

# Discretionary Trust Technical Guide

## Introduction

This guide has been written to explain what a Discretionary Trust is, and how to place a Legal & General protection policy in our Discretionary Trust. We've tried to use plain language to keep this guide easy to understand. You'll find explanations of any technical terms we use in the glossary on page 8 of this document. Whenever terms covered in the glossary appear in the main text, we've highlighted them in **dark blue**. We have a range of online support available to help you place your policy in trust. **Please note that some of the information contained in this technical guide may not apply to our online Discretionary Trust.**

## Trust information

### What is a Discretionary Trust?

A Discretionary Trust is a legal arrangement which allows the owner of a life policy (the **settlor**) to give their policy to a trusted group of people (the trustees), who look after it. At some time in the future they pass it on to some people from a group that the **settlor** has decided (the beneficiaries). The trustees have discretion about which of the beneficiaries to pass it on to, how much each will get, and when.

When a life policy is looked after in this way, it is said to be 'in trust'. The life policy which is in trust, and any payment received from the life policy are called the trust fund. This guide assumes that a Legal & General life policy will be the only asset in the trust.

### What are some of the main benefits of using a Discretionary Trust?

Using a Discretionary Trust for a life policy has lots of practical and financial benefits. For example:

**Inheritance Tax** - It should help to ensure that any money paid out from the life policy would not be part of the estate of the person covered, helping to minimise **Inheritance Tax**. Tax is covered in more detail on pages 6 and 7.

**Quicker payout** - It should help to ensure that the money paid out from the life policy can be paid to the right people quickly, without the need for lengthy legal processes. When you die, your personal representatives will need to obtain **probate** so that they have the authority to deal with your estate. In England and Wales either a 'grant of **probate**' or 'grant of letters of administration' is issued to your personal representatives. This process takes time and if you die without having made a will it takes even longer. Since the trustees are the owners of a policy placed in trust they do not have to go through this process in order to make a claim.

**Control of funds** - By placing your policy in trust, you can indicate who you want the proceeds to be paid to. A trust can control when the money from the life policy will be paid out. This can ensure that children receive some financial support from the money, but do not have full access to it.

Our draft Discretionary Trust deed makes placing a life policy in trust easy, and Legal & General provide this service to our customers for free.

### Who's involved in a Discretionary Trust?

There are three important roles:

**The settlor** - The person giving away their life policy is called the **settlor**. Once the **settlor** has put their life policy into trust they no longer personally own it and have limited rights to say how it's dealt with. However, the **settlor** is still usually responsible for paying the policy premiums, and is one of the trustees. It is possible to have joint **settlors**, for example on a joint life policy. The **settlor** chooses the trustees and the beneficiaries, and can give the trustees guidance on how he/she would like the trust fund to be used via a letter of wishes.

**The beneficiaries** - The people who can receive payment from the trust fund are called the beneficiaries. The people who may be a beneficiary are listed in the trust deed, but no beneficiary is guaranteed to receive any of the trust fund.

**The trustees** - The trustees take legal ownership of the trust fund from the **settlor**. They then look after the trust fund, and, following a claim on the policy will make arrangements for payments to the beneficiaries. The trustees have discretion about which beneficiaries named in the trust will receive the trust fund and when. However, they must act in the best interests of the beneficiaries at all times and can only do what is allowed in the trust deed.

# Setting up a Discretionary Trust with a Legal & General protection policy

## What are the important documents?

There are three key documents:

The Discretionary Trust deed – this is the legal document that creates the trust. The **settlor** and the trustees must sign it. It names the parties involved, says what roles they have, and gives details of the life policy which is being put into trust. The provisions in the trust deed are the basis of the trust arrangement. The trustees must act according to the trust deed, and cannot do anything that the trust deed doesn't allow.

The letter of wishes – as the trustee will have lots of decisions to make, the **settlor** can provide a letter of wishes, to help explain what they would like to happen to the trust fund. Unlike the trust deed, the trustee does not have to follow the letter of wishes. However, trustees usually find it to be a helpful guide on how best to manage and distribute the trust fund to the beneficiaries. A draft is available from Legal & General at [legalandgeneral.com](http://legalandgeneral.com)

The policy documents – these include the policy documentation, which contains all the important information about the life policy, which forms the trust fund.

## Can any policy be put in Legal & General's Discretionary Trust?

Legal & General's Discretionary Trust can be used for most Legal & General protection policies. The trust can be used for new or existing policies. It should not be used for policies for business insurance (e.g. key person or shareholder protection), Relevant Life Plans, or the death benefit of income protection (IP). For more details please speak with your financial adviser.

## What if I have critical or terminal illness cover?

The Discretionary Trust automatically makes you the beneficiary of any proceeds arising from a claim as a result of a critical or terminal illness as described in the policy (if your policy has those benefits). If you do not want to keep these benefits for yourself and would rather they were held for the beneficiaries of the trust then please sign the box(es) in clause 7 of Part B of the trust.

## Can I give the trust a name?

Yes. You can give the trust a name in clause 5 of Part B. You do not have to give the trust a name if you do not want to.

## Can I ever cancel the trust?

No, not usually. However, there may be circumstances when a policy can be taken out of trust. You should contact your legal adviser for advice.

# Trustee information

## What are the main duties of a trustee?

The trustees must understand the terms of the trust, and must not do anything that is not allowed by the trust or by the law.

The trustees must act in the best interests of the beneficiaries, and exercise a high degree of care and honesty and must all agree when making trust decisions.

The trustees must keep clear and accurate records and accounts of trust property and ensure that all tax, which the trust is liable for, is paid.

Being a trustee is an important responsibility, however it is unlikely that the trustees will need specific detailed knowledge of trust law to enable them to act effectively. Usually, the trustees will not have much to do until the time comes to make a claim. The trustees can seek professional advice should the need arise. The key thing is that they act honestly and in the best interests of the beneficiaries.

Further information for trustees is available in our separate guide, Your Guide to Being a Trustee, which is available online.

## Who can I appoint as a trustee?

Generally anyone, but the people appointed must be over 18 years of age and of sound mind. The trustees should be people who the **settlor** believes will act in the best interests of the beneficiaries. It is also a good idea for them to be resident in the United Kingdom for tax reasons. Solicitors and accountants can act as trustees but they will charge for their services.

## Can I be a trustee?

Yes. The Discretionary Trust automatically makes you a trustee.

## Can I appoint additional trustees in the future?

Yes, with our Discretionary Trust the **settlor** has the power to appoint additional trustees at any time. After you die, the trustees will have the power to appoint additional trustees.

## How many trustees should I choose?

It is a good idea to have at least two trustees at any time. For this reason, it is normally sensible to appoint at least two trustees in addition to yourself.

## What happens if a trustee dies?

If a trustee dies, the remaining trustees can still carry on with the role, but a replacement could be appointed. If the trustee was the last surviving trustee, their legal personal representatives will have the power to appoint additional trustees or take over as trustees themselves.

## What can the trustees do if I don't pay the policy premiums?

As legal owners of the policy, the trustees can arrange for the premiums to be paid but they are not obliged to make sure this happens or pay the premiums themselves. The trust will come to an end if, as a result of the premiums not being paid, the policy lapses with no value.

## What happens if a trustee no longer wants to be a trustee?

A trustee can retire from the trust with the consent of the other trustees, provided that there are at least two trustees following the retirement.



## How do the trustees make a claim?

In the event of your death the trustees will need to send the following items to Legal & General's Customer Claims Department:

1. Discretionary Trust deed (and any subsequent deeds)
2. The original policy documentation
3. A death certificate



The address to send these items to is:

Legal & General Customer Claims Department  
City Park  
The Droveaway  
Hove  
East Sussex  
BN3 7PY

**Once the claim is accepted, the trustees will be paid by direct credit.**



For other claims, please call us on freephone (from landlines):

For terminal illness claims **0800 137 101**.

For critical illness claims **0800 068 0789**.

We may record and monitor calls.

## Beneficiary information

### Who is automatically a beneficiary of the Discretionary Trust?

The Discretionary Trust contains a list of the discretionary beneficiaries in clause 4 of Part B of the trust.

This list includes:

- Your spouse or registered civil partner
- Your children or grandchildren (and their spouses or registered civil partners)
- Anyone descended from your mother or father (and those descendants' spouses or registered civil partners)
- Anyone who may benefit from your **residuary estate**
- Any additional beneficiary you name as an 'Additional Beneficiary' (for example, the name of a cohabitee)
- Any person or charity you later name in a deed of addition

Where there are joint **settlers**, neither of them can benefit from the trust (other than in respect of any critical or terminal illness benefits), that they have kept for themselves.

### What if the beneficiaries are still under 18 when the policy proceeds are paid out?

The trustees will have the power to invest the proceeds, and may be able to make payments out to support the beneficiaries.

### Can I be a beneficiary?

No. With the Discretionary Trust the **settlor** cannot benefit other than regarding any critical illness or terminal illness benefits that have been kept for them (known as the 'retained benefits').

# Inheritance Tax information

Whilst a policy in the Discretionary Trust will not usually form part of your estate for **Inheritance Tax** purposes, on some occasions there is a potential for an **Inheritance Tax** charge to apply. These are summarised below, however if you are unsure about this or require more detail, you should discuss this with your adviser or a tax professional.

## Entry charge for existing policies

Where an existing policy is placed into a Discretionary Trust an entry charge may apply.

Currently, individuals have an **annual gift exemption** of £3,000. As such, if the open market value of a policy falls within the annual exemption (and provided that this allowance is not used for other gifts) there will be no entry charge.

Where a life insurance policy with no surrender value is placed in trust, provided that the **life insured** is in good health the open market value of the policy for **Inheritance Tax** purposes is likely to be negligible. Therefore, even if the **annual gift exemption** did not apply, the tax charge on entry would be nil.

For some policies, such as whole of life policies, the value of the policy for **Inheritance Tax** purposes is deemed to be the higher of the open market value of the policy (considered in the same way as described above) and the value of the premiums paid to date. It is unlikely to have a negligible value.

If no exemption applies to the policy, the value of the policy should be added together with the value of all **chargeable lifetime transfers** made by you in the seven years immediately prior to setting up the trust. If this exceeds the **nil rate band** applicable at the time the trust is created, **Inheritance Tax** will be due on the excess value of the gift at the lifetime rate. The **nil rate band** is currently £325,000 (up to and including the tax year 2023/2024) and the lifetime rate is 20% if the trustees pay any tax (and an effective rate of 25% if you pay any tax).

## Entry charge for the payment of premiums

**Inheritance Tax** may be payable on premiums as they are considered to be a transfer of value. However, currently, individuals have an **annual gift exemption** of £3,000. If this exemption is not used for other gifts, and if the premiums paid fall within the annual exemption there will be no entry charges for premiums.

In addition, individuals have an **Inheritance Tax** exemption for normal expenditure out of income. If premiums fall within this exemption there will be no entry charge. In order for the exemption to apply, it would need to be shown that the payment of premiums comes out of your income, that it leaves you with sufficient income to maintain your normal standard of living and that it was made as part of your normal expenditure.

If an exemption does not apply, then the premiums will be **chargeable lifetime transfers**, and an entry charge may apply. **Inheritance Tax** will be due if the value of the premiums (after deducting any **Inheritance Tax** exemptions) together with the value of all **chargeable lifetime transfers** made by you in the seven years immediately prior to setting up the trust exceeds the applicable **nil rate band**. This will be due on the excess value of the gift at the lifetime rate. The **nil rate band** is currently £325,000 (up to and including the tax year 2023/2024) and the lifetime rate is 20% if the trustees pay any tax (or at an effective rate of 25% if you pay any tax).

Example – David Smith takes out a life insurance policy for £300,000 and the monthly premium is £150.00. David completes a Discretionary Trust deed as he doesn't want the policy proceeds to form part of his estate on his death. The value of the policy when David creates the trust is nil as he is in good health. The value of the policy and the premiums are less than £3,000 per year so they fall within the **annual gift exemption**. David's premiums are therefore not treated as chargeable transfers and an entry charge does not apply.

## Periodic charge

An **Inheritance Tax** liability may arise on each 10-year anniversary of the creation of the trust. The charge is based on the value of the property in the trust, which is referred to as 'relevant property'.

Before a claim is made, the value of the relevant property is based on the value of the policy, and as long as the **life insured** is in good health, the value of the policy for **Inheritance Tax** is likely to be negligible. A periodic charge may become payable when you die as the policy proceeds will then be in trust.

The maximum rate of tax that can be charged on the relevant property is currently 6%. This applies to the value of the assets which exceeds the applicable **nil rate band**, (the available **nil rate band** is currently £325,000 for each trust, less any chargeable transfers made by the **settlor** in the seven years before the creation of the trust).

Example – At every 10-year anniversary, as long as David is in good health, the policy will have little or no value. This means that there won't be a periodic charge.

## Exit charge

An **Inheritance Tax** liability may arise where capital leaves the trust. For example, a charge may arise where the trustees pay the policy proceeds to a beneficiary following a claim. This will usually only happen if the trustees paid an **Inheritance Tax** charge on the last 10-year anniversary or at the start of the trust, if that was less than 10 years ago. In either case, the rate of tax payable as an exit charge is a maximum of 6%. However, this rate only applies to the value of the assets in excess of the **nil rate band** available to the trust (as explained above).

Example – David dies 8 years after the trust was created and the policy proceeds are paid to the trustees. An exit charge will not apply, as long as the trustees distribute the money before the next 10-year anniversary.

## Death of the settlor

Where **Inheritance Tax** exemptions cover the payment of premiums (or the transfer of an existing policy) to the trust, there should be no charge on the death of the **settlor** with respect to those exempt transfers.

However, an **Inheritance Tax** liability could arise if the **settlor** dies within seven years of making a chargeable transfer into the trust. If the value of the gift together with the value of all chargeable transfers (including **potentially exempt transfers** that have subsequently become chargeable due to the **settlor's** death) made by the **settlor** in the seven years prior to the gifts in to the trust, exceeds the **nil rate band** applicable at the time of the **settlor's** death, **Inheritance Tax** will be due on the excess value. This will be at the death rate of up to 40%, however, any entry charges paid can be deducted from this liability. **Taper relief** should also be available to reduce the amount of tax payable for gifts made prior to three years before the **settlor's** death.

With respect to the **settlor's** estate, it should also be noted that the **nil rate band** available to the **settlor's** personal representatives would be reduced by the value of any chargeable transfers made by the **settlor** in the seven years before death.

## Death of a beneficiary

The death of a beneficiary under the Discretionary Trust is very unlikely to have any **Inheritance Tax** consequences for the trust.

## Reduced Inheritance Tax rate for estates leaving 10% or more to charity

A reduced rate of **Inheritance Tax** from 40% to 36% may apply where 10% or more of a deceased's net estate is left to charity. For details of whether this might be applicable to you please speak to your Financial Adviser or Solicitor.

# Glossary

## Annual gift exemption

Gifts in any one tax year that total £3,000 or less are exempt from **Inheritance Tax**. Where any part of the exemption is unused it can be carried forward to the following tax year.

## Chargeable lifetime transfer

For **Inheritance Tax** purposes a gift (that is not otherwise exempt) made during life to a Discretionary Trust. Where the value of the transfer is more than the available **nil rate band Inheritance Tax** is payable on the gift.

## Inheritance Tax

A tax which may be payable on certain transfers of assets, for example, a gift. **Inheritance Tax** may also be payable on certain deemed or hypothetical transfers of assets, for example, on each 10-year anniversary of a Discretionary Trust or on death.

## Life insured

The person upon whose death (or diagnosis of a critical or terminal illness as defined in the policy (if included)) the amount of cover will become payable. Where a policy has more than one **life insured** then, depending upon the terms of the policy, the benefits may be payable on the first or the last of the lives insured to die.

## Important notes

We have written this guide to give you general information about placing your Legal & General protection policy in trust. It is not intended to replace legal advice. If this trust does not meet your needs then you should talk to your legal and your financial advisers.

We have based the information in this guide on our understanding of the laws relating to trusts and **Inheritance Tax** at the time of this publication\* Although we have made every effort to make sure that the information is accurate, we cannot take legal responsibility for any particular statements.

This guide is based on our understanding of current law and HMRC practice, which can change.

In preparing this guide we have assumed that only Legal & General's Discretionary Trust is to be used in conjunction with Legal & General's protection policies. We can also provide Flexible (interest in possession) Trust deeds, Absolute Trust deeds and a Survivor's Discretionary Trust (for use with joint life first death policies only). The information in this guide does not apply to business protection; Legal & General have separate literature for business protection. Please see your financial adviser for more details.

\*There are current proposals to change how IHT is charged in trusts.

## Nil rate band

The amount of an individual's estate, which is subject to **Inheritance Tax** at 0%.

## Potentially exempt transfer

For **Inheritance Tax** purposes it includes a gift (that is not otherwise exempt) made during life to an individual or an Absolute Trust. No **Inheritance Tax** is payable at the time a **potentially exempt transfer** is made.

## Probate

The authority given by the court to your personal representatives to deal with your estate following your death.

## Residuary estate

The part of the estate of a deceased person that remains after the specific gifts, taxes, debts etc have been dealt with.

## Settlor

The person (or people if more than one) putting the policy into the trust.

## Taper relief

For **Inheritance Tax** purposes, the reduction of tax payable on a sliding scale should the **settlor** die between three and seven years following the making of a gift.

## Alternative formats

If you would like a copy of this in large print, braille, PDF or in an audio format, call us on **0370 010 4080**. We may record and monitor calls. Call charges will vary.

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