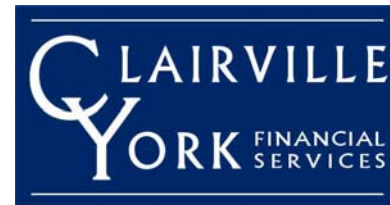


Spousal Bypass Trusts



What do I do with my death-in-service benefit? Why throw away 40% of it?

In today's sophisticated financial market, many people have death-in-service benefits through their employment or death benefits* via their pension arrangements. These death benefits are generally paid to the surviving spouse or partner and not treated as assets of the deceased's estate. However, there is a significant potential Inheritance Tax (IHT) trap for the unwary, which can deplete the value by up to 40%.

Generally speaking people nominate their death benefits to be paid directly to their spouse or partner, which is satisfactory in most circumstances. As a result, there is no liability to IHT on the first death because the benefit is not treated as an asset of the deceased's estate. However, an IHT liability does then arise on the second death. For example, on the death of the first spouse the death-in-service scheme pays a lump sum to the survivor. This payment is outside the deceased's estate for Inheritance Tax purposes. Once the benefits of the policy have been paid to the survivor they become an asset of her or his estate. Subsequently, when the survivor dies her or his estate (which would include any death-in-service benefit monies) is subject to IHT at 40% on the value of the estate in excess of the IHT threshold.

This tax burden can be avoided by directing the death-in-service benefit into a **Spousal Bypass Trust**, either by establishing one during your lifetime, or by a Deed of Variation within two years of death. The trust is held outside the survivor's estate and therefore, it is not subject to IHT on the survivor's death. However, the survivor can benefit from the trust and receive cash or other benefits.

The trust can be even more efficient if it is drafted with power to loan monies to the beneficiaries, including the surviving spouse. On death of the surviving spouse, or other beneficiary, the loans are a liability or debt on her or his estate. The debt is repayable to the trust from the survivor's estate further reducing the value of their estate and in turn the Inheritance Tax due on second death.

Spousal Bypass Trusts are not limited to death-in-service benefits. They can be used in conjunction with the various lump sum death benefits payable from a pension scheme and any form of life insurance. Therefore, most people with these arrangements should consider placing the benefit of these policies into such a trust. The surviving spouse or partner can be a trustee and therefore 'control' how the funds are used, whilst at the same timing having access and achieving considerable savings in Inheritance Tax.

Many pension and life insurance companies offer precedent trust documents, but not all contain the necessary powers to make loans and are therefore potentially limited in their effectiveness. The alternative is a "made to measure" trust which can be drafted incorporating the appropriate powers tailored to your personal circumstances.

Whilst a discretionary trust, or any type of trust for that matter, has its own taxation regime upon which advice is required, in many cases it is certainly worth investigating this type of arrangement particularly if your estate, including death benefits, is likely to exceed the IHT threshold.

Spousal Bypass Trust Taxation

As a Discretionary Trust, a **Spousal Bypass Trust** will be subject to its own IHT regime, although careful management can mitigate, reduce or even negate these tax charges:

- a 10 yearly charge of 6% on the value of the trust which exceeds the prevailing nil rate IHT band.
- a 6% exit charge.

How else would I use a Spousal Bypass Trust?

Although these trusts are mainly used to receive death-in-service benefits they can also be created to receive other assets, such as business or agricultural property passed from a Will, and if you have a substantial estate you may wish to consider a series of **Spousal Bypass Trusts**.

What formalities are required?

These trusts can be set up quickly and are typically, but not necessarily, executed at the same time as drafting a Will.

* Death benefits means the return of pension contributions or the accrued fund value on death before retirement.

Example

Without Spousal Bypass Trust

John dies and leaves his entire estate to his wife, Janet	£500,000
Lump sum death-in-service benefit paid directly to Janet	£600,000
Janet's own estate	£400,000
Total estate on Janet's death	£1,500,000
Less IHT nil rate band (x 2 to include John's unused allowance)	-£650,000
Net taxable estate	£850,000
Inheritance Tax payable at 40%	-£340,000
Value of estate retained	£1,160,000

With Spousal Bypass Trust

John dies and leaves his entire estate to his wife, Janet	£500,000
Janet's own estate	£400,000
Lump sum death benefits of £600,000 paid to Bypass Trust. Trust then makes £200,000 loan to Janet.	£200,000
Gross Estate on Janet's death	£1,100,000
Less loan due back to trust	-£200,000
Less nil rate band (x 2 to include John's unused allowance)	-£650,000
Taxable estate	£250,000
Inheritance Tax payable @ 40%	-£100,000
Value of estate retained, including Bypass Trust (£600,000)	£1,400,000

More detailed information is available on request.

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No responsibility can be accepted for the accuracy of the information in this facts sheet and no action should be taken in reliance on it without advice. Please remember that past performance is not necessarily a guide to future returns.

The value of units and the income from them may fall, as well as rise. Investors may not get back the amount originally invested

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