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TAX SAVING PILOT TRUSTS FOR DEATH IN SERVICE BENEFITS

If you have death in service benefits through your employment or death benefits through your pension, you will probably have completed a nomination form to direct the money to your spouse or partner. The funds will be paid directly to the nominated beneficiary and are therefore never part of your estate and so not liable for Inheritance Tax.

While a nomination used in this way works very well to ensure the proceeds of the payment are not taxed as part of your estate, you should give some thought to what will happen when your spouse dies.

If, on your death, your spouse or partner receives a lump sum from a death benefit scheme, the money then becomes part of their estate. They may use it to pay off the mortgage and, if there are any funds left, these might be invested for the future. When the survivor of a couple dies, their estate will have been swelled by the value of a potentially very large lump sum and therefore a large Inheritance Tax liability can arise, reducing the total value that is available to be passed on to your beneficiaries, usually your children.

THE SOLUTION

You should consider establishing a Trust in your lifetime to receive the funds on your death. Your spouse or partner and your children or other family members can all be beneficiaries of the Trust. You will nominate Trustees to administer the fund (your spouse or partner can also be a Trustee)

Managed in this way the funds will be held outside your spouse's estate for tax purposes while still allowing your spouse or other beneficiaries to receive funds from the Trust. The Trust can also be structured with a power for the Trustees to loan monies to your spouse or partner. This means that your spouse can have full use of the funds to invest, spend or live off the income as they see fit. However, as a loan has been made, a liability has been created that can be paid out of your spouse's estate, so reducing the Inheritance Tax bill on their estate.

WHAT ARE THE ADVANTAGES OF PILOT TRUSTS?

They are very flexible Trusts, often used to benefit the whole family. Particular benefits include:

- The money/property/investments in the Trust do not belong to any one beneficiary, so the funds are not subject to Inheritance Tax when one of the beneficiaries dies;
- Pilot Trusts which do not exceed the Nil Rate Band are particularly tax-efficient. For this reason, it is sometimes better to set up more than one Trust to ensure that each one is limited to the Nil Rate Band;

- You can regulate how the Trust is to operate, who will benefit and at what age;
- The funds, while they are in the Trust, are protected from divorce claims, creditors, second marriages and financial abuse of or by the beneficiaries.

HOW DO THEY WORK?

The Pilot Trust Deed is prepared and a £10 note is pinned to it to set it up. As there is no income there is no need for Trust accounts or for the Trust to be registered with HMRC – so no Trust tax returns are needed. There are no on-going administrative or legal costs until funds are paid into the Pilot Trust.

It is important that your employers are aware that you have established the Trust and would like payment to be made to the Trust. We will prepare a nomination for signature and we will register it with your Employer's Trustees. This will ensure that on death the funds will immediately go into the Pilot Trust.

LETTER OF WISHES

We will prepare a Letter of Wishes which sets out your guidelines for your Trustees to follow saying how you wish the Trust Fund to operate. You may want your spouse to be the primary beneficiary and for the Trustees to follow his/her views.

If your children are also beneficiaries under the Trust, you may want to say whether they are to be treated equally and whether you have any concerns about the age at which you would want them to take responsibility for their inheritance. You may also want your Trustees to be vigilant for such things as marriage breakdown, addictions, creditors' claims and financial abuse which may affect beneficiaries. In this way your Trustees can protect the funds and ensure they are available for your beneficiaries in a tax-efficient way with a minimum risk of loss of capital, but at the same time ensuring that your beneficiaries receive income and/or capital (depending on their personal circumstances).

THE TRUSTEES

If the Pilot Trust is a family Trust then it is often advisable to appoint the surviving spouse as one of the Trustees. You will also need another Trustee who is financially responsible and sensitive to your wishes. If you wish, you may appoint The SRB Trustee Company Limited. This is a non-profit making Trust corporation which is regulated by the Solicitors Regulation Authority and covered by our professional indemnity insurance. The SRB Trustee Company can act alone if you wish.

TAX IMPLICATIONS

- The Trust fund is not subject to Inheritance Tax if one of the beneficiaries dies;
- If the Trust fund is kept below the Nil Rate Band (currently £325,000) there is no set-up tax, no exit tax and no periodic charges;
- There is no tax while the Trust is dormant (before a death);
- Income on the Trust will be taxed in the usual way for Discretionary Trusts.

WHAT DOES IT COST?

One Pilot Trust, from	£250
Each additional Pilot Trust, from	£100
Each Letter of Wishes/Nomination	£75

Plus VAT

STORAGE

It is important that the Trust document is stored safely. You can store the document yourself and we will keep an electronic copy. Alternatively the document can be stored at our office. We make an annual charge of £20 + VAT for this service. If you choose this option, the first year's storage will be added to your bill when the Trust is drawn up. Subsequent years' payments will be by Direct Debit

FOR MORE INFORMATION, JUST ASK

We will be pleased to provide any more information. Please contact us and ask for the ***private client team.***

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