

**The Lincoln Discretionary or Absolute Split Trust
Key Features and Benefits**

Trusts

The Lincoln Discretionary or Absolute Split Trust Key Features and Benefits

Important notes

Validity and operation of Trusts

This Guide is based on Lincoln's general interpretation of the law of England and Wales and HM Revenue and Customs' ("HMRC") practice as at 1 February 2007. It is not intended to be a comprehensive guide to the law and the tax implications of using a Discretionary or Absolute Split Trust. The legal and tax implications of using a trust will depend on the circumstances and requirements of each party and on whether legislation and HMRC practice has changed since the guide was prepared. Accordingly, Lincoln cannot accept any responsibility for any loss arising from its use. Settlers/policyholders are strongly recommended to take independent professional advice before creating a trust.

Absolute Gift Trust

Please note that under an Absolute Gift Trust neither the Beneficiaries nor their share of the trust fund can be changed.

What is the Lincoln Discretionary or Absolute Split Trust?

A trust is a legal relationship which exists when an asset is held by a person or persons (called the trustee(s)) for the benefit of another person or persons (called the Beneficiary(ies)). The trustees have the control and legal ownership of the asset but must use it for the benefit of the Beneficiaries.

Based on this principle the Lincoln Discretionary or Absolute Split Trust provides a way of holding a Lincoln Financial Foundations policy (which, in this document, we will call "Policy") which provides Death Benefit as well as certain Critical Health and /or Income Protection Benefits in such a way that certain Benefits payable during the lifetime of the policyholder (see below) are held for the absolute benefit of the policyholder while any Death Benefit (including Terminal Illness Benefit) is held for the benefit of another individual or individuals.

Any Critical Health Benefit, Permanent Disability Benefit, Elderly Care Benefit and Income Protection Benefit available under the Policy will be held for the absolute benefit of the policyholder.

In effect, the trust is split into two parts: one in respect of the Critical Health options and Income Protection, and the other in respect of the Death Benefit.

The Lincoln Discretionary or Absolute Split Trust is also a trust that offers the policyholder (or the original proposer) who creates the trust (and is called the Settlor) a choice of the provisions that should apply to the trusts of the Death Benefit. The Death Benefit can be held

- on a discretionary basis
- or
- for the absolute benefit of a specified Beneficiary(ies).

The choice must be made at the outset and cannot be changed. For convenience we will refer to the Lincoln Discretionary or Absolute Split Trust as the "Split Trust". In the sections dealing with the Absolute or Discretionary Trust provisions we will refer either to one or the other as appropriate.

This Trust is not suitable where the Policy includes Critical Health Prepayment, Permanent Disability Prepayment and/or Elderly Care Prepayment options.

When the Policy is made subject to any trust, the ownership of the Policy is effectively split. The legal owners of the Policy will be the Trustees. The Trustees collectively control all dealings with the Policy on behalf of the Beneficiaries under the trust. The Beneficiaries under a trust will be entitled to enjoy the trust asset – the relevant benefit payable under the Policy.

The Settlor cannot benefit from anything other than the relevant benefits specified in the trust. The Settlor will, however, be one of the Trustees and the initial Appointor under the trust.

Under the Discretionary Trust the Appointor decides who (from the classes of Beneficiary specified in the trust) should benefit from the trust fund (ie. the Death Benefit) and when. After the Settlor's death the Trustees take over the power of appointment. If the Appointor makes no appointments by the end of the trust period (80 years) then the individual or individuals named by the Settlor as Default Beneficiaries will benefit.

Under the Absolute Trust the Settlor names in the trust the one or more individuals (normally but not necessarily a child /children under the age of 18) as the Absolute Beneficiary/ies. The Beneficiaries are absolutely entitled which means that their entitlement cannot be taken away or changed in any way. **It is therefore crucial that the Settlor is certain that he will not want to change his mind about this.**

The main objective of the Split Trust is to ensure that the Death Benefit is held for the benefit of the chosen Beneficiaries outside of the inheritance taxable estate of the Settlor, whilst the Settlor remains entitled to receive any Critical Health or Income Protection Benefit without the Settlor's entitlement upsetting the inheritance tax ("IHT") efficiency of the trust.

Why should you use the Split Trust?

You should consider using the **Split Trust** if you:

- wish to gift the Death Benefit payable under your policy to your chosen Beneficiaries but
- wish to keep the Critical Health/Income Protection Benefits for yourself.

You should consider using the **Discretionary Trust** option if you:

- wish to retain flexibility over the choice of the ultimate Beneficiaries ie. the persons who will receive the Death Benefit under the trust.

You should consider using the **Absolute Trust** option if you:

- are certain who is to benefit from your gift, ie. you do not wish to retain any flexibility over the choice of your Beneficiaries.

When should the Split Trust not be used?

The Split Trust should not be used if you wish to retain total access to all the benefits under the Policy for your own benefit.

In addition the Split Trust is not suitable where the Policy includes Critical Health Prepayment, Permanent Disability Prepayment and/or Elderly Care Prepayment options. This is because a Split Trust with a policy which includes these options would not be effective for IHT purposes.

How is the Split Trust established?

The Split Trust can be used with either a new Policy or an existing Policy which is not already held in trust.

The trust is established by the proposer for a new Policy or the policyholder of an existing Policy (known as the Settlor) completing the Split Trust deed.

The Settlor(s) must indicate the choice of the beneficial provisions, ie. whether the trust is to be a Discretionary Trust or an Absolute Trust. This decision cannot later be changed or revoked.

Once the trust is established, additional Trustees should be appointed using a separate deed, a draft of which is provided by Lincoln for the consideration of legal advisers.

It is strongly recommended that at least one additional Trustee is appointed as, without additional Trustees, there will be a delay in securing access to the Policy benefits following the death of the last surviving or only Trustee.

Once the Policy is made subject to trust, any subsequent dealings with the Policy will be between the Trustees (as the legal owners) and Lincoln.

Key provisions of the Split Trust

- The Trust is effectively split into two trusts: one part deals with what is called the Gifted Fund and the other with the Retained Fund.
- The “**Retained Fund**” includes any of the following benefits which are available under the Policy, namely: the Critical Illness Benefit, Permanent Disability Benefit, Elderly Care Benefit, Children’s Critical Illness Benefit and Income Protection Benefit. All of these benefits are held for the absolute benefit of the Settlor. This means that even though the Policy is legally owned by the Trustees, if any of these Benefits are payable the Trustees must simply pay them over immediately to the Settlor. In practice, the Trustees would instruct Lincoln to pay any such Benefits directly to the Settlor.
- If there are joint Settlers (e.g husband and wife) the Retained Fund is always held for the benefit of that Settlor in respect of whose illness or disability the relevant Benefit under the Policy is payable, except in respect of the Children’s Critical Illness Benefit which is held for both Settlers jointly.
- The “**Gifted Fund**” comprises all the other benefits under the Policy, ie. principally the Death Benefit (including the Terminal Illness Benefit). In addition, any surrender value that may accrue under the Policy also forms part of the Gifted Fund. The Settlor(s) decides whether the Gifted Fund is held on discretionary basis or for the absolute benefit of the chosen Beneficiaries. Depending on this choice, either Section “A” or “B” will apply as follows.

Section “A” - Key provisions of the Discretionary Trust

- During the trust period (up to 80 years) the Appointor (which will be the Settlor and, after the Settlor’s death, the Trustees) may appoint the trust benefits (capital or income) to any of the Discretionary Beneficiaries. These Beneficiaries include the Settlor’s spouse (provided he or she is not also a Settlor), children and grandchildren, brothers and sisters and their children as well as any person nominated by the Settlor to the Trustees in writing.
- The Settlor could leave an indication of wishes as to who he or she would like to benefit under the trust. This would not be binding on the Trustees but they would, no doubt, take it into account in determining when and who to pay benefits to.
- As the trust is a Discretionary Trust, no Beneficiary is entitled to anything until the Appointor makes an appointment in his or her favour. If any income arises to the Trustees from the trust investments (not relevant while the sole trust asset is the Policy) they can accumulate it for up to 21 years (this is the maximum time income can be accumulated under English law). After that time the Trustees will have to distribute all income to whichever Beneficiary they decide. However, no Beneficiary will have the right to any income – distributions will be at the discretion of the Trustees.
 - The Settlor cannot benefit from this part of the trust in any circumstances.
 - The Settlor names as Default Beneficiaries the individual or individuals who are to benefit from the trust fund at the end of the trust period (if no appointment is made before then) and, if more than one, the shares in which they are to benefit.

- The Trustees have wide powers to invest and deal with the trust property where the Policy proceeds are not to be distributed immediately for the benefit of Beneficiaries, for example if the intended Beneficiaries are growing children when the benefits are paid.

Section “B” - Key provisions of the Absolute Trust

- The Beneficiaries named in the trust are entitled to benefit absolutely. This means that once a Beneficiary attains age 18 he or she can demand that the Trustees pay over the benefits to him/her.
- Neither the Settlor(s) nor anybody else other than the named Beneficiary/ies can benefit from the Gifted Fund in any circumstances.
- The Settlor(s) names, as Beneficiary(ies), the individual or individuals who are to benefit and if more than one the shares in which they are to benefit. For tax purposes each of these Beneficiaries is treated as owning an appropriate share of the trust property (value of the Death Benefit).

If there is more than one Beneficiary the Settlor must decide the shares in which they are to benefit, otherwise they will benefit equally.

- The Trustees have wide powers to invest and deal with the trust property where the Policy proceeds are not to be distributed immediately for the benefit of Beneficiaries, for example if the Beneficiaries are minor children when the benefits are paid.

The Law of the Trust

The Split Trust is governed by the law of England and Wales.

The Trustees

The Settlor (or both of them in cases of joint proposers/ Policyholders) is automatically one (or both) of the initial Trustees. It is strongly recommended that at least one additional Trustee is appointed. This is done by completing a deed of appointment of additional trustees - for new Policies as soon as the Policy is issued. The Settlor during his lifetime (or both Settlers during their joint lifetime and, thereafter, the survivor) also has the power to dismiss a Trustee provided at least one Trustee other than the Settlor remains.

The Trustees must act unanimously.

The Inheritance Tax Implications of the Split Trust

Establishment of the trust

- For IHT purposes a transfer of value (a gift) takes place at the time the trust is created.
- Where there are two Settlers, each is treated as making a gift of one half of the value transferred.
- When a new Policy is made subject to trust, the value initially transferred will be the amount of the initial premium discounted for the amount that would be payable for the Critical Health Benefit and the other Benefits kept

for the Settlor. To be precise the gifted element would have to be calculated actuarially but because of the type of Policy involved this may fall within one of the Settlor’s available exemptions.

In most cases, where the Policy made subject to trust is a regular premium protection plan, the premiums paid will probably be exempt as normal expenditure out of income. Broadly speaking, to benefit from this exemption it is necessary for the payment to be habitual, out of income and such as not to affect the payer’s standard of living.

If the amount of the premium or cash transferred to the Trustees does not qualify for the normal expenditure exemption and it exceeds the available annual exemption (in 2007/8 £3,000 for each Settlor or £6,000 maximum for each Settlor if the exemption for the previous tax year has not been used), the consequences for IHT will depend on whether the trust chosen by the Settlor is Discretionary or Absolute.

Section “A” – Discretionary Trust

If the trust is discretionary, the non-exempt gift will be a chargeable lifetime transfer. This means that a potential liability to IHT at 20% may immediately arise if the value of the gift plus the value of all other chargeable lifetime transfers made by the Settlor in the previous seven years exceeds the nil rate band at the time the Policy is put in trust.

A further tax liability (a further 20%) on the gift could arise if the Settlor dies within seven years of making the gift although taper relief will be available if the Settlor survives for at least three years. 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.

Section “B” – Absolute Trust

If the trust is an absolute trust the non-exempt gift will be a potentially exempt transfer (PET) provided it is not paid directly to the life insurer but via the Trustees. This means that, regardless of the amount of the transfer, no tax liability will arise at the time of the transfer.

A tax liability on the gift could rise if the Settlor dies within seven years of making the gift and the value of the gift when made together with any chargeable lifetime transfers made in the seven years immediately preceding the gift exceeds the nil rate band at the date of death. On the Settlor’s death within seven years of making the gift the value of the gift when made will also be taken into account in determining the inheritance tax liability on the Settlor’s estate.

- When an existing Policy is made subject to trust, the value of the gift will be the market value of the Policy or, for a whole of life policy such as Financial Foundations, the premiums paid to date if greater. Other than this the tax implications will be as set out above for a new Policy.
- For further details of the IHT implications for a Discretionary Trust please see the Technical Guide.

Payment of additional premiums by the Settlor

Continuing premiums paid by the Settlor will be further gifts, and the tax implications will be as described above for the initial transfer.

No gift with reservation of benefit and no pre-owned assets tax

- As long as the Settlor's entitlement is restricted to the benefits specified at outset and the Settlor cannot benefit in any way from the remaining benefits, the gift with reservation (GWR) provisions will not apply. These provisions apply generally when someone makes a gift and yet can benefit from the asset given away. The result is that the value of the asset is treated as remaining in the donor's estate for IHT purposes.
- If the GWR provisions do not apply but the Settlor does retain a benefit under a trust, there could potentially be another tax charge on the value of that benefit, called the pre-owned assets income tax charge. However, as the Settlor's Retained Fund is held absolutely for the Settlor, these provisions are also not relevant.

Death of the Settlor

- On the death of the Settlor (or, where relevant, either of the Settlers) the value of the Policy will be outside of the Settlor's estate for IHT purposes.
- The Policy proceeds will be paid free of inheritance tax to the Trustees.
- There may be potential IHT implications on the death of the Settlor within seven years of making a gift, especially if the trust is a Discretionary Trust and the sums involved are substantial – see Technical Guide for details.

Death of a Beneficiary under an Absolute Trust

- For IHT purposes the Beneficiaries are treated as owning the trust property (value of the Death Benefit).
- On the death of a Beneficiary the value of his/her underlying interest in the trust property will be included in the estate of that Beneficiary. If there is more than one Beneficiary then the value included will be the value of their share. Where the life assured is not in serious ill health, the value would usually not exceed the total of the premiums paid to date.
- If the Beneficiary is under the age of 18 and unmarried the beneficial interest in the policy will pass to the deceased Beneficiary's parents under the rules of intestacy.

IHT whilst the trust is in existence – Discretionary Trust

For a Discretionary Trust, additional charges may potentially apply on every 10-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 a Financial Foundations policy, it is unlikely that any such charges will arise. However, for those with policies with very substantial sums assured or where the Settlor has already made other chargeable lifetime transfers, details of these charges are provided in the Technical Guide.

- **Payment of the Critical Health Benefit (and other Critical Health Options Benefits) and Income Protection Benefit**
 - Payment of any of these benefits will be made to the Settlor (via the Trustees) free of tax.

- It should be noted that there is no choice in this matter under the trust. Once the Settlor becomes entitled to a specific benefit (eg. because a critical illness has been diagnosed and the Settlor has survived for the specified period), the Settlor cannot change his mind about this and will be entitled to this benefit even if at the time he decided that he would rather pass it to his Beneficiaries. Of course, once the Settlor has received the benefit he can do with it as he likes, but if he chooses to pass it on to the Beneficiaries this will then amount to a gift and may have inheritance tax consequences.

- **Payment of the Terminal Illness Benefit**

Under the Financial Foundations policy the Terminal Illness Benefit is part of the Death Benefit and will therefore be treated for tax purposes in the same way as the Death Benefit. The Settlor will not be able to receive any part of it under the terms of the trust.

Income Tax

There is unlikely to be an income tax charge where the Policy is primarily providing protection benefits such as under a Financial Foundations policy. An income tax charge could potentially only arise if the surrender value exceeds the amount of the premiums paid which is unlikely for a Financial Foundations policy. However, if any chargeable event gains were to arise, this is how they will be taxed:

During the Settlor's lifetime and in the tax year in which the Settlor's death occurs

- For income tax purposes, any chargeable event gains arising under the Policy will be assessed on the Settlor if UK resident, unless there is an adult Beneficiary absolutely entitled when the Beneficiary will be assessed. If there are joint Settlers, each will be assessed on one-half of the gain. Please refer to the Financial Foundations policy Brochure for details of policy taxation.

After the end of the tax year in which the Settlor's death occurs

- Following the Settlor's death or if the Settlor is non-UK resident, any chargeable event gains arising in a tax year after that in which the Settlor died will be assessed on UK resident Trustees at the special rate of 40% less a lower rate tax credit (currently 20%). This means that the rate payable by the Trustees would be 20%. For an Absolute Trust, again, if there is an adult Beneficiary, the Beneficiary will be assessed. For a Discretionary Trust, to the extent that chargeable event gains fall within the £1,000 standard rate tax band available to the Trustees, there will be no charge to tax.

It should be noted that changes of Trustees or the death of a Trustee have no tax implications.

Money laundering

Under the Money Laundering Regulations 2003 we are required, in certain circumstances, to obtain independent documentary evidence of the identity and permanent address of persons seeking to invest with us. Until we receive the documentation, we may be required to delay processing your instructions and/or withhold any payments due to you from us in respect of your investment. We may check your details with credit reference agencies, who may add details of our search to your record, and with fraud prevention agencies, who may record details of any false or inaccurate information provided by you where we suspect fraud. We may also disclose details of your conduct in relation to your application, account or policy to these agencies. We or other organisations may use and search these records to help make decisions about applications, accounts, claims and other services for you and members of your household and to prevent fraud and money laundering. We cannot accept responsibility for the accuracy of information provided by these agencies nor can we accept any liability for the consequences of our undertaking these checks or declining to accept your application. Please contact us if you would like details of these agencies and how they may use your information.