CLIENT GUIDE TO THE VITALITYLIFE DISCRETIONARY TRUST

FOR USE WITH A VITALITYLIFE PLAN, VITALITYLIFE ESSENTIALS PLAN OR MORTGAGE PLUS PLAN ("THE PLAN")

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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 in trust and to explain the key issues as simply as possible.

Disclaimer

VitalityLife cannot accept responsibility that this Trust is suitable for your individual requirements. If you or your adviser are unsure about its suitability, we strongly advise that you seek specialist legal or tax advice.

The notes in this Trust form are based on VitalityLife's understanding of the law and HM Revenue & Customs practice as at March 2015. We have made every effort to ensure they are accurate but accept no responsibility for our interpretation of the law, or future changes in the law.

1. What is the Discretionary Trust?

A trust is an arrangement which allows you to gift an asset (such as a life assurance plan) but without giving the intended recipient total control and legal ownership of it. With a trust, you transfer the legal ownership of an asset to someone you can trust (the Trustee(s)) to look after for the person(s) you want to benefit from the Trust (the Beneficiary(ies)).

Under the VitalityLife Discretionary Trust, the asset being gifted and so made subject to trust is the VitalityLife Plan, VitalityLife Essentials Plan or Mortgage Plus Plan (the Plan). Legally, the asset in question is the life assurance plan as a whole and so it is not possible to simply gift your Life Cover and keep other benefits outside the Trust. You, as the proposer (or the original Planholder), will be the Settlor when you create the Trust.

When a Plan is made subject to a Discretionary Trust, the ownership of the Plan is effectively split. The legal owners of the Plan will be the Trustees. The Trustees collectively control all dealings with the Plan on behalf of the Beneficiaries. The Beneficiaries under the Trust will be entitled to enjoy the trust asset which, in the case of a Plan, is the benefits paid under the Plan.

The VitalityLife Discretionary Trust is a special type of trust where the type of benefit paid determines who benefits under the trust. The death benefit payable under the Life Cover or Mortgage Life Cover of your Plan will be held for your chosen Beneficiaries under the Trust (the Gifted Fund). Any serious illness and disability benefits will be held for your benefit (the Retained Fund). You will be able to choose whether to keep any Terminal Illness benefit for your own use or give it away to your Beneficiaries.

Our Discretionary Trust is flexible, so during your lifetime, you retain control over the decision as to who, from the designated classes of Beneficiary, will receive the payment of the death benefit under the Plan and so you can change your mind in this respect if you want to. You can even add further Beneficiaries (other than yourself) and this may be useful if your circumstances change.

The Discretionary Trust will also be suitable if you are a couple with a joint Plan which pays benefits on either the death of the first of you to die or second of you. With the "joint life first death" version of the Plan, if you want to have the choice of the Plan proceeds going directly to the spouse that survives at least 30 days after the first death rather then straight to the Beneficiary, but the death benefits are to be available to your Beneficiaries free of inheritance tax in the event that you both die within 30 days of each other, this Trust will be suitable. This option is not appropriate where the proceeds of the Plan are paid on the second death.

2. The purpose of using a Trust with a Life Assurance Plan

Under the VitalityLife Discretionary Trust the asset to be gifted is the VitalityLife Plan, VitalityLife Essentials Plan or Mortgage Plus Plan. In these circumstances, there are four main benefits from using a trust.

1. Avoid probate delays

When a Plan is held in trust, any death benefit can be paid by VitalityLife to the Trustees simply on production of the death certificate and proof of ownership, without the need for probate (or confirmation in Scotland), which can take several months and may lead to financial hardship for your family. This means that VitalityLife will be able to make the payment much quicker than if there were no Trust.

2. Tax planning

When the Plan is held in a valid trust, it will not be subject to inheritance tax (IHT) as part of your taxable estate. If the Plan proceeds were included in your taxable estate, up to 40% could be lost to the taxman on any part of an estate valued over £325,000.

3. Flexibility in gifts to future generations

When a Plan is held in trust, you can influence the way the Plan proceeds are distributed and which Beneficiaries they are distributed to.

4. Retain own benefits

When a Plan includes benefits payable during your lifetime, these can be retained by you for your own benefit.

3. Ensuring IHT efficiency when the Plan provides Serious Illness Cover or LifestyleCare Cover

For VitalityLife Plans or VitalityLife Essentials Plans only

Generally speaking, in order to ensure that IHT is not charged on the Plan proceeds you, the Settlor, must not benefit from the asset given away (the Plan). If you do, this would amount to a "gift with reservation of benefit" (GWR) and the death benefits would be treated as forming part of your taxable estate. However, where the Plan includes benefits that may be payable during your lifetime and which affect the amount of Life Cover that remains, (Serious Illness Cover or LifestyleCare Cover), it is possible for those benefits to be retained for your own benefit without there being a GWR. To achieve this:

(i) all such benefits must be held for your absolute benefit;

(ii) the lifetime benefits kept by you must be precisely defined, and this is the case under the VitalityLife Discretionary Trust; and

and

For VitalityLife Plans and VitalityLife Essentials Plans without LifestyleCare Cover

(iii) payment of any benefits during your lifetime must not reduce the value of the Life Cover i.e. the amount of the benefit payable on death (although it could completely extinguish it). To ensure that this condition is satisfied, and so avoid any adverse IHT implications under the Trust, if the Plan provides Serious Illness Cover, you must include in your Plan, from outset, either Protected Life Cover or the Minimum Protected Account option at a level of 100%. Your adviser will be able to explain this in more detail.

or

For Plans with LifestyleCare Cover VitalityLife Plans or VitalityLife Essentials

(iv) payment of any benefits during your lifetime must not reduce the value of the Life Cover i.e. the amount of the benefit payable on death (although it could completely extinguish it). To ensure that this condition is satisfied, and so avoid any adverse IHT implications under the Trust, as the Plan provides LifestyleCare Cover, you must include in your Plan, from outset, LifestyleCare Cover Protector benefit. The level required will depend on the level of LifestyleCare Cover, if it is equal to the Life Cover then Level 1 Protector is required as this will protect a Level 1 claim, on a Level 2 claim the LifestyleCare Cover will be extinguished. If the amounts are unequal then Level 2 Protector is required in addition to Level 1 to prevent a partial reduction of the amount of Life Cover. Your adviser will be able to explain this in more detail.

4. IHT treatment for Mortgage Plus Plans

If the Plan includes Serious Illness Cover for Mortgages then the Settlor should be aware that as the amount of the gifted Mortgage Life Cover may be reduced by any payment under the retained Serious Illness Cover for Mortgages benefit, the "gift with reservation of benefit" provisions will apply which means that mitigation of IHT will not be secured. The potential implications should be carefully considered and independent tax advice sought.

5. Options if the Plan is a "Joint Life First Death" Plan

If two of you are taking out a Plan with the intention that the death benefit is paid of the first of you to die (for example, as mortgage protection cover), you are likely to want the survivor to receive any death benefit and so there will be no need for any trust. However, many people are concerned about the possibility of both lives assured dying together or within a short time of each other. Without a Trust, the death benefit would then form part of the taxable estate of the second person to die and be subject to IHT. In such a case, it would be preferable for the death benefit to be payable to their beneficiaries, also in an IHT efficient manner. Fortunately, such an option is possible under the Discretionary life Trust.

The VitalityLife Discretionary Trust allows the two of you with a joint life first death Plan to select the "Reversion to the Surviving Settlor" option. This provides that if the second of you survives the first by at least 30 days, the death benefit will be payable to the survivor. However, if you both die within 30 days of each other, the Trustees will hold the death benefit for the other Beneficiaries.

It is possible to arrange this without upsetting the IHT efficiency of the Trust because the right of the surviving Settlor is absolute, clearly defined and cannot be taken away. This is necessary to ensure that the GWR provisions do not apply (as explained earlier) In effect,

the survivor will receive the benefit on survival for 30 days, irrespective of whether, at that time, it is required or not.

If you choose the Reversion to the Surviving Settlor option, then any benefit paid on Terminal Illness will have to be a benefit retained by you for use in your lifetime rather then gifted.

If a joint life plan includes Serious Illness Cover or Serious Illness Cover for Mortgages or Disability Cover, then the person who is seriously ill or disabled will be entitled to the serious illness or disability benefit in the normal way.

6. What happens with a Joint Life "Second Death" Plan

Health benefits such as Serious Illness Cover or Serious Illness Cover for Mortgages will be paid in the normal way. However, with a "joint life second death" Plan, the Life Cover or Mortgage Life Cover under the Plan is paid on terminal illness and/or death. For this reason the 30 day survivorship option is not appropriate.

Whilst Life Cover benefits will be paid on the second event, the two events do not have to be identical. So, for example, if a Plan is effected on the life of husband and wife and the husband suffers a terminal illness, then Life Cover benefits will be paid if the wife subsequently suffers a terminal illness or dies.

Similarly, if the husband dies and the wife then suffers a terminal illness, benefits will be paid on that subsequent terminal illness.

In a case where the second event is terminal illness, the trust enables you to choose at outset whether to keep or gift this benefit. Given that the nature of second death planning is to place funds in the hands of the family on the second death, it is thought that if the benefit is claimed, most people would wish to gift the Terminal Illness benefits paid on the second event and this will apply in default.

7. When should you consider using the Discretionary Trust?

VitalityLife Plans and VitalityLife Essentials Plans only

You should consider using the Discretionary Trust if you have taken out or are about to take out a VitalityLife Plan or VitalityLife Essentials Plan and have included the Protected Life Cover benefit or the 100% Minimum Protected Account option (for Plans with Serious Illness Cover) or a suitable level of LifestyleCare Cover Protector (for Plans with LifestyleCare Cover) and:

- you wish to make an IHT effective gift of the death benefits under your Plan;
- you do not need to retain access to the death benefit under the Plan for yourself in the future (other than in the special circumstances of a joint life first death Plan), but wish to keep the lifetime benefits, or some of them for yourself;
- you wish to ensure that the Plan proceeds are available to your Beneficiaries without delay following your death;
- you wish to retain flexibility over the choice of the ultimate Beneficiaries i.e. the people who will receive the Plan proceeds after your death; and
- you wish to retain flexibility over the choice of the ultimate Beneficiaries ie. the people who will receive the Plan proceeds; after your death.

Mortgage Plus Plans only

If the Plan includes Serious Illness Cover for Mortgages then the Settlor should be aware that as the amount of the gifted Mortgage Life Cover may be reduced by any payment under the retained Serious Illness Cover for Mortgages benefit, the "gift with reservation of benefit" provisions will apply which means that mitigation of IHT, if relevant to your estate, will not be secured.

8. When should the Discretionary Trust not be used

You should not use the Discretionary Trust:

- if you wish to retain access to all of the Plan for your own benefit;
- if you wish to make an outright immediate gift of the Plan to a named Beneficiary(ies) and retain no flexibility or control over who receives the benefits in the future;

- if your Plan is to be assigned as security for a loan;
- if your Plan is to be used for business protection, as a different type of trust will be more suitable (we can however provide these Trusts so please speak to your adviser); or
- if you have made substantial chargeable lifetime transfers for IHT purposes already (close to or in excess of £325,000) unless you will be paying regular premiums to the Plan that you know will be covered by your annual and/or normal expenditure out of income exemption.

For **Mortgage Plus Plans** with Serious Illness Cover for Mortgages, the IHT implications should be carefully considered with your adviser when considering the suitability of the Discretionary Trust for your Plan.

You should seek further advice on the appropriateness of this Trust if you have an existing Plan and you (or one of you in joint cases) are currently in serious ill health. And in any case you should always seek advice that the Trust is suitable to your circumstances before deciding that your Plan should be held subject to Trust.

9. How do you establish the Discretionary Trust?

Once you have decided that the draft Discretionary Trust is suitable for you, the trust is established when you complete the Discretionary Trust deed. You can use the Discretionary Trust with either a new or an existing Plan. In the Trust deed you declare that the Plan will be held subject to the trust provisions contained in the Trust deed.

As Settlor you will be automatically the first Trustee but you should appoint at least one Trustee in addition to yourself, although two are preferable. Where there are two Settlors, both will be Trustees. Without an additional Trustee there could be a delay in securing access to the Plan benefits for the Beneficiary(ies) following your death.

Additional Trustees should be appointed using a separate deed, a draft of which is provided by VitalityLife for the consideration of your legal advisers – see 'The Trustees' on page 8 below.

For those domiciled in Scotland it is absolutely essential that at least one additional Trustee is appointed when the plan is taken out to ensure the Trust is validly created under Scots law (even though the trust will be governed by English law).

Once the Plan is made subject to the Trust, any subsequent dealings with the Plan will be between the Trustees (as the legal owners) and VitalityLife, although certain rights under the Plan are reserved to you as the Settlor. For example, you will be the person effecting any new cover or reducing cover under the Plan.

10. Key provisions of the Discretionary Trust

The Trust is effectively split into two sub-trusts.

(i) The Retained Fund

The following benefits, if they are included under your Plan, will be held for your absolute benefit (payment made to you and not into Trust):

- Serious Illness Cover (including any future added benefits that become payable at the same time as the Serious Illness Cover);
- Serious Illness Cover for Children;
- Serious Illness Cover for Mortgages,
- Disability Cover;
- Mortgage Incapacity Cover,
- LifestyleCare Cover,
- Income Protection Cover;
- Family Income Cover (where the benefits become payable on the diagnosis of a serious illness; otherwise the benefits will form part of the Gifted Fund),
- all benefits arising under the healthy living part of your Plan; and
- the benefit paid on Terminal Illness benefit (but only if you choose this to be a retained benefit by initialling the appropriate box).

Any other benefits that are payable under the Plan during your lifetime by reason of you suffering an illness or condition as specified in the Plan will also form part of the Retained Fund.

If there are two Settlors and the Plan is on a joint life first death basis, the Terminal Illness benefit is paid to the one who suffers the illness or disability. In the case of a joint life second death Plan, the Life Cover or Mortgage Life Cover benefit will be paid on the second event to occur. For example if a husband suffers a terminal illness and the wife subsequently dies, the benefit will be paid on that subsequent second event.

You cannot change your mind about these benefits forming part of the Retained Fund and you will be entitled to these benefits even if, at the time, you decide that you would rather your Beneficiaries be entitled. Of course, once you have received the benefit you can do with it as you like, but if you give them away, you will be making a gift for inheritance tax purposes.

(ii) The Gifted Fund

This Fund comprises all benefits, other than the benefits in the Retained Fund, under the Plan. In effect this will include the Life Cover or Mortgage Life Cover (i.e. the benefit paid on death and the benefit paid on Terminal Illness if you have chosen for this to be part of the Gifted Fund) or in default having not made an election to retain them (unless the Reversion to the Surviving Settlor provision applies) as well as any other benefits payable after your death, for example the Education Cover. If the death benefit can be paid as a regular monthly benefit under Family Income Cover, then it will form part of the Gifted Fund.

These benefits are held by the Trustees on the following terms:

- During the Trust period (up to 125 years) the Appointor (you and, after your death, the Trustees) may appoint these benefits to any of the Beneficiaries. The potential Beneficiaries include:
  - your spouse (or civil partner) (provided the Plan is not a joint Plan)
  - your children and grandchildren
  - your brothers and sisters and their children and grandchildren
  - any person nominated in writing by you at any time to the Trustees. This means that you can add anybody else (other than yourself) including a charity, to the list of the Beneficiaries.

It is recommended that you leave a Letter of Wishes with your Trustees specifying which of the potential Beneficiaries you would like to benefit after your death. VitalityLife provides a draft form for this purpose.

- As the Trust is a discretionary trust, no Beneficiary is entitled to anything until the Appointor makes an appointment in his or her favour.
- You (both of you in the case of a joint Plan) cannot benefit from the Gifted Fund in any circumstances except where the Plan is a joint life first death Plan and you have both chosen the Reversion to Surviving Settlor provision (as explained on page 3).
- You name (as Default Beneficiaries) the individual(s) who are to benefit from the Trust Fund **at the end of the Trust period if no appointment has been made before then**, and if more than one the shares in which those individuals are to benefit. If none are specified then any children you have or, if none, those who benefit from your estate either by will or intestacy will benefit. This is necessary for the Trust to be legally valid although in practice it is unlikely that the Trust Fund will remain undistributed after 125 years.
- The Trustees have wide powers to invest and deal with trust property where the Plan proceeds are not distributed to the Beneficiaries immediately, for example, if the intended Beneficiaries are minor children at the time of your death.

11. The Law of the Trust

The Discretionary Trust is subject to the law of England although it can be used in any part of the UK as long as the Settlor(s) is happy that the Trust will be governed by English law.

The objectives of the Discretionary Trust, as indicated on page 2 (including the mitigation of inheritance tax) will be achieved in all parts of the UK.

12. The Trustees

You (or both of you where there is a joint Plan) are automatically the initial Trustee(s). At least one additional Trustee should be appointed. This is done by completing a deed of appointment of additional Trustees - for new Plans as soon as the Plan is issued. A draft deed of appointment is provided for this purpose by VitalityLife.

Anyone over 18 years old and of sound mind can be a Trustee. Obviously you should appoint people you can trust. You may wish to appoint a professional person, such as solicitor, but bear in mind that they are likely to charge fees for their services.

You can appoint other Trustees later on. You can also dismiss a Trustee provided at least one Trustee other than you (or both of your with a joint Plan) remains.

The Trustees of a trust governed by English law must act unanimously.

13. Inheritance Tax and the Discretionary Trust

In what follows, it is assumed that the Settlor is domiciled and resident in the UK and the Beneficiaries and Trustees are UK residents - special rules would apply in the circumstances where this is not so.

1. What are the IHT implications on the establishment of the Trust?

- For IHT purposes you make a gift when you establish the Trust. The technical term for this is a "transfer of value".
- If two of you are making a gift jointly, each of you is treated as making a gift of one half of the value transferred.
- When a new Plan is made subject to trust, the value transferred will initially be the amount of the first premium.
- Every subsequent premium paid will be a gift.
- Strictly speaking, for the purposes of calculating the transfer of value on the premiums, the amount of the premium should be reduced by the amount of the premium that would be payable for any of the retained benefits, that you are not gifting away (if any) ie. the Retained Fund. In practice, regardless of this discount, because of the type of Plan involved, the total premium is, in any event, likely to fall within one of your available exemptions for IHT e.g. the annual exemption or the normal expenditure out of income exemption.

  *Usually, when the plan that is being made subject to trust is a regular premium protection plan, such as a VitalityLife Plan, the premiums paid will be exempt from IHT as normal expenditure **out of income*** Broadly speaking, to qualify for this exemption, it is necessary for the payment of the premium to be regular, paid out of the Settlor's income and of such an amount that will not affect the Settlor's standard of living.

  If the amount of the premium or cash transferred to the Trustees does not qualify for the normal expenditure out of income exemption **and** it exceeds the available annual exemption, currently £3,000 for each Settlor, it will be a chargeable lifetime transfer (CLT). This means that a potential liability to IHT at 20% may immediately arise if the chargeable lifetime transfer on the gift plus the value of all other chargeable transfers made by the Settlor in the preceding seven years exceeds the nil rate band at the time the Plan is put in trust. ***However, as the nil rate band is substantial (£325,000 until April 2019), in most cases it is very unlikely that a liability will arise.***

  In the unlikely event that an IHT liability does arise on the premium(s), a further tax liability (a further 20%) on the chargeable lifetime transfer could arise if the Settlor dies within seven years of making the gift. Taper relief would reduce the tax payable if the Settlor survives the gift for at least three years. On the Settlor's death within seven years of making the gift the full value of the chargeable lifetime transfer when made will also be taken into account in calculating the IHT liability on the Settlor's estate.
  It is reiterated though that in most cases no IHT liability will arise in connection with the payment of premiums under your VitalityLife Plan, VitalityLife Essentials Plan or Mortgage Plus Plan in trust.

- When an existing Plan is made subject to trust, the transfer of value in respect of the gift will be the market value of the Plan (or, if your Plan is on a whole of life basis, the total premiums paid to date if greater).

  You should note that even though a VitalityLife Plan, VitalityLife Essentials Plan or Mortgage Plus Plan will never acquire a surrender value, if the life (lives) assured is/are in serious ill health this could mean that it has a market value for IHT purposes.

Certain gifts to discretionary trusts need to be reported to HM Revenue & Customs. This does not apply to gifts which are exempt. If you are uncertain about whether your gift needs to be reported please ask your financial adviser to explain the position.

2. Why isn't there a gift with reservation of benefit under the Trust?

- **For VitalityLife Plans and VitalityLife Essentials Plans without Lifestyle Care Cover**

  Under the Trust you retain the Serious Illness Cover, (and, if you so choose, the Terminal Illness Cover) and other lifetime benefits for yourself. However, despite this "retention" the transfer of the Plan into trust will not be a gift with reservation of benefit (GWR) because

  - your retained benefits are clearly identified and carved out, and
  - provided the Life Cover amount cannot reduce as a result of any lifetime payments (i.e. on serious illness) from your Plan

account. The complete extinguishment of life cover by a prior serious illness payment would not, however, cause an IHT problem.

To ensure that this condition is satisfied the Plan must include, from outset, either Protected Life Cover or the Minimum Protected Account at a level of 100%. If this is not so, then the gift with reservation of benefit provisions could apply.

- **VitalityLife Plans or VitalityLife Essentials Plans with LifestyleCare Cover**

  Under the Trust you retain the LifestyleCare Cover (and, if you so choose, the Terminal Illness Cover) and other lifetime benefits for yourself. However, despite this "retention" the transfer of the Plan into trust will not be a gift with reservation of benefit (GWR) because

  - your retained benefits are clearly identified and carved out, and
  - provided the Life Cover amount cannot reduce as a result of any lifetime payments (i.e. on LifestyleCare Cover claim) from your Plan account. The complete extinguishment of life cover by a prior LifestyleCare Cover payment would not, however, cause an IHT problem.

  To ensure that this condition is satisfied the Plan must include, from outset, a suitable level of LifestyleCare Cover Protector. If this is not so, then the gift with reservation of benefit provisions could apply.

3. What is the IHT position if I increase or decrease my level of cover under the Plan?

- **VitalityLife Plans or VitalityLife Essentials Plans without LifestyleCare Cover**

  Provided the amount of the Life Cover does not reduce depending on the amount payable if you suffer a serious illness, (or if it does, the Protected Life Cover or Minimum Protected Account at 100% is in place), any increase or decrease in the amount of Life Cover will not adversely affect the IHT effectiveness of the trust.

- **VitalityLife Plans or VitalityLife Essentials Plans with LifestyleCare Cover**

  Provided the amount of the Life Cover does not reduce depending on the amount payable if you meet the LifestyleCare Cover claim criteria, (or if it does, the (appropriate level of LifestyleCare Cover Protector is in place), any increase or decrease in the amount of Life Cover will not adversely affect the IHT effectiveness of the trust.

4. What is the IHT position on the payment of subsequent premiums by the Settlor?

When you continue to pay regular premiums to a Plan held in trust you will be making further gifts but these are likely to be exempt as described in section 1. above.

5. What is the IHT position on the death of the Settlor?

- On your death (or, for joint policies, the death of either or both of you) the death benefit will not be part of your taxable estate for IHT purposes. Instead the Plan proceeds will be paid free of IHT to the Trustees.
- If the initial gift gave rise to an IHT charge (highly unlikely with a regular premium Plan) a further tax liability (a further 20%) on the chargeable lifetime transfer could arise if you were to die within seven years of making the gift. However, this could be reduced by taper relief if you survived the gift by at least three years.

  As well as this, if you die within seven years of the gift, the amount of the chargeable lifetime transfer could affect the amount of IHT paid on your estate on death. This is because it has to be taken into account in working out the tax payable on your estate.

6. In the case of a joint life first death policy, what happens on the death of the first of two joint Settlors to die?

If you have elected for the Reversion to the Surviving Settlor provision to apply then, on the first death, the benefit will be paid to the Trustees (free of IHT at this stage) who would have to wait and see if the survivor of you is still alive 30 days later. If so, the surviving Settlor will then become absolutely entitled to the death benefit and the Trustees will have to make this payment to them. On the other hand, if both of you die within 30 days of each other, the Trustees will hold the funds for the other Beneficiaries.

When the survivor becomes entitled after 30 days this could result in an "exit charge" – see section 8 below.

7. What about the benefit paid on Terminal Illness?

If there is:

- only one Settlor; or
- there are two Settlors and the Plan is a joint life **second death survivor** Plan or
- the Plan is a joint life first death Plan and the Reversion to the Surviving Settlor provision has **not** been chosen

then you have a choice - you can either keep the benefit paid on Terminal Illness for yourself or you can give it away. This is done by initialling the appropriate box in the Trust deed. Once the choice is made, you cannot later change your mind.

If the Plan is a joint life first death Plan and the Settlors have chosen for the Reversion to Surviving Settlor provision to apply, then the Terminal Illness benefit must be a retained benefit.

In the case of a joint life second death Plan where it is intended that benefits will be paid on the second death, it would be unusual for the Settlors to want the Terminal Illness benefit to be paid to them and the benefit will be treated as gifted in default unless the Retained Fund box is initialled.

If the right to payment on Terminal Illness is retained, the benefit will be paid to you and, any that is not spent, will be included in your estate for IHT purposes.

If the benefit on Terminal Illness is given away under the Trust you, as the Settlor, **must not receive any part of it** if it is later paid to the Trustees. To ensure that the IHT efficiency of the Trust is not compromised it will be essential that, following the payment of this benefit, the benefit should not find its way back to you, directly or indirectly.

Particular care will be needed if the funds are paid to the spouse/children of the Settlor, (for either single or joint Plans where the Settlor(s) has gifted the Terminal Illness benefit) or to any member of the Settlor's family living with the Settlor while the Settlor is still alive. If the terminally ill Settlor actually benefits from the funds, even if they are used to meet joint expenses, this could operate to activate a gift with reservation of benefit (see earlier for an explanation of this).

8. What are the inheritance tax implications whilst the Trust is in existence?

Periodic and exit charges

Special IHT charging rules apply to discretionary trusts. Under these rules there may be IHT charges:

- on every ten-year anniversary of the Trust. This is known as "the **Periodic Charge**"; or
- whenever property leaves the Trust (e.g. when capital from the fund is advanced to a Beneficiary or when a Beneficiary becomes absolutely entitled to the fund). This is known as "the **Exit Charge**".

Both are described in more detail below but where the only trust asset is a VitalityLife Plan, VitalityLife Essentials Plan or a Mortgage Plus Plan it is highly unlikely that these charges would arise.

The Periodic Charge

Periodic charges at ten-yearly intervals may be applied to the value of the assets in the trust. There are rather complex rules for calculating the rate of tax and you should ask your financial adviser for a full explanation.

In most cases there will be no charge. A possible charge may arise, for example, if a sum assured greater than the nil rate band is paid to the Trustees after your death and the funds remain undistributed at a ten-year anniversary. The maximum potential liability will be 6% of the value of the Trust assets in excess of the nil rate band.

If all the Trust fund is distributed before the tenth anniversary, usually no tax charge will arise (see "Exit Charge" below).

The Exit Charge

Exit charges will very rarely apply to a protection plan in trust. But, if they do, they will be based on the value of property leaving the trust or being appointed absolutely to a Beneficiary. Again, there are complex rules for calculating the charges and your financial adviser will be able to explain the detail if any charges are likely in your circumstances.

Generally speaking, on the basis that your available nil rate band is not exceeded when you put the Plan in trust, there is a good chance that there will be no exit charge during the first ten years of the Trust's life.

The amount of any exit charge occurring after the first ten years will depend on the rate of tax

charged at the previous ten-year anniversary (if any) and the length of time that the property has been in the Trust since the last ten-year anniversary. This means that if there was no charge at the previous ten-year anniversary (which will almost always be the case) there will be no exit charge.

At the time of any periodic or exit charge it may be necessary to report this to HM Revenue and Customs. The forms to do this are IHT100c or 100d and form D34. Your financial adviser will be able to explain this in more detail.

If there are joint Settlors (eg. husband and wife), the Trust will be treated as two separate trusts of 50% of the overall Trust property, one with the husband as Settlor and the other with the wife as Settlor which will make it even less likely that an IHT charge would arise.

Reversion to the Surviving Settlor provision

If the Reversion to the Surviving Settlor provision is chosen under a joint life first death Plan, then in the event of the death of one Settlor with the other Settlor surviving 30 days the Plan benefits revert to the surviving Settlor under the Trust. This reversion will be treated as an absolute appointment from the Discretionary Trust with the result that an exit charge may potentially arise. A possible tax liability will only arise if the value of the benefit is in excess of the then nil rate band for IHT and there was an IHT charge on the previous ten-year anniversary (if any) of the Trust. If there was no charge at the previous ten-year anniversary there will be no exit charge. There will normally be no exit charge, regardless of the value, in the first ten years after the Trust's commencement.

For IHT purposes this position is no different from a payment to any other Beneficiary under the Trust following payment of the death benefit.

Payment of the Serious Illness Cover benefit, LifestyleCare Cover benefit and other lifetime benefits

Payment of these benefits will be made to you free of tax because they are held on absolute trust for you.

Remember that you become entitled to the serious illness benefit once you are diagnosed as suffering from any condition classified as a serious illness under the Plan.

For Plans with LifestyleCare Cover you become entitled when you satisfy the claim criteria under the cover.

Even if you decide not to make a claim (for example because at that time you may consider that you'd rather your Beneficiaries benefit on your death) the value of the benefit is likely to be included in your estate for IHT purposes even if you do not claim it. This is because you could have claimed the benefit had you so wished.

14. Other tax implications of the Discretionary Trust

Income Tax

Chargeable event gains

As the VitalityLife Plan, VitalityLife Essentials Plan or Mortgage Plus Plan do not acquire a surrender value there will never be a chargeable event.

Payments to the Settlor from the Retained Fund

There will be no income tax liability on any payments of the lifetime benefits retained by the Settlor.

Payments to the Beneficiaries of the Gifted Fund

- No payments will be made to any Beneficiary until the Plan pays out on the death or Terminal Illness of the Settlor (if the Terminal Illness benefit is not retained by the Settlor).
- As long as payments to Beneficiaries are made and documented as advancements of capital and do not acquire the character of income, there should be no income tax implications for the Trustees or the Beneficiaries.

Pre-owned assets tax (POAT)

This is an income tax charge which is levied when a person continues to benefit from property which he or she owned in the past but has given away and the gift with reservation of benefit rules do not apply.

Under the Discretionary Trust, the POAT will not apply as the Settlor's rights under the Trust are specifically retained in the Retained Fund for the Settlor's benefit. As the Settlor has no right to any benefit under the Gifted Fund, which is the property he has given away, HMRC has confirmed that in such circumstances a POAT charge should not apply.

Other taxes after the benefit has been paid to the trustees

No other UK taxes are relevant to the Discretionary Trust as long as the only trust asset is a VitalityLife Plan, VitalityLife Essentials Plan or Mortgage Plus Plan. If the Life Cover or Mortgage Life Cover benefit is paid to the Trustees and they subsequently invest the cash in other assets there may be income tax and, possibly, capital gains tax implications to consider. The Trustees should obtain suitable advice before making an investment and take the tax implications of the relevant investments into consideration at that time.

15. Frequently asked questions

1. Who can be a Trustee?

Any adult person of sound mind can be a Trustee. A professional person such as an accountant or solicitor may be a Trustee but they are likely to charge fees. A person who is a beneficiary of the trust can also be a Trustee but there are provisions in the Trust to ensure that they cannot exercise a power of appointment in their own favour if they are the sole trustee.

2. Can I change the gifted or retained benefits after the Trust has been set up?

No, once the Trust has been set up, its provisions cannot be changed.

3. What are the main duties of a Trustee?

The main duty of a Trustee is to look after the Trust assets for the benefit of the beneficiaries. As long as the Plan is in force and there is no claim, in practice, the Trustees will not have much to do. Once the Plan benefits have been paid out after a claim, the Trustees will then have to exercise their powers in accordance with the Trust, depending on which of the benefits have been paid out. If benefits are paid after the death of the insured person, the Trustees will have to decide which of the Beneficiaries should receive what and when. If it is not be appropriate to distribute the funds straight away, they can invest them and hold them for the future benefit of the Beneficiaries.

4. If a Trustee is unable to act as a result of them losing capacity, can the remaining Trustees remove them?

Yes, providing that there are two remaining Trustees. The remaining Trustees can remove any Trustee, including the Settlor, who has lost capacity as defined in the trust deed where this is confirmed by a written report from the General Practitioner of the Trustee being dismissed. Where there are only two individuals acting as Trustees, a new Trustee will need to be appointed simultaneously with the dismissal of the incapable Trustee.

5. Can my spouse/partner be a Beneficiary in respect of death benefits?

Yes, provided this is not a joint life Plan. Even if it is a joint life first death Plan, it is possible to choose an option whereby the surviving spouse will be entitled to the proceeds on death if he/she survives the first death by 30 days.

6. Why do we require default beneficiaries?

It is important to distinguish between the class of potential beneficiaries as set out in part C2 of the Trust and the default beneficiaries. The latter are required to cover the remote scenario where the trust funds have not been distributed within 125 years. In these remote circumstances the trust could fail with adverse tax consequences. Many individuals select their children (their estates would benefit in practice).

6. 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.

7. How many additional Trustees do I need to appoint?

There is no limit on the number of Trustees you should appoint, although in practice it is not recommended that more than three should be appointed in addition to you.

This is because the agreement of all the Trustees needs to be obtained when any Trustee functions are exercised.

In England it is not strictly legally necessary to appoint an additional Trustee as a valid Trust will exist even without an additional Trustee. However, clearly if there is no additional Trustee surviving you following your death, one of the objectives of the Trust will not be fulfilled as probate on your death will be necessary to determine who will be the Trustee to whom any benefit can be paid.

In Scotland, on the other hand, it is essential from a legal standpoint to appoint at least one additional Trustee (in addition to the Settlor).

8. How are the Trust funds distributed when I die?

This decision will be made by the Trustees unless you have made a prior irrevocable appointment of benefits to a named Beneficiary (which you can do during your lifetime).

If you have not, the Trustees can appoint the benefits to any of the Beneficiaries indicated in the Trust (which includes any beneficiaries nominated by you in writing during your lifetime to the Trustees). It is recommended that you, as Settlor, should leave the Trustees a Letter of Wishes to guide them as to how they should exercise their discretion after your death. VitalityLife provides a draft Letter of Wishes should you require it.

The above does not apply to joint life first death plans in Trust where the Settlors have chosen the reversion to the surviving Settlor provision. In such cases, if one of them dies and the other survives for 30 days, the survivor will become absolutely entitled to death benefits. Only if both die within 30 days of each other will the Trustees need to step in to decide to whom they should distribute the funds.

Next steps?

If you decide to make your Plan subject to the VitalityLife Discretionary Trust, it is important that you follow the process below to make sure all documents are correctly completed and submitted:

Changes to Tax Law

The notes in this Client Guide are based on VitalityLife's understanding of the law and HM Revenue & Custom's practice as at March 2015. We have made every effort to ensure they are accurate but accept no responsibility for our interpretation of the law, future changes in the law or for any loss you or anyone else suffer if you act based on any information we've given.

You/your adviser completes a Plan application form and the Discretionary Trust form. This Trust form must be dated on or after the date of the Plan application.

Consider appointing at outset at least one additional trustee to act with you and providing the Trustees with a Letter of Wishes to guide them. See VitalityLife 'Deed of Appointment of Additional Trustees' and 'Letter of Wishes'.

Post the original Trust form (along with the Plan application if placing in Trust from outset) and the 'Deed of Appointment of Additional Trustees' (if appointed at outset) to VitalityLife, Stirling, FK9 4UE.

We will return to you the original Trust form(s) by special delivery once processed.

You should then:

1. Provide all additional Trustees with copies of the Trust form(s).
2. Provide the first additional Trustee with the original Letter of Wishes (if produced) and copies to any other Trustees.
3. Make the Trustees aware of the place of safe-keeping for the original Trust form for ease at point of claim.

FIND OUT MORE

To find out more about our Business Protection Plan or any other products, please speak to your financial adviser or take a look at visit **vitality.co.uk/life**

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