

# Your guide to Protection Trusts

## About this booklet

If you (or anyone else) are thinking of using an Aviva trust, or doing anything under the provisions of one of Aviva's trusts, you should rely on the advice of your legal or financial adviser. We urge you to seek appropriate professional advice if you are in any doubt. This is important for a number of reasons:

- Creating a trust can have taxation as well as legal consequences.
- Once a trust has been created it cannot be revoked.
- The trustees have a special duty to the beneficiaries and the misuse of a trust power by a trustee can make them personally liable for any resulting loss to the beneficiary.

References in this booklet to spouse are intended to include civil partner and references to widow or widower are intended to include surviving civil partner.

Where you have taken out a life insurance policy in connection with a mortgage, you should consult the lender before the policy is placed in trust.

A lot of the information in this booklet can be relevant to trusts containing any type of asset; however, it should be noted that Aviva protection trusts are designed to be used with life insurance policies and they may not always be suitable for other assets.

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# The guide to Aviva Protection Trusts

## Introduction

This booklet is based on relevant law and HM Revenue & Customs practices as understood by Aviva on 5 February 2009. Every care has been taken to ensure its accuracy. However, it must be appreciated that neither Aviva nor its representatives can accept responsibility for loss, however caused, suffered by you or any person who has acted or refrained from acting as a result of material published in or in conjunction with this booklet.

Trust law does not apply in the same way throughout the United Kingdom. Unless otherwise stated, this booklet refers to the law as it applies in England and Wales.



# What is a trust?

In simple terms, a trust is created when the owner of an asset (the settlor of the trust) transfers that asset to persons (the trustees) who are bound to keep it for the benefit of others (the beneficiaries).

When a settlor gifts an asset into trust they are no longer the absolute owner of that property, although they can usually act as trustee. The trustees are the new legal owners of the asset and will have powers to deal with it. For example, the trustees can sell the asset and reinvest the money realised. However, the beneficiaries are the beneficial owners of the trust property and the trustees should not benefit from the trust themselves.

It is of course possible that a trustee might also be a beneficiary under the trust.

## Insurance policies and trusts

There are a number of advantages to placing your life policy under trust.

For example:

- **To reduce your inheritance tax liability**
  - by making sure that the policy proceeds do not form part of your estate
- **To ensure a speedy payment of any death claim**
  - Aviva will pay the claim to the surviving trustees on admission of the claim. There is no need to wait until personal representatives obtain probate or other appropriate court order
- **To give away the value of your policy**
  - whilst you retain some control over the investment decisions, and who will ultimately benefit
- **To protect assets from third parties, such as creditors**
  - as the trust property does not belong to you.

## The parties to the trust

The **settlor** is the creator of the trust and in most cases the original owner of the asset to be placed under that trust. For example, where an Aviva policy is to be written under trust the policyholder is the settlor.

**For the purposes of this document we, for most cases, have substituted 'you' as the 'settlor(s)' in the main text.**

The **trustees** are the legal owners of the trust property. Any individual who is aged 18 or over and of full mental capacity can be a trustee. A company can act as trustee (subject to their Memorandum and Articles of Association).

The **beneficiaries** are the persons who will receive the trust property at some time. Many, but not all, trusts will contain a provision allowing the beneficiaries to be appointed from within a group known as the **potential beneficiaries**. Your Aviva Discretionary Gift Trust (Protection) contains that provision.



# The Aviva Discretionary Gift Trust (Protection)

## What does the discretionary gift trust (protection) do?

The discretionary gift trust (protection) is designed to make a straightforward gift of your life insurance policy, which is effective for inheritance tax purposes. It can be used with a new or existing Aviva policy owned on a joint or single basis.

You have the right to appoint and change the beneficiaries. That right passes to the trustees on your death. Potential beneficiaries can be anyone other than you.

The discretionary gift trust (protection) automatically includes your spouse (where you have a single life protection policy), children, grandchildren, spouses of children and grandchildren, and anyone who can benefit from your estate on your death as potential beneficiaries. You can nominate other potential beneficiaries by simply writing a note to the trustees. You should keep such notes and all correspondence and documents relating to the trust in a safe place. If you make a joint application then neither spouse will be a potential beneficiary of the trust.

Whilst you are not a potential beneficiary under the trust, you can benefit in some limited circumstances. The trust assumes, for example, that you will retain the right to receive any critical illness or mortgage payment protection benefits which may be payable under the policy.

## How does the discretionary gift trust (protection) work in practice?

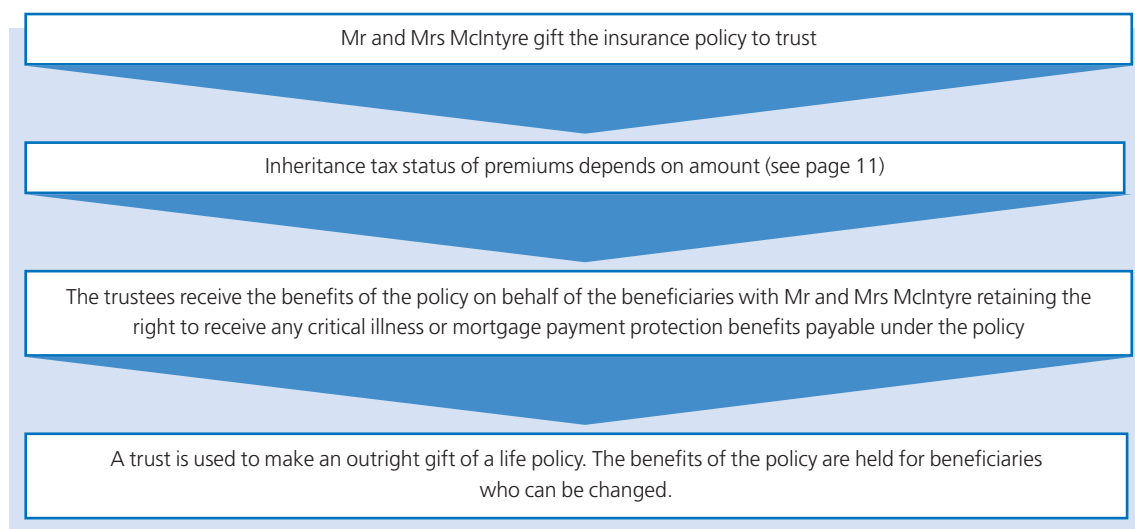
### Example

Mr and Mrs McIntyre take out an Aviva life insurance policy and put it under an Aviva discretionary gift trust (protection). In addition to themselves, they name Mr McIntyre's sister and brother-in-law as additional trustees.

The policy no longer belongs to Mr and Mrs McIntyre individually even though they continue to pay the premiums. The legal owners are the trustees (who do of course include Mr and Mrs McIntyre) and it is they who will have to administer any policy proceeds. They will hold the policy and any proceeds for the benefit of the beneficiaries specified in the trust deed.

### Quick Overview

The Discretionary Gift Trust (Protection) is used to make an outright gift of a life policy. The benefits of the policy are held for beneficiaries. The beneficiaries who actually receive the proceeds from the policy can be selected from the potential beneficiaries when a claim arises under the policy.



### The Married Women's Property Act (1882)

Aviva also offers a Married Women's Property Act (1882) trust. In common with the flexible (gift) trust, it shares the main advantages of using a trust. However, it only allows for the policy proceeds to be held for the benefit of your spouse and / or children. Whilst it is significantly less flexible than the Aviva Discretionary Gift Trust (Protection), it can provide additional protection from creditors in the event of your bankruptcy.

# The trustee's role

In many cases, often where a trust is set up with an ordinary life insurance policy providing death benefits only, the trustees are concerned only to ensure that the death benefits are paid, swiftly, to the nominated beneficiaries with as little stress as possible.

In general, a trustee should agree to their appointment by signing the trust form. As the trust might at some time hold a large sum of money, a trustee should be honest and able to deal with financial matters. A trustee must be able to understand the trust, and be in sympathy with its objectives.

More specifically, a trustee should:

- Acquaint themselves with the powers and duties they have under the trust, and the rights of the beneficiaries.
- Look after the trust property for the benefit of the beneficiaries in accordance with the terms of the trust itself and trust law.
- Treat all classes of beneficiary fairly and not favour a particular class. However, that does not mean that every beneficiary must be treated the same. You can choose who should actually benefit from the potential beneficiaries.
- Review the assets within the trust from time to time and consider whether they should be changed. This is particularly important where the trust contains investments. There is much less scope for review where the asset is a protection policy.
- Before exercising powers of investment, trustees must obtain and consider advice from a qualified person, unless they reasonably conclude that it is unnecessary or inappropriate to do so. In the case of the Discretionary Gift Trust (Protection) the trustees will only have money to invest after a policy claim.
- Keep records in respect of additions to the trust fund, investment growth, and payments out of the fund. The trustees are accountable to the beneficiaries for what they do with trust property, and must be able to show what has taken place. Again, this will only apply to the Discretionary Gift Trust (Protection) following a policy claim.
- Hold regular trustee meetings and keep written notes of discussions held and decisions made.

## How are trustees appointed?

You are automatically appointed as a trustee in the Aviva Discretionary Gift Trust (Protection).

We also recommend that at least one additional trustee is appointed at the outset in the trust documentation.

It is also possible to appoint additional trustees after the trust is set up. Where this is requested for an Aviva trust, we can often supply the necessary form (called a Deed of Appointment and/or Retirement of Trustee form). Usually, the number of additional trustees that can be appointed is limited so that the number of total trustees cannot exceed four.

## Who should be appointed as trustee?

There is no hard and fast rule about who should be appointed as an additional trustee. Generally, anyone who is 18 or over and of sound mind may be appointed as a trustee. However, the trustees are the legal owners of the trust property, and the role of trustee should not be taken lightly. You should give careful consideration to the appointment of trustees.

The following points should be remembered when deciding whom to appoint:

### Your solicitor or accountant

It is common to appoint a solicitor or accountant who is familiar with trust law. The reason is that the office of trustee carries certain duties and responsibilities that are sometimes best fulfilled by someone specially trained in trust law. However, professional trustees will charge for their services.

### Your spouse or another relative

They will often be appointed as trustees but sometimes do not have the professional skills desirable, for example, knowledge of trust law. They may of course take advice from a professional adviser.

### Can a trustee retire?

Provided there are continuing trustees, a trustee can choose to retire. Aviva may provide the necessary form (a Deed of Appointment and/or Retirement of Trustees form) for use with its trusts.

### What happens if a trustee dies?

If a trustee dies, the surviving trustee(s) will continue to act on behalf of the beneficiaries. Aviva should be informed of the death of a trustee. A further trustee can be appointed to replace one who has died. This would result in the need for a Deed of Appointment and/or Retirement of Trustee form to be completed. Should a sole surviving trustee die their legal personal representative will take over as trustee.

### Can trustees be removed?

The Aviva Discretionary Gift Trust (Protection) contains a power to remove trustees. If the trust does not contain such a power it can be difficult to remove a trustee and may require the intervention of the Courts.

### Can trustees be paid?

The trustees will always be entitled to reimbursement of proper expenses incurred by them in carrying out their duties.

Otherwise, it is not usual for trustees to be paid unless they are acting in a professional capacity (for example, solicitors, accountants). In this case, and provided there is more than one trustee, they are entitled to receive reasonable remuneration for their services. A trust corporation is also entitled to receive reasonable remuneration.

### What if trustees disagree?

A unanimous decision is required before the trustees can take action.

## The beneficiaries

### Who are the potential beneficiaries?

The potential beneficiaries are the people for whose benefit the trust is established. They may be identified by name or, in the case of the discretionary gift trust (protection), by class (for example, any child or remoter descendant of any settlor). You identify the default beneficiaries when completing the trust form. The default beneficiaries will **only** benefit if no other appointment has been made after 80 years. This is very unlikely to happen. What will happen is, following a life policy claim, an appointment will be made in favour of one or more of the potential beneficiaries, who will then receive the policy proceeds.

### Can the beneficiaries be changed?

If the trust form includes a suitable power - which the Aviva Discretionary Gift Trust (Protection) does - the beneficiaries can be changed. However, different trusts may have different classes of potential potential beneficiaries, ie those beneficiaries in whose favour a change can be made.

With the Aviva Discretionary Gift Trust (Protection) it isn't usually necessary to change beneficiaries. It is sufficient to write a letter of wishes to the trustees making them aware of any revised intentions. (See Page 17).

### What rights do the beneficiaries have?

The beneficiaries can take steps to ensure that the trustees are administering the trust properly. If the trustees commit a breach of trust or act fraudulently, the beneficiaries can take legal action against them. Only if the trust is absolute can the beneficiaries actually demand that the trustees hand over their entitlement, ie their share of the trust fund. The Discretionary Gift Trust (Protection) is not an absolute trust.

### What happens if a beneficiary dies?

There are no tax consequences if a potential (or default) beneficiary dies under the Discretionary Gift Trust (Protection). Clearly, the deceased beneficiary can no longer benefit under the trust but it may be that their spouse and/or children might be able to benefit.

# What are the taxation consequences of a trust?

The following assumes that the trust only contains a life insurance policy. The tax treatment of other forms of investment is quite different and you should consult your own professional advisers for advice in those circumstances.

## Inheritance tax

The gift of a policy into the Discretionary Gift Trust (Protection) is a chargeable lifetime transfer. Your annual exemption, if available, may be used to reduce the chargeable value.

The value of the chargeable lifetime transfer will be the greater of the open market value of the policy (the surrender value is a reasonable approximation of this if the life insured is in good health) at the time the Trust is created, and the total premiums paid under the policy up to that time. However, if the policy is a Term Assurance the premiums can be ignored and only the open market value of the policy is taken into account. Whilst the surrender value of a Term Assurance policy is typically nil it can still have an open market value. This would be the case if the life insured is in bad health and is likely to die before the end of the term.

The premiums you pay to a trust policy will be gifts for inheritance tax purposes unless they are exempt. For example, premiums may be exempt as gifts out of normal expenditure and/or under the annual exemption.

If the aggregate value of your chargeable lifetime transfers in any seven year period exceeds the available nil rate band, which is £325,000 for 2009/10, then inheritance tax is payable on the excess at half the death rate (ie currently at 20%).

The trust fund may also be subject to periodic inheritance tax charges at every 10 year anniversary of its creation. A charge will arise on the relevant value of the trust fund that exceeds the then available nil rate band. Any chargeable lifetime transfers you made in the seven years up to creating the trust will also be taken into account in the calculation. The charge is 6% of the excess.

Exit charges might apply when capital is distributed to beneficiaries. These will apply where there has been a charge to inheritance tax at the last 10 year anniversary or at the start of the trust if within the first 10 years.

If the seven year aggregate value of your chargeable transfers is below the available nil rate band at the start of the trust there will be no initial charge to inheritance tax. Similarly, if the relevant value of the trust property and chargeable transfers at subsequent 10 year anniversaries is less than the available nil rate band, there will be no inheritance tax charge.

If you die within seven years of making a chargeable lifetime transfer, the value of that transfer will become chargeable to inheritance tax at the rate applying on death (currently 40%). Any tax payable on death will be reduced by any tax that was payable when the transfer was made. Taper relief may also be applied to reduce the tax payable.

**In the case of protection policies it is very unlikely that there will be a charge to inheritance tax when the trust is created or at 10 year anniversaries if the life insured is in good health.**

The actual policy proceeds will generally not be subject to inheritance tax as the policy itself will not be part of your estate. However, where you have a right to claim a benefit under the trust policy for yourself (for example, a critical illness benefit under a protection policy) and you fail to do so, that may result in an inheritance tax charge.

If you make a chargeable lifetime transfer in the 2009/10 tax year in excess of £260,000 (including all other chargeable lifetime transfers in the preceding seven years), or £325,000 where cash or quoted shares/securities are transferred, you must complete forms IHT100, IHT 100a (and D34 for life assurance policies), and send this to HM Revenue & Customs. The trustees will also have to complete an IHT100 and either IHT100c or IHT100d when reporting a proportionate (exit) charge or principal (periodic) charge.

The inheritance tax treatment of trusts is complex and the above is simply a brief summary. Further information can be found on the HMRC website at [www.hmrc.gov.uk](http://www.hmrc.gov.uk).

### Example 1

John Black is married with two young children. On the advice of his financial adviser he takes out a Term Assurance policy for £400,000 and writes this under a Discretionary Gift Trust (Protection) for the benefit of his children.

The death benefit from this policy will not be part of his estate and hence will not be subject to inheritance tax. Should a death claim arise, the sum insured can be paid to John's surviving trustees as soon as the claim is admitted, ie there is no need to wait for probate or other grant of representation.

As the value of the policy is nil when the trust is created (because John is in good health), there is no chargeable lifetime transfer and no need to complete an IHT100 form. In this instance, John's premiums are exempt under the normal expenditure exemption and are therefore not chargeable transfers.

Provided John is in good health at a 10 year anniversary, there will be no periodic charge to inheritance tax as the policy will have little or no value. If a claim subsequently arises and the trustees pay the proceeds to the beneficiaries before the next 10 year anniversary there will be no exit charge.

Should the trust property have a value in excess of the available nil rate band at a 10 year anniversary, either because John has died or he is terminally ill, there will be a charge to inheritance tax, ie a periodic charge as described in the 'Inheritance tax' section above. There may also be exit charges on subsequent distributions to beneficiaries.

John might reduce the chance of an inheritance tax charge even further by taking out two separate policies for £200,000 each, and writing these under separate trusts on separate days. Each trust may then have its own nil rate band to set against the value of the policy.

### Joint bank accounts and single settlor trusts

Where the discretionary gift trust (protection) is executed by a single settlor the settlor's spouse is a potential beneficiary.

If a payment to a single settlor trust is made from a joint account, the spouse might be treated as making a gift to the trust. Whether or not a gift is actually made by the spouse will depend on the particular circumstances as to ownership of the money within the joint account. If the spouse is treated as making such a gift, it could have adverse inheritance tax consequences.

(Please note that the above can also apply where the couple who jointly own the account are not married to one another.)

### Capital gains tax

Provided the policy within the trust is not bought by the trustees (ie they don't purchase a second-hand policy) or acquired for some other consideration, there will be no capital gains tax liability. In most cases, the trustees receive the policy as a gift for the beneficiaries and no capital gains tax liability will arise.

## Income tax

When a chargeable event occurs under a life insurance policy a calculation is required to decide whether there is a chargeable gain. It is rare for a chargeable gain to arise under a protection policy.

A chargeable gain will not usually arise under a policy which provides only death and/or critical illness benefits, for example, a Term Assurance policy, and therefore no income tax or capital gains tax liability would arise.

A protection policy with an investment element, such as a whole of life policy with a surrender value, might bring about a chargeable gain but that is likely to be uncommon, as the surrender value of the policy is used to calculate the gain and that is likely to be less than the premiums paid.

A chargeable gain will usually only arise under a qualifying insurance policy (including an investment element) if it is surrendered, sold or if premiums are stopped within 10 years of being effected.

The following are chargeable events for a non-qualifying policy, such as non-qualifying whole of life policy:

- death resulting in payment under the policy, ie when the last or only life insured dies
- surrender
- sale of the policy for money or some other consideration, ie not as a gift.

There could be a liability to excess rate income tax (ie the difference between the tax credit available and higher rates of income tax) if a chargeable gain occurs. There is no liability to basic rate tax in the case of an Aviva policy issued in the UK as corporation tax is suffered within UK life insurance company funds and a tax credit is given. This satisfies an individual's liability to all but higher rate income tax. However, a gain could affect your entitlement to age related allowances and to means-tested benefits and credits.



# The trustees and income tax self assessment

Trustees are assessable to tax on income and gains within the trust and are subject to self-assessment.

Whilst in practice trustees may often agree that one of them will deal with HM Revenue & Customs, all of them are jointly and severally liable for any tax payable. This means that unpaid tax or penalties may be recovered from any of the trustees.

Trustees have the same obligations as individuals regarding notification of liability, completion of tax returns, and the making of interim and balancing payments. Also, when they account for income tax under the trust, trustees should complete a tax deduction form R185E and give this to each beneficiary who has received income. This form sets out the gross and net amounts of income enabling the beneficiaries to correctly complete their own tax returns.

However, life insurance policies do not produce income. All payments from a life policy – whether surrenders, maturities or death claims – are capital. Unless trustees give some consideration for a life policy (for example, buy it from the original owner), it will be exempt from capital gains tax. So, while the only trust asset is a life policy, an income tax charge will only arise when a taxable chargeable gain is realised under the policy. (See income tax consequences on page 12.)

The person liable for income tax on a taxable insurance gain is you, if you are alive and UK resident. Otherwise, the trustees – if they are UK resident – are liable.

# Administration issues of the trust

All payments under the policy are paid to, or at the direction of, the trustees as legal owners of the policy. It is up to the trustees to decide to whom any trust money should be paid. In the case of some trusts, the trustees have no discretion in this and should pay the money to the beneficiaries entitled (or perhaps to the beneficiary's guardian in the case of a minor).

However, the trustees must have regard to the actual trust deed, as in many cases there is still a power to change the beneficiaries entitled even after a claim. For example, the discretionary gift trust (protection) allows changes to beneficiaries for almost 80 years from the start of the trust, regardless of whether or not there has been a claim under the policy.

Before making a capital distribution to a potential beneficiary, the trustees should make an irrevocable appointment in favour of that beneficiary for the amount to be distributed. This is done by executing a formal Deed of Appointment of Benefits.

It should be noted that the income and capital gains tax treatment of general trust assets would be different to that for life policies. When policy claim money is paid, the trustees should take professional advice if that money is reinvested elsewhere or has attracted interest.

# Completing the Aviva Discretionary Gift Trust (Protection)

The Aviva Discretionary Gift Trust (Protection) can be used with a new or existing Aviva policy owned on a joint or single basis. In the case of a single settlor trust the settlor's spouse is also included as a potential beneficiary.

## **How should I make known which beneficiaries should benefit from policy proceeds?**

When you complete the Discretionary Gift Trust (Protection) you will name default beneficiaries. However, they will only benefit in the unusual event that no other appointment is made within 80 years of the trust starting. You have the power to make appointments in favour of particular beneficiaries, but this power falls to your trustees when you die (and the policy proceeds are paid out).

There are a number of possible (or potential) beneficiaries under your trust (see pages 7 and 10). When a claim is made under your policy, proceeds can be appointed in favour of any beneficiaries.

You should write a note to your trustees setting out which beneficiaries you would like to benefit from any policy proceeds and in what proportions. This note is not binding and you can change your mind, say, if circumstances change, for example, if a new grandchild is born and you want him/her to receive some of the proceeds.

Any such notes should be kept safe with the trust documentation.

# Life insurance with tax relief and mortgage life insurance with tax relief

**These products are no longer available for new business and these details are provided for the benefit of existing customers holding these products only.**

Both of these products form part of the Aviva Personal Pension Plan. They are, therefore, automatically written under a master trust. This means that the value of any death benefits under a policy is outside the policyholder's estate for inheritance tax (IHT) purposes.

The policyholder can nominate, to Aviva, who they wish to receive any death benefit. Aviva will take note of any such nomination when deciding how to deal with the death benefit. Any death benefit will be distributed by Aviva, at the latest, by the second anniversary of the policyholder's death.

Alternatively, the policyholder can place their policy under an individual trust. The only trust deed Aviva can offer for consideration is our Trust Deed for Stakeholder/Personal Pension/Retirement Annuity Contract. As with a nomination, the value of any death benefits under the trust is outside the policyholder's IHT estate. The main advantage of an individual trust is that the policyholder can appoint trustees of their choice and those trustees will decide which beneficiaries will receive any death benefits. The beneficiaries under this trust cannot be changed after the second anniversary of the policyholder's death.

Please note that both these products are unsuitable for use in business protection planning using Aviva's trust for partners/directors, and any business protection trust submitted for one of these products will be rejected.

# Important Notes

This booklet is not intended to give advice. Anyone thinking of using a trust or doing anything under the provisions of a trust, must rely on the advice of their own legal and/or financial advisers. We would urge you to seek appropriate professional advice relevant to your own circumstances before proceeding. This is important for a number of reasons:

- Creating a trust has taxation, as well as legal, consequences.
- Once the trust has been created it cannot be revoked.
- The trustees have a special duty to the beneficiaries and the misuse of a trust power by a trustee can make her/him personally liable for any resulting loss to the beneficiary.

References to tax treatment in this booklet are based on Aviva's understanding of current legislation and HM Revenue & Customs' practice as at 5 February 2009. Both of these are likely to change in the future, and this could result in tax being suffered under an existing arrangement. Every care has been taken as to the accuracy of the information. However, neither Aviva nor its representatives can accept responsibility for loss, however caused, suffered by any person who has acted, or refrained from acting, as a result of material published in or in conjunction with this booklet.

Aviva cannot act as financial or legal adviser for you or your clients.

