Guide to the Discretionary Trust

What's in this guide?

This guide provides some information on trusts generally and then focuses on the key points of the Zurich Discretionary Trust. We've written it for customers who are consulting a financial adviser. If you are reading this booklet and are not dealing with a financial adviser, we strongly recommend you take advice to help you decide whether setting up a trust is appropriate for your circumstances.

Please read this guide with the Trust as its guidance notes give a much fuller explanation (though more detailed and technical) of how the trust works and how it is taxed.

What is a trust?

A trust is a legally enforceable agreement where a person puts assets into safe keeping so that others may benefit.

The person creating the trust is called the donor or settlor (truster in Scotland). For this trust, we will use **'settlor'**.

The people who deal with the trust property are called the **trustees**. Trustees must act according to the terms of the trust, which is usually a formal written document.

Those who will benefit from the trust are called **beneficiaries**.

Why use a trust?

Trusts, as we know them today, grew from the medieval custom of transferring land and property from the owner to another person who would then hold them, not for himself, but for someone else. It would have been used as a means of keeping land and property safe, for example, while men were away fighting wars.

Today, because payment of proceeds arising from assets in trust can be made to the trustees without the need to get Probate or Letters of Administration, they are often used because assets under trust can be passed quickly and without delay to the beneficiaries.

Also, because trusts can define who will benefit both during the lifetime and on the death of the settlor, they can help to avoid family disputes.

Trusts can also be used as part of inheritance tax (IHT) mitigation and planning.

Are there any disadvantages with trusts?

Once a trust is set up, the legal ownership of the assets in the trust passes from the settlor to the trustees, who will then be in control of the operation of the trust. Once set up, the settlor cannot alter the terms of the trust.

It 's important you seek advice to understand what placing assets into trust means for you.

What types of trust do we offer?

We currently offer two main types of trust. They are absolute trusts (also known as bare trusts) and discretionary trusts.

Absolute trusts should only be used where you want to make an outright, absolute gift, as the beneficiaries cannot be changed. Most commonly used by parents to create a trust for their children, a drawback can be that, as soon as the children reach age 18, they become absolutely entitled to claim the trust's assets.

Please note that HM Revenue & Customs Inheritance Tax currently (1 February 2007) take the view that it is not possible for an absolute trust for the benefit of a minor beneficiary to be treated as such for IHT purposes. Final clarification is not yet available. Please speak to your adviser for more details, and about the most up-to-date position.

Discretionary trusts are trusts where the trustees decide how much, if any, of the trust property the beneficiaries should receive. The beneficiaries have no entitlement unless or until the trustees decide to provide them with benefits.

What type of trust is the Discretionary Trust?

The Zurich Discretionary Trust is a discretionary trust.

What are its aims?

The Discretionary Trust is designed to be used with Zurich's regular payment life assurance plans. It can also be used with investment bonds.

It should not be used with joint settlor / joint life first death plans; critical illness assurance, income protection plans, plans to be assigned to secure mortgages, or if your plan is to be used for business protection.

It has the following aims:

- to enable you, as the settlor, to transfer the plan into trust to be held for the benefit of the trust beneficiaries
- to ensure that most, or all, of the plan proceeds will not be liable to inheritance tax
- to ensure that if the benefits of the plan are paid on the death of a life assured, they are paid into the trust without probate delay.
- to enable you, or after your death the trustees, flexibility to appoint benefits in favour of any of the trust beneficiaries.

How is the Discretionary Trust set up?

If you are applying for a new plan and you ask for it to be written in trust, the trust will commence when the plan is issued. If you are transferring an existing plan into trust, the trust will commence on the date the trust deed is signed and dated by you, the settlor.

Completion of the trust form is straightforward.

As the person declaring the trust (the settlor), you need to complete the box at the top. Your spouse or civil partner, can be a joint settlor.

Please note that neither settlor can benefit from the plan proceeds so this type of trust is not suitable for joint life first death plans.

You (both) need to sign the trust and have your signature(s) witnessed.

Box A on the trust form lists a wide range of potential beneficiaries to which you, or after your death the trustees, can appoint benefits in the future. A settlor cannot be a potential beneficiary because if they were, the inheritance tax aims of the trust would not be achieved.

If no new beneficiaries have been appointed during the trust period (usually 80 years from the start of the trust), any benefits will pass to the 'default beneficiaries.' They should be listed in Box B. By completing Box B you can provide an indication to the trustees who you might wish to receive benefits, and this is particularly important should you die. Default beneficiaries can be changed at any time. It is very important that, when there is more than one default beneficiary, the total shares add up to 100%.

You are automatically a trustee and you have the power to appoint and remove trustees. We recommend you appoint at least two additional trustees. This will avoid any delays caused by having to obtain probate or letters of administration, and helps to exercise certain rights within the trust. The trustees will be in control of the operation of the trust and, as payment will be made to the trustees, they should consider setting up a trustee bank account.

The names of the trustees should be entered on the trust deed, which we will return to you for safe-keeping after we have noted it in our records.

How does the Discretionary Trust work in respect of IHT?

Transfers into discretionary trusts are chargeable lifetime transfers (CLTs), and they may be liable to IHT charges.

When making the gift into trust

Transfers into Discretionary Trusts – unless the transfer is made within the available nil-rate band – will be liable to an immediate IHT payment at one half of the rate currently applying on death. This could mean an IHT charge of 20% on the amount above the nil-rate band.

Also, as this is a CLT, if the value of your CLTs in the tax year in which you set up the trust, including the initial gift, is more than £10,000 (or if your total gifts are more than £40,000 cumulated over the previous ten years) you must report it to HM Revenue & Customs using Forms IHT 100 and 100 (a). These are the limits that apply on 1 February 2007, but they may change in the future.

For regular payment life assurance plans, each payment is treated as a gift in its own right. However, such payments may be covered by one of the IHT exemptions (e.g. the annual exemption and/or normal expenditure out of income) making them exempt from IHT altogether.

Periodic charge

This charge arises ten years after the trust was set up and every ten years after that. The value of the trust property for the purposes of the periodic charge will be based on the market value of the plan. For term assurance plans, the value is likely to be negligible unless the life assured is in serious ill-health or the plan proceeds have already been paid into the trust and have not been distributed to the beneficiaries. For whole of life plans, the value will be the total of all the payments made if this is more than the market value of the plan. If this amount is below the nil-rate band applying at that time, (taking into account any CLTs in the seven years before the trust was created) there will be no IHT due. If it exceeds the available nil-rate band IHT will be payable on the excess at a maximum of 6%. If IHT does arise, it may be much less than this rate.

Exit charge

This charge arises when all or some of the trust property leaves the trust.

Where property leaves the trust before the first ten-year anniversary, in general terms if no IHT was paid when the trust was set up, there will be no exit charge if property leaves the trust in the first ten years.

If property leaves the trust after the first ten-year anniversary and there was no IHT charge at the previous ten-year anniversary, and no new money has been added to the trust since then (payments which fall within the annual exemption and/or normal expenditure out of income are not taken into account for these purposes) there would be no exit charge.

Where tax is due, the calculation can be complex, so you should consult your adviser.

What can change or go wrong?

- Once a trust is set up, the legal ownership of the assets in the trust passes from you (as settlor) to the trustees, who will then be in control of the operation of the trust. Most trusts are irrevocable, which means that, once set up, you cannot alter the terms of trust (even in your capacity as one of the trustees). It 's important you understand what placing assets into trust means for you now and in the future, as trusts cannot accommodate a change of mind. You cannot appoint the benefits back to yourself at any time.
- You should be aware that tax law on trusts may change, as can HM Revenue & Customs current practice.

Some important notes

This guide covers the main points about the Zurich Discretionary Trust but it cannot cover every situation. There are many other questions you may have and some of these may be covered in the guidance notes accompanying the trust form.

You should always consult your usual adviser or other professional advisers, such as your solicitor or accountant, if you are considering setting up a trust.

The trust, once created, is irrevocable and the plan and its benefits must be held according to the terms of the trust. The trustees will be in control of the operation of the trust, which means that they may need to set up a trustee bank account.

Taxation law is likely to change. Such changes cannot be foreseen. This trust, and the statements in this guide, while aimed at letting you know how the trust works, are based on our understanding of current law and practice (1 February 2007). Before proceeding you are recommended to refer the trust to your own legal advisers to ensure it meets your needs.

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