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GUIDE TO INSURANCE TRUSTS

What is a trust and why use one?

Trusts give you control over your assets and how they're distributed, so you can ensure your beneficiaries receive the money you intend to leave them.

They can be a really effective way to manage your wealth and avoid inheritance tax. Put simply, they can help protect your assets and guarantee that your loved ones will have financial stability once you're gone. So, if you're worried about the impact of care home fees, inheritance tax or probate, or simply want to ensure the ongoing protection of disabled or vulnerable members of your family, a trust could be the right solution for you.

Life insurance could be subject to inheritance tax at 40% if it tips the value of your estate above the nil rate band. Trusts are often used to ensure your loved ones won't face the burden of inheritance tax or probate on your life insurance policy and other assets.

How do trusts work?

A trust is a legal arrangement that allows you (the settlor) to gift your assets to one or more people (the beneficiaries). The trust is looked after by one or more people, called trustees. As the settlor, you are automatically one of the trustees.

A variety of assets can be put into a trust. Cash, shares, property and land, as well as life insurance policies.

If you are gifting your life insurance policy via a trust, you remain responsible for paying the insurance premiums. Your trustees are responsible for keeping safe the documentation and ensuring your beneficiaries receive the money when a claim is made.

What types of trusts are there?

Bare trust

This is the simplest type of trust and is often set up by a will. They're commonly used to pass assets onto minors (under 18's or 16's in Scotland). The trust is subject to tax on the beneficiary, as if the money were owned in the beneficiary's name.

Discretionary trust

A discretionary trust names potential beneficiaries, for example 'my children and grandchildren', but no-one has an absolute right to any income or capital. Rather, it is the trustees that have the authority to decide who from the potential beneficiaries will benefit from the trust and when. Often to provide guidance to the trustees on what to pay to whom, a letter of wishes is also provided by the settlor.

As such, discretionary trusts are frequently used in inheritance tax planning. The settlor can move money out of their estate while still retaining control over it by gifting it into a discretionary trust.

It's worth noting that if the settlor transfers more than the inheritance nil rate band into a discretionary trust within a seven-year period, there will be an immediate inheritance tax charge on the excess amount at 20%. The trust itself is assessed for inheritance tax every ten years or when money is transferred out to a beneficiary.

Survivors discretionary trust

Similar to a discretionary trust, a survivor's discretionary trust is only suitable for joint life policies, where the insurance money is paid after the first person dies. If one settlor dies but the other settlor survives, the survivor will be entitled to the money from the policy. If both settlors die within 30 days, then the discretionary beneficiaries will benefit in the same way that they would for a standard discretionary trust.

Absolute trust

This is the least flexible type of trust as the beneficiaries are named individuals who cannot be changed in the future. This can be problematic if, for example, children are born after the trust is set up or a divorce occurs. The beneficiaries are absolutely entitled to the trust fund, and the trustees do not have discretion on who to pay.

Flexible trust

A flexible trust is similar to a discretionary trust, but it is more complicated. There are two types of beneficiaries:

1. **The default beneficiary:** people who are entitled to any income from the trust as it arises.

2. **The discretionary beneficiary:** people who your trustees can decide to give money to at their discretion. They only receive capital or income from the trust if the trustees make appointments to them during the trust period.

The pros and cons of putting life insurance policies into trust

The advantages of using a trust are:

1. **Control** – You will be a trustee and so have the say over who the beneficiaries and other trustees are. Without a trust the money from your life policy forms part of your estate and therefore may not automatically benefit who you want. If you're not married or in a registered civil partnership or when there are children involved, a trust can be really important to retain control of what happens to the money from your life policy when you die.

2. **Avoid Inheritance Tax** - A life policy will normally be considered part of your estate, which means it can be subject to inheritance tax (40% of any part of your estate over nil rate band). To increase the amount passed onto your loved ones, placing your life insurance into a trust can ensure your beneficiaries won't pay tax on the proceeds from the policy.

3. **Quicker payment** – Gaining a grant of probate can be a lengthy legal process which can hold up the money paid out from your life insurance policy. Using a trust should help ensure that the money can be paid to your beneficiaries faster.

But be aware there are also disadvantages:

1. **Cancellation restrictions -** Once the trust has been created it cannot usually be cancelled before it has served its purpose and the policy cannot be cancelled without the permission of the trustees. It's important to therefore consider how flexible you want the trust.

Get advice

As trusts usually can't be changed once they're set up, getting specialist advice is recommended.

Talk to us about setting up a trust.

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