Sharing the benefits
of healthy living

Adviser guide to The VitalityLife Discretionary trust.

Contents.

About this document.

At VitalityLife, we recognise that trusts can seem complicated and the laws around them daunting. This guide is to help your clients understand the benefits of putting their plans in trust and how best to meet your client's needs and to provide technical support in a way that's easy to digest.

If you have any questions about how to complete the Trust form, you can download the "VitalityLife Discretionary Trust Case Studies 1 and 2".

If you have any further queries let us know and we'll try to answer them as simply as possible.

In this document the term "spouse" includes a registered civil partner under The Civil Partnership Act 2004 and any reference to widow, widower and married couple should be construed accordingly.

1. Objectives and suitability

There are four main objectives of the Discretionary Trust.

Tax planning

The first objective is to ensure that the benefits payable on death under the Plan are held for the chosen Beneficiaries outside of the (inheritance) taxable estate of the Settlor (who is the Plan holder(s) and the person, who places the Plan under Trust). By using the Discretionary Trust with a Plan, the Settlor, will transfer the gifted benefits under the Trust outside his or her taxable estate. This means that the Life Cover and any other benefits payable on death, will be paid to the Trustees free of inheritance tax (IHT).

Avoid probate delays

The second objective is to ensure that the Life Cover (and any other benefits payable on death) is paid quickly without the need to wait for probate or letters of administration (confirmation in Scotland). This will be possible as long as at least one Trustee survives the Settlor. For further details see Section 3.

Retaining lifetime benefits

The third objective is to ensure that the benefits payable during the Settlor's lifetime (e.g. following the Settlor's illness or disability) will be paid to the Settlor for their own benefit but without affecting the IHT efficiency of the trust.

Flexibility in gifts to future generations

Life assurance represents an effective and economic way of ensuring that funds are available to an individual's family/dependants following their death. However, putting cover in place is only half of the story. It is also necessary to ensure that the funds are available in the right hands, at the right time and in a way that is tax efficient. If it is certain at the outset who should benefit from the Life Cover and it is the only type of cover on the Plan, a simple form of trust, or even an absolute assignment of the Plan, may be suitable. However, in most cases, as personal circumstances change, there will be a need for flexibility over who should benefit. This may be especially so for those with growing families. The Discretionary Trust provides maximum flexibility in a relatively tax efficient way.

Key issues affecting suitability

- **For the Personal Protection Plan with Serious Illness Cover.**

  To ensure IHT efficiency (see below) where Serious Illness Cover is included under the Plan, the Plan should be written on an additional basis.

- **For use with Personal Protection Plan with LifestyleCare Cover**

  To ensure IHT efficiency (see below) the amount of the gifted Life Cover must not be reduced by any payment under the retained LifestyleCare Cover. To ensure that this does not happen the Plan must include LifestyleCare Cover Protector benefit. The level required will depend on the level of LifestyleCare Cover, if it is equal to the Life Cover then Level 1 Protector is required, if unequal then Level 1 and Level 2 Protector are required. If that is not the case, the "gift with reservation of benefit" provisions will apply which means that mitigation of IHT will not be secured.

- **For all Plans**

  The Settlor must indicate in the Trust deed whether they wish to keep the benefit payable on the diagnosis of Terminal Illness (which is an advance payment of the Life Cover) for their own benefit during the remainder of their lifetime or to give it away to Beneficiaries in the same way as the Life Cover benefit payable on death. If this benefit is kept by the Settlor then, unless all of it is spent before death, any remaining amount will be included in the estate of the Settlor for IHT purposes. Prospective Settlors must carefully consider this choice as, once made, it cannot later be amended. The only exception is where there are joint Settlors of a "joint life first death" Plan who choose the "Reversion to the Surviving Settlor" provision. This is explained later on in section 2.5. Where this provision is chosen the Terminal Illness Benefit must always be retained.

- Under the Discretionary Trust the Appointor decides who (from the classes of Beneficiary specified in the Trust) should benefit from the Trust fund and when. The initial Appointor is the Settlor (or both Settlors in the case of a joint life Plan). After the Settlor's death the Trustees take over the power of appointment.

- When establishing the Trust the Settlor specifies who should be the Beneficiary(ies). The Settlor can also provide the Trustees with a Letter of Wishes. Although this letter will not be binding, the Trustees will normally follow the Settlor's wishes unless they find compelling reasons not to.
- The Trust is suitable for use with new or existing Plans.
- As the Trust is a discretionary trust, the transfer of a Plan to this Trust and payment of premiums by the Settlor will be gifts for IHT purposes.
- Premium payments will be transfers of value. Because of the type of Plan involved, the total premium is, likely to fall within one of the Settlor's available exemptions for IHT e.g. the annual exemption or the normal expenditure out of income exemption.

  Usually, when a plan that is being made subject to trust is a regular premium protection plan, such as one of our Plans, the premiums paid will be exempt from IHT as normal expenditure out of income. Broadly speaking, to qualify for this exemption, it is necessary for the payment of the premium to be regular, paid out of the donor's income and of such an amount that will not affect the donor's standard of living.

  If the amount of the premium or cash transferred to the Trustees does not qualify for the normal expenditure out of income exemption **and** it exceeds the available annual exemption, currently £3,000 for each Settlor, it will be a chargeable lifetime transfer (CLT). This means that a potential liability to IHT at 20% may immediately arise if the chargeable lifetime transfer on the gift plus the value of all other chargeable transfers made by the Settlor in the preceding seven years, exceeds the nil rate band at the time the Plan is put in trust. However, as the nil rate band is substantial (£325,000), in most cases it is very unlikely that a liability will arise.
- In the unlikely event that an IHT liability does arise on the premium(s), a further tax liability (at 20%) on the chargeable lifetime transfer could arise if the Settlor dies within seven years of making the gift. Taper relief would reduce the tax payable if the Settlor survives the gift for at least three years. On the Settlor's death within seven years of making the gift the full value of the chargeable lifetime transfer when made will also be taken into account in calculating the IHT liability on the Settlor's estate.
- In most cases no IHT liability will arise in connection with the payment of premiums under the Plan in trust.
- When an existing Plan is made subject to trust, the transfer of value in respect of the gift will be the market value of the Plan (or, if the Plan is on a whole of life basis, the total premiums paid to date if greater). Other than this, the tax implications will be as set out above for a new Plan.

  You should note that even though a Plan never acquires a surrender value, if the life (lives) assured is/are in serious ill health this could mean that it has a market value for IHT purposes.
- A transfer of an existing Plan will be a chargeable transfer and may have important consequences, especially if the prospective Settlor is in serious ill health. The taxation implications of the trust is dealt with in more detail in section 5.
- The Discretionary Trust can be used regardless of whether an existing Plan or a new Plan is being effected by one individual or two individuals jointly.
- Under a Plan effected jointly, the Life Cover benefit may be paid on the first death or on the second death depending which option is chosen. If the death benefit is payable on the first death, the survivor may benefit if they survive the first death by 30 days – see below. If the Life Cover benefit is payable on the second death then neither of the Settlors will be able to benefit from the Life Cover benefit and it is available for the Trustees to appoint to the Beneficiaries instead.
- If a joint life first death Plan is effected subject to the Discretionary Trust, the Settlors can choose, at outset, – whether the surviving Settlor should benefit on surviving the first to die by 30 days or should not be able to benefit and the benefit becomes payable to the Beneficiaries via the Trustees instead. However, once the choice is made and the Reversion to the Surviving Settlor provision has been selected this cannot be changed.
- Although the Trust is governed by the law of England, it can be used by individuals domiciled in all parts of the UK. The tax implications of the Trust are the same throughout the UK.

2. Inheritance tax planning

2.1 IHT-free Life Cover benefit

The Discretionary Trust ensures that the Life Cover is held outside of the Settlor's estate. It may even be that the main (or only) purpose of effecting the Plan is to provide funds free of inheritance tax to meet an inheritance tax liability on the estate. The Life Cover benefit would normally be paid, by the Trustees, to those who inherit the estate of the life assured for them to meet the liability to IHT.

The Life Cover benefit will be paid free of tax to the Trustees although a potential IHT liability could arise in certain circumstances - see section 4 for more details.

2.2 Settlor's entitlement to the lifetime benefits

So as to be sure of freedom from IHT, the Settlor normally must not benefit from the asset given away (the Plan). If the Settlor can benefit, this would amount to a gift with reservation of benefit (GWR) which would mean that the value of the Plan would be included in the Settlor's taxable estate. However, where the Plan includes benefits that may be payable during the Settlor's lifetime, such as Serious Illness Cover, LifestyleCare Cover (and the Terminal Illness benefit where the Settlor has made this choice), it will be normal for those benefits to be retained by the Settlor for his own benefit.

- **For Personal Protection Plan with Serious Illness Cover**

  Under the Discretionary Trust, all such lifetime benefits are held for the absolute benefit of the Settlor. It is possible to arrange this in such a way that the IHT efficiency of the Trust is preserved (so that the GWR provisions do not apply).

  First, the benefits kept by the Settlor must be precisely defined, and this is the case under the Discretionary Trust.

  Second, payment of any Serious Illness Cover benefits must not reduce the value of the Life Cover (i.e. the amount of the benefit payable on death) other than by completely extinguishing it. To ensure that this does not happen, and so avoid any adverse IHT implications for the Trust, the Plan should be written on an additional basis which means that the Serious Illness Cover and Life Cover operate independently. Full details of these benefits are explained in the Plan Provisions.

  If the payment of any lifetime benefits would reduce the value of the Life Cover (other than fully extinguishing it), this would mean that the arrangement is not effective for IHT purposes. In such a case the full value of the Life Cover, despite it being held for the benefit of Trust Beneficiaries, would be included in the estate of the Settlor as the Plan and Trust would fall within the GWR provisions. **For this reason the Discretionary Trust is not recommended unless the cover was selected on an additional basis.**

- **For Personal Protection Plan with LifestyleCare Cover**

  Under the Discretionary Trust, all such lifetime benefits are held for the absolute benefit of the Settlor. It is possible to arrange this in such a way that the IHT efficiency of the Trust is preserved (so that the GWR provisions do not apply)

  First, the benefits kept by the Settlor must be precisely defined, and this is the case under the Discretionary Trust.

  Second, payment of any LifestyleCare Cover benefits must not reduce the value of the Life Cover (i.e. the amount of the benefit payable on death) other than by completely extinguishing it. To ensure that this does not happen, and so avoid any adverse IHT implications for the Trust, the Settlor must ensure that the Plan includes, from outset, LifestyleCare Cover Protector at the appropriate level. This will depend on the amount of the LifestyleCare Cover and the Life Cover.

  If the amount of LifestyleCare Cover is equal to the amount of Life Cover then Level 1 Protector is required as this will protect a Level 1 claim, on a Level 2 claim the LifestyleCare Cover will be extinguished. If the amounts are unequal then Level 2 Protector is required in addition to Level 1 to prevent any partial reduction of the amount of Life Cover. Full details of these benefits are explained in the Plan Provisions.

  If the payment of any lifetime benefits would reduce the value of the Life Cover (other than fully extinguishing it), this would mean that the arrangement is not effective for IHT purposes. In such a case the full value of the Life Cover, despite it being held for the benefit of Trust Beneficiaries, would be included in the estate of the Settlor as the Plan and Trust would fall within the GWR provisions. **For this reason the Discretionary Trust is not recommended unless the LifestyleCare Cover Protector is included at the**

appropriate level. This would operate to automatically restore the Life Cover to its level prior to the payment of the lifetime benefit.

2.3 Settlor as the Appointor

The retention of the power of appointment of Beneficiaries by the Settlor(s) during their lifetime under a Discretionary Trust does not constitute a reservation of benefit for the purposes of the GWR provisions as the Settlor cannot exercise the power in his or her own favour.

2.4 Spouse as the Beneficiary of single life Plans

When the Trust is declared by one Settlor, the inclusion of the Settlor's spouse or civil partner as one of the Beneficiaries will not be a GWR. However, care must be exercised if a Terminal Illness Benefit is a Gifted benefit. If the Settlor suffers a Terminal Illness and the benefit is actually paid, via the Trustees, to the Settlor's spouse/civil partner while the Settlor is still alive, it would be essential that no part of this benefit is used directly or indirectly for the benefit of the Settlor for example by paying into a joint bank account. If this were to happen the Trust could be seen as one under which the Settlor had reserved a benefit which would make it ineffective for IHT purposes (as the benefit would be treated as still being in the estate of the Settlor for IHT purposes).

Of course, in the case of joint Settlors (where the Settlors are, say, husband and wife) such an appointment to a spouse would not be possible as both Settlors would be excluded from all benefit under the Trust unless the Plan is a joint life first death Plan and the Reversion to the Surviving Settlor provision is chosen (see section 2.5 below).

2.5 "Joint life first death Plan" and the Reversion to the Surviving Settlor

If a couple are effecting a Plan (so both of them are Settlors) with the intention that the death benefit is paid on the death of the first of them to die, for example as mortgage protection cover, they would normally prefer the survivor to receive the benefit and so there will be no need for any trust. However, many people are concerned about the possibility of both dying together or within a short time of each other. In such a case, they would prefer for the death benefit to be payable to their beneficiaries and in an IHT efficient manner. Fortunately, it is possible to satisfy both of these desires.

The Discretionary Trust allows the Settlors to choose the "Reversion to the Surviving Settlor" provision. This provides that if the second Settlor survives the first to die by at least 30 days, the Life Cover benefit will be payable to the survivor. If they both die within 30 days of each other, the Trustees will hold the benefit for the other Trust Beneficiaries.

It is possible to arrange this without upsetting the IHT efficiency of the Trust because the right of the surviving Settlor is clearly defined and cannot be defeated. By choosing the option at outset, this will ensure that the survivor will receive the benefit if he/she survives the first to die by 30 days. Having chosen the option it will not be possible to reverse it at a later date.

If the Settlors choose the Reversion to the Surviving Settlor provision then any benefits paid on Terminal Illness will have to be a Retained Benefit, payable to the Settlor suffering from the Terminal Illness.

If there are two Settlors and the Plan includes Serious Illness Cover, the person who is seriously ill will be entitled to the Serious Illness benefit.

2.6 What happens with a "joint life second death" Plan

With a Plan that is written on "joint life second death" any health benefits, say Serious Illness Cover benefit, will be paid in the normal way. However, life assurance benefits will be paid on the second event to occur be it death or terminal illness. For this reason the 30 day survivorship option is not appropriate.

Whilst benefits will be paid on the second event, the two events do not have to be identical. So, for example, if a Plan is effected on the life of husband and wife and the husband suffers a terminal illness, then benefits will be paid if the wife subsequently dies (even if the husband is then still alive). Similarly if the husband died and the wife then suffers a terminal illness, benefits will be paid on that subsequent terminal illness.

In a case where the second event is terminal illness, there is the option to either keep or gift this benefit. Given that the nature of second death planning is to place funds in the hands of the family on the second death, it is thought that most people would wish to gift Terminal Illness Benefits paid on the second event if they are claimed and this will apply in default unless the Retained Fund box is initialled.

2.7 Making gifts

When the Settlor pays regular premiums to the Plan, the premiums paid (even if paid directly to VitalityLife by the Settlor) will be gifts for IHT purposes. If the Plan provides any lifetime benefits, such as Serious Illness Cover, these will be held for the absolute benefit of the Settlor and so the amount of the actual gift should be discounted by the proportion of the premiums paid for these retained benefits to take account of this.

Provided the premiums are paid habitually out of income without detrimentally affecting the Settlor's standard of living (as they usually will be), those premiums should be exempt from IHT as normal expenditure out of income. To the extent that this exemption is not available then the annual exemption of £3,000, if not used elsewhere, could be used. These exemptions will mean that there will rarely be any IHT concerns over the payment of premiums.

When an existing Plan is made subject to a Discretionary Trust the gift (normally based on the market value of the Plan) will also be a chargeable lifetime transfer (CLT) for IHT purposes to the extent that the gift exceeds the Settlor's available annual exemption(s).

If the value of the gift (less any annual exemption(s)) plus the value of all CLTs made by the same Settlor within the seven immediately preceding years, does not exceed the Settlor's IHT nil rate band (£325,000) there will be no actual liability to inheritance tax – see section 4 for more details.

If the Settlor dies within seven years of making a gift, any liability would need to be recalculated at the death rates (see section 4 for a full explanation). The amount of any non-exempt gifts made within seven years of death would also use up part or all of the nil rate band available on death.

2.8 Other IHT considerations

Because the Trust is discretionary, which means that the Trust assets are not in anybody's estate for IHT purposes, a special IHT regime will apply (see section 4 for a full explanation). However, as explained in section 2.7 above, as long as the gifts (normally the regular premiums) are exempt or fall within the Settlor's available IHT nil rate band, there will rarely, if ever, be any adverse IHT implications of these special inheritance tax charging rules on premium payments.

Also, under a regular premium Plan which does not acquire a surrender value, where the life assured is in good health and the premiums paid under the Plan do not cause the Settlor's nil rate band at the time of the periodic charge or exit to be exceeded, IHT is unlikely to arise at any time.

For a detailed consideration of the IHT implications of the Discretionary Trust see section 4.

3. Avoiding probate (confirmation in Scotland)

As well as providing important tax benefits, a Plan that is subject to the Discretionary Trust will not be an asset of the Settlor's estate for probate (confirmation in Scotland) purposes.

To ensure that the need for probate/confirmation in the event of the Settlor's death is avoided, the legal ownership of the Plan must be with a person(s) other than the Settlor on their death. Having the legal ownership of the Plan vested in the Trustees achieves this. Of course, this is only secure if there is at least one Trustee who survives the Settlor. Under the Discretionary Trust the Settlor is automatically the initial Trustee. It is strongly recommended that further Trustees are appointed within the Discretionary Trust. If any of the additional Trustees retire or die before the Settlor, a further Trustee or Trustees should be appointed.

If there are no additional Trustees appointed, or they have been appointed and resigned/died/been removed so that there is no surviving Trustee on the death of the Settlor (the Settlor therefore being the sole Trustee at the time of his or her death), the Trust will nevertheless continue to exist and the tax planning and flexibility advantages will remain, but the speed of payment advantage will be lost. The personal representatives of the deceased Settlor will assume the role of Trustee under the Discretionary Trust and although the Plan will not be part of the Settlor's estate for IHT or probate/confirmation purposes, securing probate/confirmation to the Settlor's estate will still be necessary to ensure that the personal representatives can act as Trustees under the Discretionary Trust. Clearly then it is very important that additional Trustees are appointed who are likely to survive the Settlor so as to avoid a delay in dealing with the Plan.

4. Provisions in detail

The Trust is effectively split into two sub-trusts.

Retained Fund

The following benefits, if they apply under the Plan, will be held for the Settlor's absolute benefit:

- Serious Illness Cover (including any benefits which become payable at the same time as the Serious Illness Cover , as well as Dementia and FrailCare Cover),
- Life with Serious Illness Cover (including any benefits which become payable at the same time as the Life with Serious Illness Cover),
- Child Serious Illness Cover,
- LifestyleCare Cover,
- Income Protection Cover,
- Family Income Cover (where the benefits become payable on the diagnosis of a serious illness; otherwise the benefits will form part of the Gifted Fund),
- all benefits arising under the healthy living programme,
- if the Settlor has so chosen, by initialling the appropriate box in the trust deed, any payments made on diagnosis of Terminal Illness as defined in the Plan provisions

and all other benefits which are payable under the Plan during the Settlor's lifetime by reason of the Settlor suffering an illness or condition as specified in the Plan.

If there are two Settlors who have chosen the Reversion to the Surviving Settlor provision then any benefit paid on Terminal Illness will always be a retained benefit.

If there are two Settlors, the benefit is held for the one whose illness or disability results in the payment of the benefit.

Joint life first death Plan

In the case of a trust of a joint life first death Plan, the Terminal Illness benefit is held for the Settlor whose illness or disability results in the payment of the benefit.

If there are two Settlors who have effected a joint life first death Plan and chosen the Reversion to the Surviving Settlor provision, then any benefit paid on Terminal Illness will always be a retained benefit.

Joint life second death Plan

For a joint life second death Plan, the Life Cover benefit is payable on the second event to occur be it terminal illness or death.

Here it would normally be the case that, if claimed, the Settlors would want the Terminal Illness benefit payable on the second event to be part of the Gifted Fund.

Gifted Fund

This fund comprises all the other benefits, in effect the death benefit (and any benefit payable on Terminal Illness if the Settlor has chosen this option) or in default having not made an election to retain (unless the Reversion to the Surviving Settlor provision applies) as well as any other benefits payable after the Settlor's death. Family Income Cover paid on death will form part of the Gifted Fund for these purposes. These are held by the Trustees on the following terms:

- During the Trust period (up to 125 years) the Appointor (the Settlor(s) – and, after their death(s), the Trustees) may appoint these benefits (capital or income) to any of the Beneficiaries. These Beneficiaries include:
    - the Settlor's spouse (or civil partner) provided the Plan is not proposed for jointly by both of the couple
    - the Settlor's children and grandchildren
    - the Settlor's brothers and sisters and their children and grandchildren
    - as well as any person nominated by the Settlor at any time to the Trustees in writing. This means that the Settlor can add anybody else (other than themselves) to the list of the Beneficiaries.

As explained above, it is strongly recommended that the Settlor leaves a Letter of Wishes with the Trustees to indicate which of the Beneficiaries they would like to benefit after their death. VitalityLife provides a draft form for this purpose (see also Part 6.1.4 for more detail on this).

- As the Trust is a discretionary trust, no Beneficiary is entitled to any benefit under it until the Appointor (the Settlor(s) and then the Trustees) makes an appointment in their favour.

- The Settlor (both Settlors in the case of a joint Plan) cannot benefit from the Gifted Fund in any circumstances except where the Plan is a joint life first death Plan and both have chosen the Reversion to Surviving Settlor provision to apply (as explained earlier).
- The Settlor must name beneficiaries within the trust. Where the Trustees have not distributed the benefits during the Trust Period the individual or charity who is entitled to the largest part of the Settlor's estate will benefit. This is necessary for the Trust to be legally valid although in practice it is unlikely that the trust fund will remain undistributed after 125 years (Trust Period).
- The Trustees have wide powers to invest and deal with Trust property where the Plan proceeds are not to be distributed immediately for the benefit of Beneficiaries, for example, if the intended Beneficiaries are minor children at the time of the Settlor's death. Appropriate advice on suitable investments would need to be taken at this time.

Meaning of the Trust Clauses

Part A Request and Declaration

In this Part the Settlor(s) and the Additional Trustee(s) add their full names and addresses together with the Additional Trustee(s) date of birth(s) and email address(es). This confirms the Settlor's intention to create the Trust. When the Trust is for a new Plan application, it incorporates a direction for the Plan to be issued subject to trust from outset.

Part B Plan subject to trust

In this Part all the variables are included, namely the details of the Plan, the life/lives assured and the choice of the Reversion to the Surviving Settlor provisions, if applicable.

Also in this Part the Settlor must indicate whether the Terminal Illness benefit is to be gifted or retained. In cases where the Reversion to Surviving Settlor provision has been chosen the Terminal Illness benefit must be part of the Retained Fund.

Part C Definitions

These include all the relevant definitions, in particular the definitions of the Beneficiaries and the classes of people who can be one, as explained above.

Part D Principal Trust terms – the Retained Fund

This confirms that the Retained Fund is held for the absolute benefit of the Settlor.

Part E Principal Trust terms – the Gifted Fund

This part of the Trust deed contains the beneficial provisions relating to the Gifted Fund – i.e. who can receive the benefits payable on death from the Trust and when.

As previously indicated, the power to appoint capital and income under the Trust is vested in the Appointor - that is the Settlor(s) during their lifetime and the Trustees afterwards. The power is exercisable by the Appointor and includes a power to create further trusts in favour of the Beneficiaries. So, for example, if necessary the trustees could declare further trusts for the beneficiaries and transfer the Plan benefits to those trusts.

The Trustees have power to accumulate in the Trust fund any Trust income that is not distributed.

If the Trust fund has not been distributed by the end of the Trust period, the Trustees will distribute the Trust fund to the individual or charity who is entitled to the largest part of the Settlor's estate. It is, however, most unlikely that the Trust fund will not be distributed within 125 years.

There is also a special provision dealing with any potential conflicts of interest. In many cases the Trustees of the Trust would be family members who may also be Beneficiaries under the Trust (for example the spouse and/or children of the Settlor). If the Trust fund were to be distributed to a Beneficiary who is also a Trustee then a suspicion of a conflict of interest could arise.

For this reason there is a provision in this Trust which states that if a Beneficiary is also one of the Trustees, the Trustees can only distribute the Trust fund to that Beneficiary if there is at least one other Trustee who does not benefit, directly or indirectly, from the appointment being made.

The Trustees have wide powers included in the Trust to advance capital from the trust fund to the Beneficiaries.

The Trustees also have power to make loans to the Beneficiaries. The power to lend may be more appropriate than the power to advance funds in many circumstances - for example, where it is desired to pay benefits to the surviving spouse of the Settlor but without increasing his/her taxable estate. In such a case, say after the death of the Settlor and the payment of the death benefits, the Trustees, could make an interest-free (repayable on demand) loan to the surviving spouse which would usually be repaid on his/her death. This would effectively reduce the net estate of the surviving spouse for IHT purposes (unless the surviving spouse had previously made gifts to the Settlor, in which case no deduction for IHT purposes will be allowed).

This Part also deals with the Reversion to the Surviving Settlor provision where this applies. It confirms that, if this provision is chosen, if one Settlor survives the death of the first to die by 30 days, the Gifted Fund shall be held for the absolute benefit of the surviving Settlor, rather than for the other Beneficiaries.

Part F Administrative powers of the Trustees

The Trustees have wide administrative powers to deal with the Plan and to reinvest the proceeds of the Plan in any way they wish.

However, certain rights are reserved to the Settlor. This includes exercising any option to increase or decrease benefits under the Plan.

The Trustees also have power to borrow funds and to make payments to parents or guardians of Beneficiaries, who are under the age of majority (16 in Scotland, 18 in the rest of the UK).

Part G Appointment and dismissal of Trustees

The power to appoint new or additional Trustees is vested in the Appointor (ie. initially the Settlor).

The Settlor also has power to dismiss any Trustee provided at least two Trustees remain after such dismissal at least one of whom is not the Settlor. After the death of the Settlor, the Trustees cannot dismiss other Trustees. It must also be remembered that the Trustees must act unanimously.

Part H Remuneration and liability of Trustees

Trustees who act in their professional capacity are entitled to charge fees.

The liability of individual Trustees is limited so that they will not be held liable for any loss to the Trust fund provided they act in good faith.

A Trustee who is paid for his services will however be liable for negligence.

Part I The law of the Trust

The Trust is governed by the law of England. This means that if any dispute were to arise it would be settled by a court in England.

5. UK tax implications of the VitalityLife Discretionary Trust

In what follows it is assumed that the Settlor, the Beneficiaries and the Trustees of the Trust are all UK resident and domiciled. Special rules apply when this is not the case.

5.1 Establishment of the Trust

The creation of the Trust (with either a new Plan application or existing Plan) will give rise to a "transfer of value" by the Settlor for IHT purposes. In this respect the following points are important:

- Strictly speaking, in order to calculate the amount of the transfer of value, ie. the amount gifted, the amount of the premium should be discounted for the amount that would be payable for the retained benefits, if any. To be precise, this would have to be calculated actuarially but, because of the type of Plan involved, the whole premium is likely to fall within one of the Settlor's available exemptions for IHT e.g. the annual exemption or, for a regular premium plan, the normal expenditure out of income exemption. Such an actuarial calculation will rarely therefore be necessary – the whole premium being exempt in any event.
- Where there are two Settlors (eg. husband and wife), each is treated as making a gift of one-half of the value transferred.
- When a new Plan is made subject to trust, the value initially transferred will be the amount of the initial premium.

In most cases, where a plan made subject to trust is a regular premium protection plan, such as a VitalityLife Plan, the premiums paid will be exempt as normal expenditure out of income. Broadly speaking, to benefit from this exemption it is necessary for the payments to be habitual and made out of income without affecting the payer's standard of living. These conditions will usually be satisfied in relation to regular premium payments.

If, unusually, the amount of the premium or the cash transferred to the Trustees does not qualify for the normal expenditure exemption and it exceeds the available annual exemption, (currently £3,000 for each Settlor), the non-exempt gift will be a chargeable lifetime transfer (CLT).

This means that a potential liability to IHT at 20% may immediately arise if (unusually) the value of the gift, plus the value of all other CLTs made by the Settlor in the preceding seven years, exceeds the nil rate band at the time the transfer is made.

A further tax liability (at 20%) on the CLT could arise if the Settlor dies within seven years of making the transfer. This will be subject to taper relief if the death occurs more than three years after the gift. On the Settlor's death within seven years of making the gift the full value of the gift when made will also be taken into account in determining the inheritance tax liability on the Settlor's estate.

It is stressed that for most regular premium protection plans, such as a VitalityLife Plan, held subject to the Discretionary Trust the premiums are likely to be exempt under the normal expenditure out of income exemption and/or the annual exemption.

- When an existing Plan is made subject to trust, the value of the gift will be the market value of the Plan which will (subject to the following proviso) be nil unless the life assured/lives assured is /are in serious ill health. Provided, however, that if the Plan is on a whole of life basis, the value of the Plan for IHT purposes will be not less than the premiums paid to date. Other than this, the tax implications will be as set out above for a new Plan.
- If the gift is not an "excepted transfer" (see below) it will have to be reported to HMRC using Forms IHT100, 100a and D34 even if no actual tax liability arises. In practice it is extremely unlikely that a transfer of a Plan to the Discretionary Trust would not be an excepted transfer.

For the transfer of an asset such as the Plan (different rules apply to cash and quoted stocks and shares) to be an excepted transfer, broadly speaking:

- the value of the current CLT, plus the cumulative total of all CLTs made by the Settlor in the last **seven** years, must not exceed 80% of the nil rate band (ie. £260,000) **and**
- the amount gifted (ie. before any exemptions) must not exceed the nil rate band less any CLTs made by the Settlor in the last seven years.

5.2 Continuing premium payments

Subsequent premiums would normally be covered by the normal expenditure out of income and/or annual exemption but if they were not, the amount added would be treated as a further CLT, with the IHT implications described in 5.1 above.

For a discretionary trust, additional payments into the trust that are not exempt can also have an impact on the periodic and exit charges (see below). However, this is rarely the case in connection with regular premiums paid directly to VitalityLife.

5.3 IHT whilst the Trust is in existence

Under these rules there may also be IHT charges:

- on every ten-year anniversary of the trust - “the Periodic Charge” or
- whenever property leaves the trust (e.g. when capital is advanced to a Beneficiary) - “the Exit Charge”.

In practice, with any Plan, it is unlikely that any such charges will ever arise. However, for those with policies with very substantial sums assured or where the Settlor has already made other substantial chargeable lifetime transfers in the last seven years before he puts the Plan in trust, the IHT charges may be relevant. Full details of these charges are as follows.

The Periodic Charge

Periodic charges at ten-yearly intervals may be applied to the value of the assets in the trust. The rate of IHT charged will be determined based on an “assumed transfer” by an “assumed transferor”. This will mean that it will broadly be necessary to take account of:

- the value of the property in the trust on the ten-year anniversary, certain additions made to the trust (added property) and the value, when they were set up, of any other trusts created on the same day which are known as “related settlements”. This amount is known as “the assumed transfer”.
- the Settlor’s cumulative total of chargeable transfers made in the seven years immediately preceding the creation of the trust (assuming there has been no added property) and any sums paid out of the trust in the ten years prior to the anniversary. This amount is known as “the cumulative total of the assumed transferor”.

The maximum liability will be 6% of the value of the Trust property that exceeds the available Nil Rate Band (initially the Plan). In most cases, the Plan will have no or very little value.

In cases where the Settlor has not made any chargeable transfers in the seven years before the Trust is created, no payments have been made out of the Trust in the previous ten years and there has been no added property (and regular premiums that are exempt can be ignored for this purpose), there will be no liability provided the value of the Trust fund (ie. the Plan or the proceeds if the Life Cover benefit has been paid but not distributed by the Trustees) at the time of the periodic charge does not exceed the nil rate band applicable at the ten-year anniversary. Any excess over the then nil rate band will suffer IHT at an effective rate of 6%.

Case study: Nigel

Nigel effects a Plan subject to a Discretionary Trust on the 8 May 2012. He pays regular annual premiums of £2,000. These are covered by the normal expenditure out of income exemption. He has made no chargeable transfers in the seven years prior to establishing the trust. Nigel dies in April 2022 and the Life Cover benefit of £450,000 is paid to the Trustees.

On 8 May 2022 the Trustees have not yet paid out the funds to the Beneficiaries (say, because the intended Beneficiaries are very young) and no payments whatsoever have been paid out of the trust in the previous 10 years. The Trust fund is now worth £450,000. Let’s assume the nil rate band is then £400,000. The IHT charge will be calculated as £50,000 @ 6% = £3,000. This equates to 0.66% of the total value of the fund.

Had Nigel died in say April 2017 and the proceeds distributed quite soon thereafter, a tax charge would not arise because there was no tax charge when the trust was established. Therefore, in general, if all the trust assets are distributed before the tenth anniversary, in most cases no tax charge will arise (see next section).

However, if it is likely that assets will remain in the Trust after a claim is paid, or if further assets are added to the Trust, the Trustees will need to take specialist tax advice.

If Nigel is alive and well at the tenth anniversary, the value of the Trust fund (comprising the Plan) for IHT will be the surrender value or premiums paid to date if greater, ie. potentially £20,000 under a whole of life version of the Plan or nil under a term version of the Plan (as the 'not less than premiums paid' valuation rule does not generally apply to term policies). So in both cases, the ten-year value of the policy for IHT purpose will be well below the nil rate band and so no IHT charge would arise.

The Exit Charge

Exit charges will be based on the value of property leaving the Trust or being appointed absolutely to a Beneficiary and the length of time since the last periodic charge.

Exit charges within the first ten years will be nil, regardless of the value of the property leaving the Trust, if the value of the initial chargeable transfer going into the Trust (including the cumulative total of the Settlor's chargeable transfers in the seven years prior to creating the Trust and the value of any added property and related settlements) is below the nil rate band at the time of exit. If an exit charge does arise, it will increase according to the number of quarters that have expired since the Trust was created.

The amount of any exit charge occurring after the first ten years will be derived from the rate of tax charged at the previous ten-year anniversary (if any) and the length of time (in quarters) that the property has been in the Trust since the last periodic charge. If there was no charge at the last ten-year anniversary there will be no exit charge.

Case study continued

Assume Nigel died as in the earlier example and the Trustees continue to hold the funds in the Trust as the intended Beneficiaries are minor children. On 8 May 2028, 6 years since the first ten-year anniversary (when a 0.66% IHT rate was charged), the Trustees of Nigel's trust make a payment of £50,000 to a Beneficiary. The IHT charge will be £50,000 x 0.66% x 24/40 = £198.

No IHT charge will arise on property paid out of the Trust if there was no IHT charge at the last ten-year anniversary.

Exit charges should not arise on loans made by the Trustees to Beneficiaries.

As indicated above, certain transactions and events, such as capital payments to the Beneficiaries, and the value of the Trust property on ten-year anniversaries may also have to be reported to HM Revenue & Customs on Forms 100c and 100d (respectively), and Form D34 (if a life assurance policy is transferred out of the trust or the trust assets include a life assurance policy at a ten-year anniversary). However, no reporting is required, broadly speaking, if the Settlor remains UK domiciled, the Trustees are resident in the UK, there are no related settlements and the total value of the "notional transfer", ie. the value calculated for the purpose of the periodic or exit charges, does not exceed 80% of the nil rate band at that time.

If there are joint Settlors who have contributed equally, the Trust is effectively treated as two separate trusts, each for half the total value and each settled by one Settlor, for all IHT purposes.

5.4 Payment of benefits to Beneficiaries after the death of the Settlor

Any payment of Trust capital to the Beneficiaries (where the Plan is and always has been the sole asset of the Trust) should not give rise to any income tax or capital gains tax liability. IHT implications on payments would be as explained for exit charges in 5.3 above.

5.5 Death of the Settlor

On the death of the Settlor (or either of the Settlors) the value of the Plan will be outside of the Settlor's estate for IHT purposes. However, if the Plan includes Serious Illness Cover and is written on an accelerated basis any remaining life cover, under the Life with Serious Illness Cover, will be in the Settlor's estate for IHT purposes.

- Inheritance tax may need to be considered where the value of the gift(s) to the Trust in the seven years preceding the Settlor's death is not covered by any available exemption(s), the Settlor has already used their nil rate band and the Settlor dies within seven years of creating the Trust.

  If the initial gift gave rise to an IHT charge (highly unlikely with a regular premium Plan) a further tax liability (a further 20% on the gift could arise if the Settlor were to die within seven years of making the gift. Taper relief maybe available if the Settlor survives the gift by three years.

  As well as this, if the Settlor dies within seven years of the gift, the amount of the gift could affect the amount of IHT paid on the Settlor's estate on death. This is because it has to be taken into account in working out the tax payable on his/her estate.
- The Plan proceeds will normally be paid free of IHT to the Trustees.

5.6 Death of the first of two joint Settlors of a joint life first death Plan

Where the Plan includes Serious Illness Cover and is written on an additional basis if the Settlors have elected for the Reversion to the Surviving Settlor provision to apply then, on the first death, the benefit will be paid to the Trustees (free of IHT at this stage) who would have to wait and see if the Surviving Settlor survived the first death by 30 days. If so, then the sum paid will vest absolutely in the Surviving Settlor. If not (ie. if both Settlors have died within 30 days of each other) the Trustees will hold the funds for the Beneficiaries under the Trust.

When the survivor becomes entitled after 30 days this could result in an "exit charge" – see section 5.3 above.

5.7 Benefits on Terminal Illness

If there is only one Settlor or there are two Settlors and the Plan is a joint lives last survivor Plan then the Settlors have a choice: they can either keep the benefits paid on Terminal Illness for themselves as a Retained Benefit or they can give them away as a Gifted Benefit. This is done by initialling the appropriate box in the Trust deed. Once the choice is made, they cannot change their mind. In the case of a joint life second death Plan, the Terminal Illness benefit will be paid on the second event to occur. It would normally be the case that the Settlors would arrange for this benefit to form part of the Gifted Fund.

If there are two Settlors and the Plan is a joint life first death Plan, then the position in relation to Terminal Illness Benefit depends on whether the Settlors choose the Reversion to the Surviving Settlor provision to apply. If they do, then the benefit on Terminal Illness must be a Retained Benefit.

If the benefit on Terminal Illness is retained, it will be paid to the Settlor who suffers the Terminal Illness and, to the extent it is not fully spent, it will be included in their estate for IHT purposes.

If the Terminal Illness benefit is given away at the outset, the Settlor must not receive any part of it. Indeed, to ensure that the IHT efficiency of the Trust is not threatened, it will be essential that following the payment of this benefit, the funds do not find their way, directly or indirectly, back to the Settlor.

Particular attention to tax consequences will be needed if the funds are paid to the spouse of the Settlor, whether in single Settlor cases or in joint life first death cases where the Settlors have not opted for the Reversion to the Surviving Settlor provision or in joint life second death cases where the Terminal Illness benefit is part of the Gifted Fund. If the Settlor actually benefits from the funds, even if they are used for joint expenses, this could amount to a gift with reservation of benefit (see earlier for an explanation of this). Specialist tax advice should be obtained here.

5.8 Income tax

There is unlikely to be an income tax charge where the Plan is primarily providing protection benefits such as under a VitalityLife Plan. Under a protection plan an income tax charge could only arise if the surrender value exceeds the amount of the premiums paid. As the Plan never acquires any surrender value there is no possibility of any chargeable event gain arising.

It should be noted that a change of Trustee or the death of a Trustee does not give rise to any tax implications.

5. 9 Pre-owned assets tax (POAT)

This is an income tax charge which is levied when a person continues to benefit from property which he or she owned in the past but has given away. Generally the question of POAT applying may be raised if the Settlor is a beneficiary under a trust which is not a bare trust, (called a "settlement").

With respect to the Discretionary Trust, the Settlor can only benefit from the Retained Fund (or, in the case of a joint life first death Plan, if the Settlors have elected for the Reversion to the Surviving Settlor provision). As both these are benefits clearly carved out and held for the Settlor (or the Surviving Settlor) absolutely, the Settlor is treated as being absolutely entitled to this benefit. As this amounts to a bare trust of this benefit, it is not a settlement and so the POAT rules do not apply.

For POAT purposes what matters is whether the Settlor may benefit from the Gifted Fund and under this Trust the Settlor is excluded from all benefit under the Gifted Fund and so the POAT will not apply.

6. Practical aspects

6. 1 Setting up the Discretionary Trust

6.1.1 Joint life first death Plans and the Reversion to the Surviving Settlor provision

The draft Trust can be used in joint Settlor cases. When the Plan set up on a joint life second death basis, then neither of the Settlors will be able to benefit from the Life Cover.

However, if the Plan is on a joint life first death basis, then the Settlors can choose whether, in effect, the Discretionary Trust provisions should only apply in the event of both of them dying together or within 30 days of each other. They can choose (by indicating so in Part B(3) of the Trust) that if one survives the other by 30 days, the survivor will receive the benefit payable on death.

The choice is personal and will depend on the wishes of the Settlors but it is anticipated that, in most cases where cover is effected for pure protection or mortgage cover reasons, this option will be chosen.

It should be noted that if the Reversion to the Surviving Settlor provision is chosen then the benefits paid on Terminal Illness will always be a benefit within the Retained Fund and kept for the benefit of the Settlor who suffers from the Teminal Illness covered by the Plan.

6.1.2 Settlor's spouse/partner as a Beneficiary in single Settlor cases

Under the Discretionary Trust the Settlor's spouse is included automatically as a Beneficiary to whom the Trustees can make payments from the Trust.

When a couple are living together but are not married, the name of the partner should be added to the list of the Beneficiaries.

The potential problems that could arise when the benefit on Terminal Illness is a Gifted Benefit and it is paid to the Trustees and advanced to the spouse while the Settlor is still alive has been covered in section 2.4 of this Guide.

6.1.3 Execution of the Trust deed

The draft Trust deed is provided on the basis that a Trust is declared by the Settlor(s). There are instructions on how to complete it if it is to be used unamended. Any amendments should only be made with the assistance of a solicitor. It is important, in all cases, that before using the draft Trust, the Settlor is satisfied (after taking advice) that the provisions are suitable to meet their requirements. Advice will usually be necessary.

As explained in Part 3 of this Guide it is important to appoint additional Trustees.

Any person over the age of 18 can be a Trustee. A person who is a Beneficiary of the Trust may also be a Trustee although clearly a potential conflict of interest may arise. In some cases it may be desired to appoint a professional Trustee, such as an accountant or solicitor. Such persons are likely to charge fees for their services.

6.1.4 Letter of Wishes

The purpose of the Letter is for the Settlor to let the Trustees know who the Settlor wishes to benefit from any payments under the Plan made after the Settlor's death.

As the Settlor is the Appointor under the Discretionary Trust during their lifetime, the Letter of Wishes is only needed to guide the Trustees as to who should benefit after the Settlor's death.

The Settlor cannot control or restrict the Trustees' discretion in any way because this would affect the nature of the Trust and possibly have adverse tax consequences. However, notwithstanding this, the Trustees will normally take account of the Settlor's wishes in making their decision. It should be noted that the completion of the Letter does not create any legal or beneficial rights or obligations. The Settlor is also free at any time to replace the Letter with another one, should he or she want to make a different indication of wishes.

Although this is a very personal document, frequently Settlors need some guidance on how to deal with this matter. VitalityLife provides a draft with suggested wordings and an explanatory note to help them.

6.1.5 Dealing with benefits paid on Terminal Illness (TIB)

As indicated previously, unless there are joint Settlors who have chosen the Reversion to the Surviving Settlor provision, (when the TIB will always be a Retained Benefit) the Settlor(s) have a choice: they can either keep TIB for themselves as a Retained Benefit or they can give them away. This is done by **initialling** the appropriate box in the Trust deed. Once the choice is made, they cannot change their mind so it is important that the Settlors give this matter **careful consideration**.

In practice most people are likely to understand that a payment on Terminal Illness is to provide some financial "comfort" at the end of the Settlor's lifetime rather than see it as an advance payment of death benefit destined for other Beneficiaries.

On the other hand, from a tax standpoint, if one of the motives for using the Trust is to mitigate IHT on death then the TIB should be gifted in the same way as the death benefit, as otherwise it will simply increase the estate of the Settlor that will be subject to IHT to the extent that any sum received cannot be spent before death. So, for example, in the case of a joint life second death Plan where TIB would be payable if the other life assured had already died or suffered a terminal illness, it would be expected that the Settlors would want TIB to form part of the Gifted Fund and would indicate that in the trust at outset. However, there are practical considerations.

If the TIB is a Gifted Benefit under the Trust, the Settlor cannot have it, and indeed there could be IHT implications if the TIB is paid by the Trustees to, say, the spouse (or children) of the Settlor, and the spouse/children lets the Settlor benefit (directly or indirectly) from this sum. Here the gift with reservation rules could apply to negate all the IHT planning. Full details have been explained earlier in this Guide.

It is essential that this matter is given full consideration before the choice is made.

6.2 Administration

6.2.1 Dealing with HM Revenue and Customs

There is no need to notify HMRC about the Trust when it is made as there will be no income or capital gains to be reported, at least not until the Settlor dies and only then if the Trustees invest the trust funds or hold the proceeds in a trust for longer than two years (see 6.2.5). At that time the Trustees will need to take advice.

However, there are special reporting rules for IHT purposes as indicated in Part 5.1. Where a person makes a gift that is a chargeable lifetime transfer (i.e. to a discretionary trust) he may need to report it to HM Revenue and Customs on IHT Forms 100, 100a and D34.

Whether a gift will need to be reported depends on the amount of the gift and the nature of the assets gifted. The gift will need to be reported:

(a) In cases where the gift is of cash or quoted shares, it causes the donor to exceed the then nil rate band taking account of CLTs the donor has made in the previous seven years.

(b) In cases where the gift is of all other types of asset, it causes the donor to exceed 80% of the then nil rate band taking account of CLTs made in the previous seven years, or the amount gifted exceeds the then nil rate band less CLTs made in the previous seven years.

In practice, when regular premiums are paid under a Plan they will almost always be exempt (see sections 4.1 and 4.2 of this Guide for a full explanation) and so no reporting will be needed.

Trustees of discretionary trusts may also have to submit special IHT returns on ten-year anniversaries and on occassions when distributions from the trust are made even though IHT charges may then not apply. The forms to use here are IHT 100 and Form 100c (for exit charges) and Form 100d (for ten-year anniversary (periodic) charges).

In practice, given the amounts involved before any reporting is required, it is unlikely that VitalityLife planholders will have to satisfy these requirements.

6.2.2. Appointment of and changes of Trustees

Trustees may retire and a new Trustee may need to be appointed or additional Trustees may need to be appointed. Under the Discretionary Trust the Settlor retains the right to appoint Trustees. After the Settlor's death, or the second death where there are joint Settlors, the remaining Trustees have this power.

The Trustees have to act unanimously.

During his lifetime, the Settlor also has the power to dismiss a Trustee. In such cases a new Trustee may need to be appointed in the place of the dismissed Trustee so there is always at least one Trustee remaining who is not the Settlor.

VitalityLife provides a draft deed to facilitate changes of trustees in the circumstances described above, for consideration of the parties' legal advisers.

6.2.3 Dealing with the Retained Fund

The Retained Fund is held absolutely for the Settlor. Although the Plan is legally owned by the Trustees, when any of the retained benefits become payable, VitalityLife will normally pay these direct to the Settlor.

6.2.4 Dealing with the Gifted Fund

In practice the Trustees' role will only become active after the death of the Settlor when the death benefit is paid to them.

If it is not intended that all the benefits are to be paid out immediately, the funds will need to be invested. The Trustees should obtain investment advice at that time. It is a legal requirement under the Trustee Act 2000 that such advice must usually be obtained.

After the Settlor's death the Trustees, as Appointor, have a discretion to decide which of the Beneficiaries should receive any benefits. The Trustees can use any part or the whole of the trust capital for the benefit of any Beneficiary who is entitled, ie. a prior appointment needs to be made by them.

If it is intended to make an advancement of capital to a Beneficiary, the Trustees will first have to make an absolute appointment for the appropriate amount in favour of that Beneficiary. They would also need to take into account the inheritance tax implications of such an appointment, namely that an "exit" charge may arise – see section 5.3 for full details.

6.2.5 Trust Registration Service

Provided the only asset held within the trust is the VitalityLife Plan it will not need to be registered under the Trust Registration Service during the Settlor's lifetime. This is because as the Plan only pays out on the death, terminal illness, serious illness or permanent disability it is an excluded trust.

Where the Settlor dies and the proceeds are paid to the Trustees the Plan will remain excluded from registration for up to two years from the date of death, giving time for the trustees to distribute the funds to the beneficiaries of the trust. If by the end of this period the funds have not yet been distributed to the beneficiaries, the trust is from that point required to register on the Trust Registration Service.

7. Frequently asked questions

1. How can the Settlor benefit from the Trust without this being a gift with reservation of benefit?

- **For Personal Protection Plan with Serious Illness Cover**

  Where the Plan is written on an additional basis although the Settlor can retain Serious Illness Cover and other lifetime benefits for himself, the transfer of the Plan into Trust will not be a gift with reservation of benefit (GWR) because the Retained Benefits are clearly carved out for the Settlor. This is subject to the strict proviso that the Life Cover amount is not reduced following any payment of benefits under Serious Illness Cover from the Plan. This is because the amount of cover that is held for the Beneficiaries must not vary by reference to what is held for the Settlor.

- **For Personal Protection Plan with LifestyleCare Cover**

  Although the Settlor can retain LifestyleCare Cover and other lifetime benefits for himself, the transfer of the Plan into Trust will not be a gift with reservation of benefit (GWR) because the Retained Benefits are clearly carved out for the Settlor. This is subject to the strict proviso that the Life Cover amount is not reduced following any payment of benefits under LifestyleCare Cover from the Plan. This is because the amount of cover that is held for the Beneficiaries must not vary by reference to what is held for the Settlor.

  To ensure that this is so, the Plan must include, from outset, appropriate level of LifestyleCare Cover Protector. If this is not so, then the gift with reservation of benefit provisions apply, as explained earlier.

2. Who has the option to increase or decrease Plan benefits?

This option is reserved under the Trust for the Settlor and does not need the consent of the other Trustees.

3. Who should be the additional Trustees?

Anybody over 18 years of age and of sound mind can be a Trustee. Obviously only persons that can be trusted to fulfil their duties towards the Beneficiaries should be chosen.

4. Can the Beneficiaries also be Trustees?

Yes, although they need to be aware of the potential conflict of interest that may arise. If a Trustee is also a Beneficiary, they cannot make an appointment of benefits in their own favour unless there is at least one other Trustee who is not receiving any benefit from the appointment.

It is important to distinguish between the class of potential beneficiaries as set out in part C2 of the trust and the default beneficiaries. The latter are required to cover the remote scenario where the trust funds have not been distributed within 125 years. In these remote circumstances the trust could fail with adverse tax consequences.

5. Can a Trustee be removed?

A Trustee can be removed by the Settlor as long as at least two Trustees remain, one of whom is not the Settlor. There is no power to remove a Trustee after the Settlor's death.

6. If a Trustee is unable to act as a result of them losing capacity, can the remaining Trustees remove them?

Yes, providing that there are two remaining Trustees. The remaining Trustees can remove any Trustee, including the Settlor, who has lost capacity as defined in the trust deed where this is confirmed by a written report from the General Practitioner of the Trustee being dismissed. Where there are only two individuals acting as Trustees, a new Trustee will need to be appointed simultaneously with the dismissal of the incapable Trustee.

7. How many additional Trustees should be appointed?

There is no limit on the number of trustees, although in practice is not advisable to appoint more than say, three.

8. Who can witness the signatures on a deed?

Although there are no statutory restrictions in England on this, a witness should be an independent person, i.e. not a Beneficiary or Trustee under the Trust. The same person can witness all the signatures. Trustees and Settlors should not cross-witness each other's signatures.

9. Why can the trust not be written subject to Scots law?

The principles of trust law in Scotland are different from their English equivalent; in particular there is no concept of "split ownership" under Scots law. For this reason it would seem likely that it is not possible to have a legal "carve-out" of certain benefits for the Settlor to retain for themselves under a Scottish trust. However, individuals domiciled in Scotland can freely create trusts governed by English law, as long as they are happy that any disputes will be decided on English legal principles and, if necessary, by English courts.

10. Can further covers be added to the Plan later?

Yes. Any further covers will be held subject to the same Trust terms.

11. Can the VitalityLife Discretionary Trust be used with a plan from another company?

No. This is because the Trust structure is designed specifically to deal with the benefits available under the Plan, and not with life assurance policies from other life companies.

12. Can a Plan be placed into trust using a form from another company?

It is not recommended that this should be done. Any VitalityLife planholder is free to create a bespoke trust of their Plan with the help of their legal advisers and once the Plan is validly assigned to the Trustees and a notice of assignment is given to VitalityLife, we will deal with the Trustees as the legal owners. However, we will not be able to advise on the tax or legal effectiveness of such a trust.

Because of the special structure of our Plans, it is extremely unlikely that another company trust will be able to achieve the same objectives as this Trust.

13. Can a trustee witness the Settlor's signature (or vice versa)?

No, see question "Who can witness the signatures on a deed?" above.

14. Why is it not possible for the Settlor to gift all the benefits under the Plan to the Discretionary Trust?

There are a number of reasons for this. There are some benefits that are personal to the Settlor, such as the healthy living programme. As for the Serious Illness Cover, LifestyleCare Cover, Income Protection, Child Serious Illness Cover, it is thought that most individuals generally prefer to keep such benefits for themselves. It is of course possible to choose to gift the Terminal Illness cover, an option that may be attractive to some high net worth clients.

15. Why must the Plan be written on an additional basis if it includes Serious Illness Cover and is made subject to the Discretionary Trust?

A Trust will not be effective for inheritance tax if it is subject to the gift with reservation provisions.

In the case of a life assurance policy, these provisions can apply in a case where the benefits that the Settlor is entitled to vary in proportion with the benefits that the beneficiaries are entitled to.

This means that if the value of the beneficiary(ies)'s entitlement to death benefits reduces in accordance with any payment of Serious Illness Cover to the Settlor, the gift with reservation rules could apply.

In order to avoid this problem, for cases where a VitalityLife Plan is being placed in a Discretionary Trust, it will be necessary for it to be written on an additional basis.

16. Why must LifestyleCare Cover Protector be included on a Plan with LifestyleCare Cover that is made subject to the Discretionary Trust?

A Trust will not be effective for inheritance tax if it is subject to the gift with reservation provisions.

In the case of a life assurance policy, these provisions can apply in a case where the benefits that the Settlor is entitled to vary in proportion with the benefits that the beneficiaries are entitled to.

This means that if the value of the beneficiary(ies)'s entitlement to death benefits reduces in accordance with any payment of LifestyleCare Cover to the Settlor, the gift with reservation rules could apply.

In order to avoid this problem, for cases where a Plan is being placed in a Discretionary Trust, it will be necessary to include a suitable level of LifestyleCare Cover Protector on the Plan.

Changes to Tax Law

The notes in this Adviser Guide are based on VitalityLife's understanding of the law and HM Revenue & Custom's practice. We have made every effort to ensure it is accurate but accept no responsibility for our interpretation of the law, future changes in the law or for any loss you or anyone else suffer if you act based on any information we've given.

In relation to VitalityLife's Discretionary Trust, we have sought the views of leading Tax Counsel, who has confirmed that the arrangement is in his view efficient for inheritance tax purposes, however no guarantee can be given (although it is unlikely) that the Inland Revenue will not take a different view or that tax law will change in future. For a summary of Tax Counsel's opinion, please contact your Account Manager.

Next steps?

If you decide to make your Plan subject to the VitalityLife Discretionary Trust, it is important that you follow the process below to make sure all documents are correctly completed and submitted:

You/your adviser completes a plan application form and the Discretionary Trust form. This Trust form must be dated on or after the date of the plan application.

Consider appointing at outset at least one additional trustee to act with you (advised).

Post the original Trust form (along with the Plan application if placing in Trust from outset to VitalityLife, PO Box 619, Darlington, DL1 9FH.

We will return to you the original Trust form by special delivery once processed.

We will confirm to you by letter when your Plan has been successfully placed into Trust.

You should then:

1. Provide all additional Trustees they've appointed with copies of the Trust form(s).
2. Provide the first additional Trustee with the original Letter of Wishes (if produced) and copies to any other Trustees.
3. Make the Trustees aware of where the Trust form is kept for safe-keeping for ease at point of claim.

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