



Inheritance Tax - Trusts of insurance and pension benefits

[Inheritance tax and life insurance](#)

If you take out insurance on your own life the insurance policy belongs to you, unless you arrange otherwise.

A lump sum paid on your death from a policy that belongs to you is an asset of your estate. It is added to the other assets you own at your death. Your family may have 40% inheritance tax (IHT) to pay, so that the policy is worth only 60% of its value.

You should put in place a trust for any money that may be paid on your death.

[A trust has other advantages](#)

Assets of your estate cannot usually be cashed in for some time after your death. Your executors must obtain probate before they have full control.

Trustees of life insurance, on the other hand, can claim what is payable immediately. This may avoid the need for your executors or family to borrow to pay tax and other bills.

[What does this apply to?](#)

You may have insurance, either for your whole life, or in the event of your death before a particular date.

Your employer may run a pension scheme (or a death benefit scheme) under which cash is paid if you die.

You may have your own pension arrangements under which the fund you have paid into is returned on your death.

[What trust arrangements should I have?](#)

Flexibility is the most important feature. If the trust is not flexible you must be absolutely certain you want the particular payment to go to a particular person. What if he or she dies before you or with you?

Life changes many things. You can only change those who benefit from a trust if the trust allows it.

The Insurance Company has given me a trust form. Is this OK?

It may be.

Good insurance companies and financial advisers recognise the need for a trust. They will often provide a standard printed form. Sometimes this will include enough flexibility.

But if your estate (with or without life insurance or pension benefits) is likely to be more than the IHT threshold (£312,000 in 2008/09) a trust deed individually tailored to your family's needs is usually better.

Married couples who want to minimise IHT must take particular care if a substantial sum is payable to the survivor when the first of them dies.

[Married couples](#)

If the value of your joint assets, including lump sums payable on the death of either of you, exceeds £624,000, your family will have IHT to pay.

Our leaflet *Wills for Married Couples* explains how a will trust can save IHT. A similar strategy for insurance and pension lump sums can save still more.

[Example](#)

Derek and Mary Evans own, in equal shares, a home worth £440,000, and investments and building society accounts totalling £184,000.

Following the plan outlined in Wills for Married Couples Derek and Mary have wills under which the first to die leaves up to £312,000 worth of assets to a discretionary trust, and any surplus to the survivor.

Derek dies. There is no IHT on his death. Assets worth £312,000 pass to the will trust. Mary can benefit from the trust during her lifetime but there should be no IHT when she dies, because she has only £312,000 of assets all of which are free of IHT.

But Derek's employer has a generous benefit scheme. Derek has left wishes asking for any benefits to be paid to Mary. She receives £350,000.

There is no IHT on this £350,000 on Derek's death. But it is all subject to IHT on Mary's death. IHT on this cash is then £140,000.

A trust for insurance and pensions

Almost all the IHT can be saved if Derek creates, in his lifetime, a trust to receive any benefits that may be paid on his death. This trust is separate from Derek's will.

Derek asks his employers to pay the lump sum benefit direct to the trust, rather than to Mary. Mary can benefit from the £350,000, just as she can from the trust in Derek's will. But like Derek's will trust, the new trust is not taxed when Mary dies.

The creation of this trust will have no IHT implications for Derek if he is in good health when he sets it up.

Derek can make exactly the same arrangement if he has funded a personal pension plan which is returned on his death. Any death benefits go to the trust. This has no effect on Derek's entitlement to a pension.

The same trust can be used for insurance on Derek's life.

IHT in the lifetime of the trust

It is usually best for the trust to be fully discretionary, just like the trust of £312,000 in Derek's will.

If more than £312,000 is paid to Derek's trust some IHT may be payable during the lifetime of the trust. Special rules charge IHT on trusts every ten years. There may also be IHT on payments out of the trust. But the rate of tax is never more than 6% every ten years. It is probably less because there is usually no IHT on the first £312,000 in the trust.

Suppose Derek creates his trust on 1 December 2008 and the £350,000 is paid shortly after his death on 1 February 2014. Mary lives until June 2032 and the trust is then wound up immediately.

If the IHT threshold is £312,000, the ten-yearly charges in December 2018 and 2028 will be £1,140 and £2,280 respectively. A final £798 IHT is due when the trust ends, bringing the total IHT to £4,218.

If the appropriate trust is not put in place, IHT when Mary dies is £140,000.

The IHT saving is £135,782

The table below shows the equivalent IHT charges on the same dates for higher amounts in trust. The larger the value of the trust assets, the higher the effective rate of IHT. It may be possible to reduce this by creating a number of separate trusts, on different days.

	£	£	£	£	£	£
Value in trust	350,000	400,000	450,000	500,000	600,000	750,000
December 2018	1,140	2,640	4,140	5,640	8,640	13,140
December 2028	2,280	5,280	8,280	11,280	17,280	26,280
June 2032	798	1,848	2,898	3,948	6,048	9,198
Total IHT	4,218	9,768	15,318	20,868	31,968	48,618
IHT if no trust	140,000	160,000	180,000	200,000	240,000	300,000
IHT saving	135,782	150,232	164,682	179,132	208,032	251,382

Other methods of planning for IHT

- Can you afford to give away assets during your lifetime?
Can you afford to make small or regular gifts?
- Consider the use of a two year deed of variation for any assets you inherit. These can be put into trust in a way that allows you to benefit without the assets being treated as yours for IHT.

We will be pleased to advise you in more detail on other opportunities for saving IHT.

Are there any other complexities?

This guide can only provide a brief summary of some of the main features of IHT. As with other taxes, there are many complicated and detailed rules laid down by Parliament.

For further information, or to discuss your estate planning needs, please contact Barry Glazier, Richard Fairbairn, Jeremy Mills, Michael Norton, Emily Copping, Natalie Gamble, Paula Shea or Mahendree Naidoo of our Tax and Trusts team who will be pleased to help you.