CORNERSTONE
WILLS

The Family Trust

In today's sophisticated financial markets many people qualify for death-in-service benefits (DISB) from their employer.

This is not generally a problem as the lump sum goes straight to the beneficiary, usually the surviving partner (*). The lump sum is never counted as part of the deceased's estate, so there is no Inheritance Tax (IHT) to pay – whether the deceased was married or not. However, on the surviving partner's subsequent death the estate - now including the lump sum your partner received - would be liable to Inheritance Tax. (IHT is payable at 40% on the value of the whole estate above the tax-free threshold.)

Although this page and the Case History on the right describe the IHT issues with paying your DISB directly to a person – whether to your partner or to your children – there are other reasons where paying to trust can still be hugely beneficial. These are discussed overleaf.

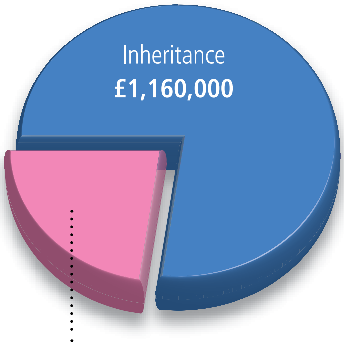
All these problems can be avoided by simply having the death-in-service benefit paid into a Family Trust with trustees of your choice (usually including your partner) and the partner, children and other family members as the beneficiaries.

> "Trusts can reduce or eliminate any inheritance tax your family pays"

The partner gets full access to the funds (often through a loan arrangement with the Trustees) to spend as they wish. This loan arrangement helps by creating a liability on the partner's estate that must be repaid on their death from their estate to the trust, thus reducing the overall value for IHT. The trust funds are then made available to the children and/or other family members.

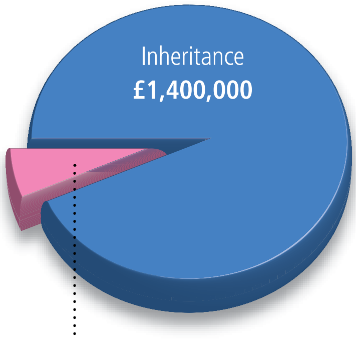
From April 2017 a new tax free allowance on the home (the Residential Nil Rate Band or RNRB) has been introduced which has several qualifying rules. One such rule is that the allowance reduces by £1 for every £2 that your estate value exceeds £2M. By the 2020/21 tax year the RNRB, which is transferable between spouses, will be £175,000. Under the rules if the value of a couple's estate is over £2.7M then the RNRB would be lost totally. By directing your DISB to a Family Trust and not to your partner might be advantageous if it were to keep the estate value on second death below the £2.7M threshold which could save the family a further £140,000 of IHT.

Without Family Trust



Inheritance Tax **£340,000**

With Family Trust



Inheritance Tax **£100,000**

*For simplicity, the word partner has been used throughout. This term refers to spouse, Civil Partners and unmarried partners.

A CASE HISTORY

Peter and Jane are married with two children and their joint estate is worth £900,000. Peter has £600,000 DISB and has appointed Jane to receive these benefits by completing the nomination form with his employer. Peter thought that he would live into retirement and failed to consider any estate planning around his DISB. Unfortunately he died on a business trip. Because Jane directly received his DISB (and hadn't spent any of it in her lifetime), £240,000 IHT was paid on Jane's death. Peter's children could have received this £240,000 if he had set up and nominated a Family Trust to receive his DISB instead of Jane.

Note, in this example any calculations involving the Residential Nil Rate Band have been intentionally excluded to aid understanding.

Tax on Jane's death - Without the Family Trust

Joint Estate	£900,000
Death benefit paid to Jane	+£600,000
Inheritance Tax on Jane's death:	
Gross Estate	£1,500,000
Minus the two tax-free allowances	– £650,000
Net Estate for calculation of IHT	£850,000
Inheritance Tax @40%	£340,000
Children's Inheritance	
The Estate	£1,500,000
Minus Inheritance Tax	– £340,000
Total Children's Inheritance	**£1,160,000**

Tax on Jane's death - With the Family Trust

Joint Estate	£900,000
Loan to Jane from the Family Trust	+£600,000
Inheritance Tax on Jane's death:	
Gross Estate on Jane's death	£1,500,000
Minus loan due back to Trust	– £600,000
Minus the two tax-free allowances	– £650,000
Net Estate for calculation of IHT	£250,000
Inheritance Tax @40%	£100,000
Children's Inheritance	
The Estate	£900,000
Minus Inheritance Tax	– £100,000
Plus the funds in the Family Trust	+£600,000
Total Children's Inheritance	**£1,400,000**

For more information please contact us or visit our website **www.cornerstonewills.co.uk**
Tel: 01276 415835 **Email:** info@cornerstonewills.co.uk

The Family Trust (continued)

Other things you may need to know

Trustees can decide to make interest-free loans from the trust or to charge interest on the loan. Charging interest on the loan creates a further liability on second death. This interest must be paid from the estate back to the trust in addition to the loan thus reducing the overall value of the estate for IHT purposes. Note: the trustees should seek professional advice at the time as an income tax charge could arise on any interest paid.

If your partner doesn't leave enough money to pay back the loan on their death, there will be no liability on the trustees.

The Family Trust could incur its own Inheritance Tax charges. If the value of the trust fund exceeds the tax free threshold then there is a charge of 6% is made every 10 years and there is also an exit fee when funds are taken out.

Other "Asset Protection" benefits of the Family Trust

Although the Case History overleaf describes the benefits of the Family Trust in terms of the huge Inheritance Tax savings there are other benefits as summarised below:

- Should your partner enter into a new relationship or [re-]marry after your death...
  - ... and be the first to die in that new relationship the funds could pass to that new partner – e.g. where they have made new simple Wills together leaving everything to each other or perhaps have made no Will at all and it passes via intestacy
  - ... and use the funds to purchase joint property – the property will automatically pass to the new partner should your partner die first
  - ... and then subsequently divorce the funds will be part of any divorce proceedings
- Should your partner need long term care then the funds will be included when their estate is assessed for the funding of their care costs
- Should your partner (or even their new spouse/partner) become bankrupt then the Trustees in Bankruptcy will claim your funds to settle the account
- Should you partner die before you, then you may or may not have nominated secondary beneficiaries of your DISB, e.g. your children:
  - If you haven't, then who will your employer pay out to? Perhaps your children, perhaps not; it is at their discretion
  - If your employer will pay out to your children then some of the above issues raised against your partner will apply to your children
  - If your employer will pay out to your children then what if they are under 18? Your children are minors – they cannot sign paper work as a receipt. Your employer will insist on a trust being established for your minor children. Who would your employer chose as trustees? Possibly not your choice of trustee
  - If your employer will pay out to your children and one or more is 18 then do you consider it an appropriate age to come into such large sums of money or would you rather they completed university and the funds managed for them until you consider them old enough
- Should you, your partner and children unfortunately all be involved in the same accident then who would your employer pay out to? Your Will would cover this scenario but your nomination of death benefits form lodged with your HR department wouldn't go this far.

All the above issues could be resolved at a single stroke by setting up a Family Trust with a letter of wishes and redirecting your DISB to the trust instead.

How else would I use a Family Trust?

Although these trusts are mainly used to receive death in service benefits they can be used in other ways to receive assets in order to save inheritance tax (on the death of the surviving partner or other beneficiary) and ring-fence these assets for your family and future generations. These additional uses could include:

- To gift business or agricultural property that qualifies for 100% business/agricultural property relief;
- To gift your estate via your Will (for example, where your children are wealthy in their own right, gifting your estate into a Family Trust rather than directly to your children will save inheritance tax on your children's death);
- To receive any lump sum death payouts from other life assurance policies and
- To receive gifts made in your lifetime that would be free from inheritance tax from your estate after 7 years.

For more information please contact us or visit our website **www.cornerstonewills.co.uk**
Tel: 01276 415835 **Email:** info@cornerstonewills.co.uk