



TRUSTS

The Facts

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Trusts are an essential tool of financial planning. They can help ensure that the ‘right money’ goes to the ‘right people’ at the ‘right time’. But deciding how to set up a trust to best suit your client’s needs can be complicated.

We’ve put this guide together to assist you in discussing trusts with your clients. It gives you straightforward facts about trusts, the benefits of using them and the types of trusts available.

Your client may want to seek professional advice from a solicitor.

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WHAT IS A TRUST?

A trust is an arrangement where the settlor (or in some cases the settlors) i.e. the person making the gift, transfers ownership of his/her assets to another party – the trustees. The trustees hold the assets for the benefit of a chosen person or group of people – the beneficiary, without giving them access to the assets for the time being.

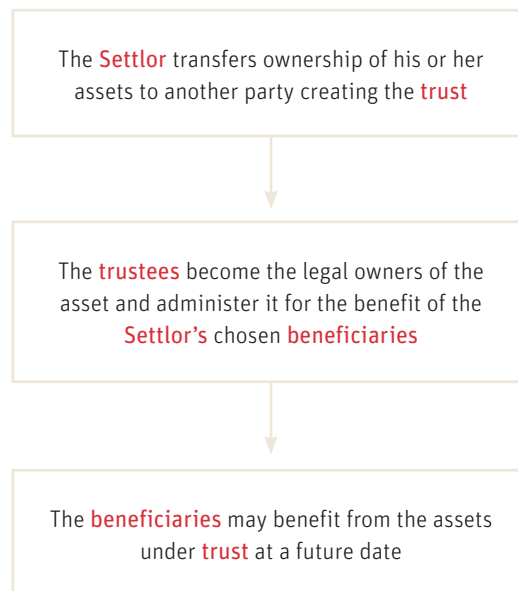
Who becomes involved in setting up a trust?

There are normally three parties involved in setting up a trust.

- **The settlor** – this is the person who creates the trust. They will appoint trustees to administer the trust and decide who will benefit from the trust assets.
- **The trustees** – these are the people the settlor chooses to hold and manage the assets, according to the terms of the trust, for the sole benefit of the beneficiary.
- **The beneficiary** – this is who the settlor wants to benefit from the assets held under trust. Everything that is done with the trust assets by the trustees must be in the best interests of the beneficiary.

HOW DOES A TRUST WORK?

The following diagram shows how a trust would work.



The effect of writing a Protection for Life policy under trust

The most important consequence of a trust is that the legal ownership of the asset is transferred to the trustees and it no longer belongs to the settlor outright.

Once a protection policy is written in trust, the settlor is not able to benefit from the policy proceeds, except where the trust allows the settlor to benefit from any proceeds payable under critical illness cover or terminal illness benefit.

In the event of a death or illness claim, the policy proceeds will be paid to the trustees who must deal with this payment according to the terms of the trust. The trustees are bound by the terms of the trust and must act in the best interest of the beneficiaries at all times.

Important: A trust cannot generally be cancelled after it has been set up.

WHY USE A TRUST?

Reasons for putting a Protection for Life policy in trust

Provision for your dependants

Putting a protection policy in trust can ensure that the death benefit is paid to the right people, as the trustees have a legal obligation under the terms of the trust to use the trust proceeds for the sole benefit of the beneficiaries. This is particularly appropriate when the beneficiary is a minor or someone incapable of looking after their own affairs and it would be inappropriate to give them outright control over the policy proceeds.

Prompt payment of policy proceeds on death if there are trustees

Provided there are trustees in place, when a Protection for Life policy is written in trust it means we can pay a claim more quickly than we could if it wasn't in trust. If your client dies and their policy is not written in trust, their personal representatives will need to obtain the appropriate grant of probate or letters of administration before they can administer the estate. If the client dies without having made a will, i.e. intestate, their estate is effectively frozen until a court has appointed someone to deal with their affairs. Until this happens your client's loved ones could suffer financial hardship. This is known as the probate trap.

By writing a Protection for Life policy in trust and ensuring trustees are appointed, your client can avoid the need to wait for probate in respect of the policy proceeds, providing there is at least one surviving trustee following their death. As the trustees are the legal owners, they can claim the policy proceeds quickly and ensure the money is paid to the named beneficiaries without delay.

All that Scottish Widows normally requires to pay the policy proceeds is a completed claim form together with the death certificate, the trust documentation and the policy documentation.

To reduce an inheritance tax liability

Inheritance Tax (IHT) applies to assets which are in your estate on death. Proceeds from a protection policy will be added to the value of the estate if the policy isn't written in trust. If your client puts the policy in trust prior to their death, provided they are not the beneficiary, the proceeds could be free from IHT. Any premium payments that are made within seven years of their death would normally be treated as gifts that would become chargeable to IHT on death but usually fall within one of the many IHT exemptions.

To provide funds to pay for inheritance tax on death.

If the value of your client's assets will exceed the IHT 'nil rate' band, your client could use a protection policy to cover the IHT liability that will arise on their death. If the protection policy is not written in trust the proceeds will form part of your client's estate and be liable for IHT. Placing it in trust can free the policy proceeds from IHT.

In short, trusts can help make sure that the proceeds from your client's Protection for Life policy end up in the right hands at the right time – quickly and tax efficiently.

TYPES OF TRUSTS

The following are the main forms of trusts used with protection products:

- Absolute Trust
- Discretionary Trust
- Split Trust

What is an Absolute Trust?

- These trusts are also known as bare or fixed trusts. They clearly define the beneficiaries and their share at outset.
- The beneficiaries cannot be changed once the trust has been set up. For this reason, a discretionary trust is usually more appropriate, to allow for changes in circumstances.
- The trustees hold the death benefit of the policy for the beneficiaries of the trust.

Why use an Absolute Trust?

- If the only purpose of the policy is to provide funds for the chosen beneficiary(ies). For example, a disabled dependant.
- The policy proceeds will not form part of the settlor's estate and will be free from IHT, including entry, periodic and exit charges, should the trustees be holding the benefits for a prolonged period of time. For example, until a child reached an agreed age.
- The benefits are paid to the beneficiaries quickly, provided there is a surviving trustee, as they're not included in the settlor's estate and probate is avoided.

What is a Discretionary Trust?

- A Discretionary Trust gives the trustees discretion over when they pay the death benefit and to whom out of a range of possible beneficiaries.
- The settlor does not retain an interest in the policy. This means that they cannot receive benefits from a death, terminal illness or critical illness claim.

Why use a Discretionary Trust?

- Your client may want someone else such as their children to benefit from the policy on their life.
- The trustee discretion allows for future changes, for example, to include future children or grandchildren.
- The death benefits payable will not form part of the client's estate and will be free from IHT. The trust may be subject to entry, periodic and exit charges but as our protection policies are regular premium and have no surrender value, this is highly unlikely.
- As above, the benefits are paid to the beneficiaries quickly if there is a surviving trustee.

What is a Split Trust?

- The life assured, or settlor, retains an interest in the policy allowing them to receive any benefits from a critical illness claim and also, in some trusts, from a terminal illness claim.
- The trustees hold the death benefit for the beneficiaries of the trust, usually on a discretionary basis.

Why use a Split Trust?

- A client may use this when they wish someone else, such as their children, to benefit from the policy on their death, whilst ensuring proceeds resulting from illness are still payable to themselves.
- The death benefits payable will not form part of the client's estate and will be free from IHT. If on a discretionary trust basis, the trust may be subject to entry, periodic and exit charges.
- As with all trusts, the benefits can be paid more quickly as long as there is a surviving trustee.

Trust	Advantages	Disadvantages
Absolute	• Beneficiaries and their shares are clearly defined • Speed of payment • Benefits are paid free from IHT	• The beneficiaries cannot be changed after the trust is set up
Discretionary	• Decisions about who will benefit can be changed • Speed of payment • Benefits are paid free from IHT	• Potential exit and periodic charges may apply
Split	• A client can keep the right to illness benefits, whilst ensuring death benefits are dealt with efficiently • Decisions about who will receive the death benefit can usually be changed • Speed of payment • Benefits are paid free from IHT	• Potential exit and periodic charges may apply

Scottish Widows Flexible Power of Appointment Trust

This is the trust which should usually be used for Protection for Life policies. It is meant for personal and not business protection. It is both a discretionary and split trust, so it combines the advantages of both types.

ROLE OF TRUSTEES

Choosing the right trustees is one of the most important decisions your client will have to make when setting up a trust.

Who can be a trustee?

- Your client can appoint an individual or a corporate trustee such as a legal firm. In general, trustees are family members or close friends. It should be someone your client can trust.
- The basic rule is that a trustee must be at least 18 years old and of sound mind. They should also be resident in the UK and financially solvent.
- The named trustee must accept the appointment for it to be valid.
- The settlor will usually be a trustee as well. This gives them a degree of control over the trust in their lifetime. It's normal for a trust to begin with the settlor as a trustee.

How many trustees does a trust need to have?

- Although a trust may be valid with only one trustee, it's essential that at least one trustee is appointed in addition to the settlor. This is a requirement for the trust to be valid where the trust is under Scots Law. It also ensures that, provided the trustee is alive, the trust continues to function following the death of the settlor and that Scottish Widows can pay the claim without having to wait for probate. However, to have a better chance of there being a surviving trustee, the ideal is to appoint two.
- If there was only one trustee and they died, then the administration of the trust would transfer to the deceased trustee's legal personal representatives.
- In practice there's no upper limit on the number of trustees that can be appointed. However, appointing too many could lead to administrative problems as they all have to agree on any decisions made about the trust.

What are the duties of a trustee?

- To look after the trust property in accordance with the terms of the trust and trust law.
- Administer the trust honestly and impartially for the benefit of all beneficiaries.
- Make decisions about the trust collectively. If one trustee disagrees then it cannot proceed with the proposed course of action unless the trust provides for a majority decision or the settlor has made the trust subject to Scots Law.

What if the trustees act outside the terms of the trust?

- If the trustees act in a manner which the terms of the trust do not allow, there will be a breach of trust for which the trustees will be personally liable.

Do trustees receive payment for their duties?

- Professional trustees such as lawyers can receive payment for their trustee duties. However, a trustee is not normally allowed to make a profit out of their trustee duties.

Who can appoint trustees?

- Generally, the settlor will have the power to appoint additional trustees. This right will continue during the settlor's lifetime and then it will be transferred to the remaining trustees. New or additional trustees can be appointed at a later date by completing a 'Deed of Appointment of additional Trustees' form.

Is it possible to change or remove a trustee?

- It may be possible for a trustee to be removed in certain circumstances and where the trust deed includes provision for this. If there is no clause in the trust, the trustees may be able to remove another trustee either by statutory removal or by obtaining a Court Order. Removing a trustee without their consent should be regarded as a last resort, that's why it's so important that trustees are selected with care.

Can a trustee retire?

- A trustee can retire from trusteeship as long as all of the trustees agree to their retirement. The person who has the power to appoint additional trustees, normally the settlor, must also agree.

Can the settlor terminate the trust?

- Once the settlor has written a policy in trust, they have no power to terminate the trust which will only end once the trust property has been distributed to the beneficiaries. The only action that the settlor can take is to stop paying the premiums.
- If all of the possible beneficiaries are identifiable, over 18 and of sound mind, then it may be possible to end the trust if they were prepared to give up their interest. Legal advice would be required.

All information contained in this brochure is based on Scottish Widows understanding of the current tax law legislation and HMRC practice as at 6 April 2013. All references to taxation refer to UK taxation. Tax rules can change.



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