.

VitalityLife's trusts

VitalityLife's absolute and discretionary trusts are 'spilt trusts'. This means that the person who receives the benefit depends on the type of benefit paid. The death benefit will be held for the beneficiary(ies) in a fund known as the 'Gifted Fund'. Whilst serious illness and disability benefits will be held for your benefit in a fund known as the 'Retained Fund'.

You will be able to choose whether to keep any terminal illness benefit for yourself or give it away to your beneficiary(ies).

Can a joint life first death plan be placed in a VitalityLife's trust?

Yes, either trust can be used with a joint life first death plan. Normally with a joint life first death plan, you want the survivor to benefit from any death benefit so there is no need for a trust.

However, some people are concerned about the possibility of both dying together, or within a short time of each other, and want to make sure that in this situation the death benefit goes to the correct people and is not part of the estate of the second to die.

So, our trusts include an option (which can be chosen when creating a trust)) that enables the survivor to benefit from the death benefit if they survive the other by 30 days. However, if both of you die within 30 days of each other, the death benefit will be held for the beneficiary(ies).

If you choose this option, then any benefit paid on terminal illness must be a benefit retained by you for use in your lifetime rather than gifted.

If a joint life first death plan includes serious illness cover, then the person who is seriously ill or disabled will be entitled to the serious illness or disability benefit in the normal way.

Important Tax Information

a) Inheritance Tax (IHT)

- You make a gift when the trust is established. For IHT purposes this is called a 'transfer of value'.
- If two of you are making the gift jointly, each of you is treated as making a gift of one half of the value transferred.
- In the event of your death the death benefit will normally not be included in your estate for IHT purposes, but please see "Gift with Reservation of Benefits" section.
- Any retained benefit paid to you that is not spent will be included in your estate, on death.
- Any retained benefit that you are entitled to and decide not to claim as you would like your beneficiaries to receive it, rather than you, is also likely to be included in your estate, on death.
- Where you have gifted terminal illness benefit in the event of a claim it is essential that you don't benefit in any way from the payment. Care will be needed if the funds are being paid to your spouse and/or children.
- If an absolute beneficiary dies, before you, the value of their share will be included in their estate for IHT purposes. Their share then passes to the people named in their will or under the rules of intestacy.
- When a discretionary beneficiary dies, before you, there is no value included in their estate for IHT purposes. This is because they aren't entitled to any benefit until the trustees make an appointment in their favour. Because of this the trust itself is subject to special IHT charging rules. If you require further information, please ask your legal adviser.
- When a new plan is made subject to a trust, the value transferred will initially be the amount of the first premium.
- When an existing plan is made subject to a trust, the initial value transferred is the market value of the plan (or, if the plan is on a whole of life basis, the total premiums paid to date, if greater). The market value is normally the surrender value (which under your VitalityLife plan is zero). However, if the life (lives) assured is/are in serious ill health when the plan is placed in trust potentially there could be a market value for IHT. Please ask your legal adviser for more information if you think this might apply to you.
- Every subsequent premium paid will be a gift (unless exempt).
- The premiums under a regular premium paying plan (such as your VitalityLife plan) will normally be exempt under the normal expenditure out of income exemption to the extent that:
  - it is part of your normal expenditure;
  - it was made from your net income; and
  - you are left with sufficient income to maintain your usual standard of living.
- Each year, every individual has an annual IHT exemption, currently £3,000. So, if the premiums don't qualify under the normal expenditure out of income exemption, then they may be exempt under the annual exemption.
- If the premium is not exempt, then it will be a potentially exempt transfer (PET) if you are using an absolute trust or a chargeable lifetime transfer (CLT) if you are using a discretionary trust. A PET/CLT will not be subject to any IHT charge provided you survive for at least seven years afterwards. If that doesn't happen the PET/CLT will become chargeable and could potentially be liable to IHT.
- Where the premiums are CLTs and you exceed your lifetime gifting allowance (currently £325,000), in any seven year period, there will be an immediate liability to IHT at 20% on the excess. Where an immediate IHT liability arises on a premium being paid, a further IHT liability could arise if you died within seven years of making that premium payment.
- Furthermore, where you have selected the revert to settlor provision under a joint life first death plan, irrespective of the type of trust used, the premiums (unless exempt) will be treated as CLTs and not PETs. However, IHT will only apply if the premiums are substantial and cause you to exceed your standard nil rate band (currently £325,000). If you require further information, please ask your legal adviser.
- In most cases the premiums will be exempt under the normal expenditure out of income or the annual exemption and there will be no IHT liability.

Gift with reservation of benefits

Normally, to ensure that the death benefits do not form part of your estate, you should not benefit from the plan that you have gifted into the trust. If you make a gift with "strings attached" (meaning that you can benefit) it is known as a 'gift with reservation of benefits'.

However, where the plan includes benefits that may be payable during your lifetime (such as serious illness cover), which affect the death benefits that could potentially be paid, it is possible for those benefits to go to you without breaking the gift with reservation of benefits rule. To achieve this:

- all the retained benefits (benefits that are held for you) must be held for your absolute benefit;
- the lifetime benefits kept by you must be clearly defined (which is the case under our trusts); and
- payment of any benefits during your lifetime must not reduce the value of the death benefit. To ensure this condition is satisfied your plan must be written on an additional basis (if your plan includes serious illness cover). Or, if your plan includes lifestylecare cover you must include, from the outset, LifestyleCare Cover Protector. The level of this protector will depend on the level of LifestyleCare Cover you have opted for. Your adviser will be able to provide you will more details.

b) Income Tax

There is no income tax liability on any payments made to yourself, or the beneficiaries, from the trust.

c) Pre-owned assets tax (POAT)

As the retained rights in your trust are held absolutely for you and you have no right to benefit from the gifted part, a POAT charge should not apply.

d) Other taxes after the benefit has been paid to the trustees

No other UK taxes are relevant as long as the only trust asset in the trust is the VitalityLife plan. If the death benefit is paid to the trustees and they subsequently invest the cash in other assets, the trustees should obtain suitable advice regarding any tax implications.

Frequently Asked Questions

1. Who can be a trustee?

Anyone over 18 who is of sound mind can be a trustee. You can appoint a professional person (such as an accountant or solicitor), but they are likely to charge fees.

2. Do I need to appoint additional trustees?

Strictly speaking, you don't need to appoint any additional trustees to create a valid trust. One of the reasons for placing a plan in trust is quick payment in the event of your death. If there are no surviving trustees, VitalityLife will need to wait for probate to establish the legal owners. This will cause a delay.

3. Can I remove a trustee?

Yes, you can remove any trustee if there are at least two remaining trustees.

4. Can a trustee also be a beneficiary of the same trust?

Yes. But it is important to remember that a trustee cannot pay any proceeds to themself. There must be at least one other trustee who is not receiving any of the proceeds to authorise a payment like this.

5. Who can be a witness?

A witness needs to be independent and over the age of 18. This means that the witness cannot be another trustee or a beneficiary under the trust. Also, they should not be a spouse of a trustee or beneficiary.

6. Can my spouse/partner be a beneficiary?

Yes, provided you and your spouse/partner have not taken out a joint life plan. But remember, with a joint life first death plan, both of you can opt for the survivor to receive the death benefit if they survive at least 30 days from the first death.

7. Can I change the beneficiary under an absolute trust?

No, the beneficiaries are fixed and cannot be changed at any time.

8. Can I change the beneficiary under a discretionary trust?

Before your death, you can offer guidance to the trustees on who you would like to receive the benefits by completing a letter of wishes. This letter of wishes is non-binding and does not create any obligations on the trustees. Ultimately, it is the trustees who will choose who receives the benefits from the classes of beneficiaries referred to in the trust.

9. What is the purpose of default beneficiaries, under a discretionary trust?

It is important that a trust doesn't continue indefinitely. So, if the trustees still haven't shared out the proceeds after the trust has been in existence for 125 years, the default beneficiaries become the absolute beneficiaries. Under our current trust, the default beneficiary is the individual or charity entitled to the largest part of your estate.

10. How are the trust funds distributed when I die?

If the trust is absolute, then the trustees must pay the beneficiaries in line with the details contained in the trust.

If the trust is discretionary, all trustees jointly need to decide who to pay the benefits to from the potential beneficiaries listed within the trust. Normally, during your lifetime you will have provided guidance on who you would like the benefits paid to either within the trust itself or by a separate letter of wishes. However, if you have changed the discretionary trust to an absolute trust, by making an absolute appointment in favour of a beneficiary, then the trustees must pay that beneficiary.

11. Does the trust need to be registered with HMRCs' Trust Registration Service?

The trustees may need to register the trust with HMRCs' Trust Registration Service. This would normally only be the case following a claim being paid to the trustees and the trustees not distributing the proceeds to the beneficiaries within two years.

12. What happens on the death of the first to die under a joint life first death plan?

If you have selected the revert to settlor provision, on the first death VitalityLife will pay the death benefit to the trustees. The trustees will need to wait and see whether the surviving settlor survives the other by 30 days. If they do, the trustees will pay the death benefit to them. However, if both settlors die within 30 days of each other the trustees will pay the death benefit to the beneficiary(ies).

13. Can the revert to settlor provision be used under a joint life second death plan?

No, as the plan will only paid out on the event of the second death

14. Can I change the gifted or retained benefits after the trust has been set up?

No, once the trust has been set up you cannot vary the benefits.

15. What happens if I add further covers to the plan later?

These further covers will be held subject to the same trust provisions as if they had been included in the plan from outset.

16. If I increase or decrease the level of cover under my plan, will it affect what inheritance tax needs to be paid?

Provided the amount of life cover does not reduce as a result of a Serious Illness or LifestyleCare claim, there will be no adverse inheritance tax implications if the amount of cover under the plan changes. If your plan includes Serious Illness Cover it needs to be set up in **addition** to Life Cover. LifestyleCare Cover, must include, from the outset, LifestyleCare Cover Protector.

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