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# Briefing document

## Life policies

**Introduction**
Life assurance has an important role to play in protecting the financial well-being of a family and in providing for dependants. Any proceeds paid out under a life insurance policy to an individual's estate on death will be included in his or her estate and Inheritance Tax (IHT) may need to be paid, depending on the values involved and the availability of any reliefs or exemptions. The proceeds would also need to be included as part of the probate process, which will delay distribution of the funds until probate has been completed. For these reasons, individuals tend to assign their policies into trust, often a discretionary trust, as the proceeds would not then be taxed as part of the estate.

Assigning life policies into trust may be appropriate for individuals who would like to achieve any of the following, although all relevant factors would need to be considered carefully:

- Reducing IHT payable on sums paid out under the policy.
- Retaining flexibility over the choice of individuals who will receive the proceeds.
- Avoiding unexpected IHT liabilities in the unfortunate event of the policyholder and his or her spouse or civil partner dying simultaneously, as the policy proceeds would not be within the policyholders' estates for IHT purposes.
- As noted above, potentially accessing policy proceeds more quickly than if the proceeds were paid directly into the estate, in which case the proceeds would be subjected to probate before they could be distributed.

This note assumes that the policyholder and his or her family members are UK resident and domiciled, and so within the scope of income tax, capital gains tax and IHT on worldwide income, gains and assets. Different considerations may apply to non-UK resident and/or non-UK domiciled individuals.

**What is involved?**
A trust is a legal relationship between a person who has legal ownership of an asset (a trustee) for the benefit of a beneficiary of the trust. In practice there can be more than one trustee and beneficiary of the trust. The trustees have the control and legal ownership of the asset (i.e. the policy) but must use it to benefit the beneficiaries of the trust according to the specific terms of the trust deed. If the trust is a discretionary trust the decisions as to when and to whom to distribute the insurance proceeds received following the policyholder's death ultimately lie with the trustees. The analysis below assumes a discretionary trust is used, as would normally be the case.

There are various parties involved in a trust, as follows:

- **Settlor:** If a trust is to be used, it is preferable for the settlor to be excluded from benefiting under the terms of the trust; otherwise the proceeds paid under the policy following the settlor's death will be included in his or her estate for IHT purposes and will be included in the probate process. The settlor can give the trustees a 'letter of wishes' as to whom they might want to benefit from the trust and when. Although this is not legally binding on the trustees, they should take it into account when considering distributions.

- **Beneficiaries:** During the trust period (which is usually 125 years under the law of England & Wales), the trustees can appoint assets to any of the trust beneficiaries. These beneficiaries can include the settlor's spouse or civil partner, children, grandchildren, siblings and/or any other individuals the settlor nominates.

- **Trustees:** The trustees can be selected by the settlor and may include the settlor him or herself.

**What are the UK tax implications for a discretionary trust?**

### Inheritance Tax (IHT)

A lifetime gift into a discretionary trust is a chargeable transfer for IHT purposes and potentially subject to an immediate IHT charge of 20%, which can increase to the full death rate of 40% where the donor does not survive seven years from the date of the gift. A form of taper relief applies where the donor survives for between three and seven years from the date of the gift that gradually reduces the IHT payable on death. No further IHT is payable on death if the donor survives for more than seven years from the date of the gift.

IHT is payable based on the value of the assets given to the trustees. There are special rules for valuing the gift where life assurance policies are involved, though in general no IHT should arise if the settlor is in good health at the date of transfer, assuming the policy does not have an investment element. Advice should however be taken on a case by case basis, as values can vary.

IHT could also potentially arise if the settlor continues to pay premiums in respect of a policy held by the trustees, though in practice exemptions may be available on the basis that the expenditure represents part of the individual's normal expenditure out of income (subject to meeting certain conditions), or where the annual exemption is available, which enables up to £3,000 per annum to be given away each tax year.

The normal expenditure out of income exemption may be unavailable and the annual exemption exceeded in some circumstances where larger, one-off, premiums are paid, though, in any event, no immediate IHT liability would arise provided the settlor's nil rate band is available. The nil rate band is an amount which can be given away tax free. The nil rate band is £325,000 in the 2020/21 tax year, though will be reduced if the settlor has made any other chargeable lifetime transfers in the preceding seven years (such as gifts into trust which were not eligible for relief or exemption).

Trustees may be subject to ongoing IHT charges every ten years, when assets leave the trust and/or when fixed interests are appointed. The maximum IHT charge per occasion of charge is 6% of the value of the trust assets (compared to 40% for assets held on death). Assuming there is no investment element in relation to the policy, the actual value of a policy will often be negligible in comparison to the amount which might be paid out on the event of death, which reduces the likelihood of an IHT charge arising. However, IHT may be payable on the ten year anniversary if the policy proceeds have been paid to the trustees but not distributed to beneficiaries at the point of the anniversary. A policy may be more valuable if the person whose life is assured is in ill health, which may affect whether or not IHT is payable. In some circumstances IHT can arise when the policy proceeds are distributed from the trust, depending on the particular circumstances of the case.

### Income tax

Provided the life policy is a 'qualifying' life policy, no income tax should arise when proceeds are paid following the death of the person whose life is assured. Various conditions need to be met in order for a policy to be a qualifying policy: in particular, the maximum annual premiums that can be paid into qualifying policies issued on or after 21 March 2012 is £3,600 per annum. Income tax may arise to the extent a 'chargeable event gain' arises on a non-qualifying policy. On the basis the policy proceeds will be payable on the death of the life assured, the trustees would be liable to pay income tax on the gain realised on the policy, assuming that they are UK resident.

A UK resident discretionary trust where the settlor and his or her spouse (or civil partner) is excluded from benefiting from the trust is subject to income tax on most income at a rate of 45%. Dividend income is usually subject to 38.1% income tax. Lower rates will apply to the extent the income is within the trustees' standard rate band, which is £1,000 in 2020/21. Anti-avoidance provisions apply to prevent individuals setting up multiple trusts in order to benefit from multiple standard rate bands.

On the basis the trust is unlikely to hold any assets besides the life policy (and so is unlikely to receive any income) until the death of the life assured, there should not be any ongoing income tax implications.

If the settlor of a trust is alive and can benefit from the trust he or she may be taxable on the income arising to the trust, even if he or she has not received a benefit from the trust.

### Capital Gains Tax (CGT)

When a UK resident individual transfers chargeable assets to a trust, they are treated as disposing of the asset(s) for market value, and a CGT liability may arise accordingly. Non-UK residents are generally not within the scope of CGT, subject to some exceptions that are unlikely to be relevant in this context.

In this instance, the asset being settled in the trust is the policy itself and any ongoing cash premiums relating to the policy. Sterling cash is never a chargeable asset and it is unusual for life insurance policies to be chargeable assets, and so, assuming the policy is given rather than sold to the trustees, there are unlikely to be any CGT implications of assigning the policy into trust.

**Reporting**

While the trust should not initially have tax liabilities to report it may be subject to other reporting requirements. This includes providing information for the trust beneficial ownership register. The register in force at present only requires certain trusts to register where the trustees have incurred a UK tax liability.

This is due to change in light of the UK Government's implementation of the European Union's Fifth Money Laundering Directive (5MLD) which will, in due course, require almost all UK trusts and certain non-UK trusts to disclose beneficial ownership information.

The government are currently considering how to implement the 5MLD trust register following a consultation. The consultation document proposed that trusts that only hold life insurance policies which are pure protection policies that only pay out in the event of the death or terminal illness of the insured person will be exempt from registration. Further information on the intended 5MLD trust register is available on request.

**When should a trust not be used?**

Although a trust may be appropriate in many cases, it may not be suitable for individuals who wish to do any of the following:

- Retain access to the policy. This may be the case if there were an investment element to the policy itself.
- Make an outright gift of the policy and retain no further control over who should benefit, or;
- Pay an enhanced premium to cover a spouse's life.

**Life policies held via pensions**

Life assurance policies held via registered pension schemes are typically written into trust and are therefore outside of estates for IHT purposes. They can, however, give rise to income tax charges on death under the pensions regime in some circumstances (lifetime allowance charges or lump sum death benefit charges). Separate briefing notes on lifetime allowances and pension benefits are available on request.

**Find out more…**

This briefing note gives a brief overview of the tax issues involved in placing a life policy in trust: please be aware that it does not cover all aspects of this subject. Detailed advice, both on the tax and the insurance issues, should be taken before entering into any transaction of this nature. There are also various other matters that should be considered when reviewing estate planning arrangements.

This note reflects the law in force as at 15 April 2020. It also refers to the 5MLD and Trust Registration Service consultation document published by HMRC and HM Treasury on 24 January 2020. The outcome of the consultation has not yet been published. Further details of how the 5MLD trust register will be implemented in the UK should be available in due course.

To find out more about any aspect of the above, please discuss with your usual Deloitte contact. If you do not have a usual contact, please contact Patricia Mock (pmock@deloitte.co.uk). For further information visit our website at www.deloitte.co.uk.

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