

## **Trusts for Life Insurance and/or Death In Service Benefits: Spousal Bypass Trusts**

### **Why set up a Spousal Bypass Trust?**

Many people organise their affairs so that in the event their death, their husband, wife or civil partner will receive a cash payment when they die – for example, in the form of a lump sum from life insurance or death in service payment. This is clearly very sensible planning and is in the best interests of those left behind.

However, this planning it can inadvertently create an extra Inheritance Tax (IHT) burden when the surviving spouse or civil partner dies. Capital paid directly to them will be included as part of their estate and will be subject to IHT at 40% if the estate exceeds the nil rate threshold. This charge can be reduced or eliminated if the death benefit is diverted into a trust for the benefit of the survivor and the wider family – a Spousal Bypass Trust.

A Spousal Bypass Trust also offers the asset protection benefits which trusts generally offer, offering shelter to family wealth in the event of bankruptcy, divorce or the influence of third parties. Capital is safeguarded for children and other descendants. The trust structure also provides an element of control over how assets are used after your death, who benefits from them and when. This is beneficial if children are young or you have concerns on their use of a potential inheritance.

### **Inheritance Tax for estates of married couples/civil partners**

Every person has a 'Nil Rate Band' of £325,000 which they can leave to anyone they choose, without any IHT being payable. Over this threshold, and subject to the availability of the Residential Nil Rate Band that was introduced in April 2017, assets may be subject to IHT at a rate of 40%.

Gifts to surviving spouses or civil partners are exempt from IHT, regardless of the amount given. The Nil Rate Band (and the Residential Nil Rate Band) can also be in effect transferred between spouses and civil partners as well:

If a person dies leaving their entire estate to their surviving spouse/civil partner and has made no gifts in the last seven years to anyone else, then on the survivor's death, he or she will be able to leave up to £650,000 (or £1,000,000 if the both Residential Nil Rate Band is available) free of IHT.

### **How does this potential IHT saving with a Spousal Bypass Trust work?**

When insurance or death in service benefits are paid out, they are often free of IHT. However, if the benefits are paid directly to the survivor of a married couple/civil partnership, the benefits will increase his or her estate, which will be potentially subject to IHT on their death, and the potential IHT benefits which once existed will have been lost.

By placing the death benefits into a trust structure from which the survivor can benefit, you allow them access to the payment and the income it generates. However, it is held outside their estate for the purposes of the IHT calculation on their death. This means that the IHT charge on the survivor's estate will be reduced or eliminated entirely, which will increase the amount ultimately paid to their beneficiaries.

### **How would the Spousal Bypass Trust work?**

There are several different Spousal Bypass Trust structures and part of our role involves selecting the one which is best suited to your particular circumstances. You would set up the appropriate Spousal Bypass Trust in your lifetime. It then sits dormant, holding either contractual death benefits if that is most suitable to you, or as an empty vessel ready to receive the death benefits at the discretion of your scheme's trustees.

As you create the Spousal Bypass Trust in your lifetime, you determine who the trustees are. These are the people who will make decisions as to which beneficiaries benefit from the trust, when, and to what extent.

You will also determine the beneficiaries of the trust: this would normally be your surviving spouse/civil partner, any children, your wider family and close friends (for example the guardians of any children), but you could choose anyone you wanted.

You could if you wished write a letter of wishes to your trustees, explaining your thoughts on the use and investment of the trust fund, when beneficiaries should benefit, and the form this might take.

### **Taxation of the Trust**

The trust once it holds assets would be subject to taxation in its own right.

Commonly the trust will have its own Nil Rate Band for Inheritance Tax of a maximum of the individual Nil Rate Band (£325,000 in 2014/15). The exact amount of the Nil Rate Band will depend on your personal circumstances. Only if the trust fund exceeds this will it be subject to IHT. This IHT charge occurs every ten years and on the exit of assets from the trust if the fund value exceeds the available Nil Rate Band. This charge is a maximum of 6% of the value of the trust on the 10 year anniversary date and on the amount that exits the trust.

The trust has its own limited annual allowance for Capital Gain Tax and gains would be taxed at 20% on the 2017/18 rates.

The trust income would be charged to Income Tax at 45% based on current rates but if beneficiaries receive income from the trust, they can recover most if not all of the tax paid by the trust on the income they receive, if they pay Income Tax at a lower rate.

The trust can be constituted and run in whatever way is most suited, from an administrative and taxation perspective, to your family's circumstances.

### **Illustration**

Adam and Bethan have been married for 25 years and have two children. Adam and Bethan's joint assets amount to £750,000: a property worth £700,000 and savings of £50,000. Currently the total value of their joint assets is below £1,000,000, which means they do not appear to have an IHT problem based on current rules.

Adam has a life insurance policy which would pay out £200,000 on his death and a death in service benefit which would pay out £300,000 if he died while employed by his current employer.

The benefit offered by the Spousal Bypass Trust is shown in these two possible scenarios:

#### Scenario A: no Trust set up

If Adam does not establish a trust and all his assets pass to Bethan on his death, the situation would be as follows in the event he dies whilst still employed:

Bethan receives death in service benefit £300,000 and the insurance payment, now £200,000. Bethan's estate is now worth £1,250,000.

Bethan dies ten years later, her estate and the IHT rules having remained the same. The IHT calculation on her death would be as follows:

Estate	£1,250,000
Less double Nil Rate Band	(£650,000)
Less double Residential Nil Rate Band	(£350,000)
Taxable Estate	£250,000
IHT at 40%	£100,000

#### Scenario B: Trust set up

If Adam creates a trust in lifetime to receive the insurance payment and death in service benefits, and all his assets pass by survivorship to Bethan on his death, the situation would be as follows in the event he dies whilst still employed:

The trust receives £300,000 and the insurance payment of £200,000. Bethan's estate is worth £750,000, comprising the house and the savings.

Bethan dies ten years later, her estate having remained the same. The IHT calculation would be as follows:

Estate	£750,000
Less double Nil Rate Band	(£650,000)
Less double Residential Nil Rate Band	(£350,000)
Taxable Estate	£0
IHT at 40%	£0

The trust will have experienced two ten year charges for IHT in that period. This will be a maximum of 6% of the value of the trust fund, assuming the full Nil Rate Band is available. If the value of the trust fund remains the same, the Inheritance Tax on the trust would be £10,500. Overall the resulting IHT saving as a result of the trust is £89,500.

**CRANLEIGH**  
TEL: 01483 273515

**EPSOM**  
TEL: 01372 729555

**GUILDFORD**  
TEL: 01483 752700

**LEATHERHEAD**  
TEL: 01372 374148

**LONDON (CHELSEA)**  
TEL: 020 3826 0135

**LONDON (FULHAM)**  
TEL: 020 7736 6277

**LONDON (MAYFAIR)**  
TEL: 0330 555 4950

**REIGATE**  
TEL: 01737 221212

**WIMBLEDON**  
TEL: 020 8946 6454