Zurich International Portfolio Bond

Probate Trust customer guide

You should read this guide in conjunction with the Discretionary Gift Trust Deed (Settlor included) and consult with your professional adviser in order to determine its potential suitability for you.

A. General principles

Objectives

The Probate Trust (PT), when used with the Zurich International Portfolio Bond (the Plan), enables you to:

- remove the Plan from your estate for probate purposes (but not for inheritance tax) on your death;
- retain access to Plan benefits for yourself via the Trustees; and
- retain flexibility over who will ultimately benefit from your gift after you die.

How does the PT work?

If you want to set up a PT, you can:

- use the Trust at the time you apply for the Plan; or
- transfer an existing Plan into the Trust.

The Trust Deed that is used in this arrangement is called the 'Discretionary Gift Trust Deed (Settlor included)'. Under this Trust, the person or persons chosen by the Trustees from the list of Beneficiaries specified in the Trust Deed will be entitled to the Trust Fund, which will be looked after on their behalf by the Trustees. You are one of the Beneficiaries. No Beneficiary is entitled to anything until the Trustees make an appointment in their favour.

The person who sets up a PT is known as the Settlor. The PT only permits an individual to be a Settlor; it is not available for joint Settlors.

You will be one of the Trustees (unless you resign) and so nothing can be done with the Plan during your lifetime without your consent. You must, however, appoint at least one other person (preferably two) to act with you as Trustees to ensure that there are no delays in dealing with the Trust Fund in the event of your death; and also to ensure that the Trust is legally valid and that the Trustees can exercise their functions.

Using discretionary trusts under which the Settlor can benefit

When using a discretionary trust (such as the PT) to avoid probate and to make future provision for others, there are some important points to be considered:

- Gifts to discretionary trusts are chargeable lifetime transfers (CLTs) which means that an immediate liability to inheritance tax (IHT) could arise if the gift (together with other similar gifts made by you in the previous seven years) exceeds the nil rate band (see below for a further explanation of this).
- In addition, there may be charges to IHT every ten years and when benefits are paid to trust beneficiaries.
- A gift to a trust under which a UK-domiciled Settlor can benefit (such as the PT) will amount to a 'gift with reservation of benefit' which will mean that the value of the trust fund will remain in the estate of the Settlor for the purposes of IHT. This means that the PT should not be used if you wish to make a gift to a trust that is effective for IHT purposes.

Additional amounts can be invested into the Plan (subject to minimum contribution levels) and the additional investment would be treated as a further CLT. This is likely to complicate subsequent tax calculations so preferably such additions should be avoided. You can always invest in a new Plan subject to a new Trust.

B. Details

Investing in the Zurich International Portfolio Bond (the Plan)

If you choose the life insurance version for your Plan, it is recommended that you set up the Plan on the lives of some or all of your intended Beneficiaries. This will help to minimise the risk of an unplanned and inconvenient or detrimental encashment. Up to ten lives can be included. However, if your Plan is already in force and is on your own life, it can still be transferred to the PT. You can also use the PT with a Plan based on the capital redemption version under which no lives insured are required.

Your financial adviser will assist you with the completion of the relevant forms.

The Trust

To create the Trust (assuming you and your legal advisers are happy that the draft is appropriate in your circumstances) you and your additional Trustees should complete and sign the Trust Deed. To help you, a completion guide is included at the front of the draft Trust Deed.

You must name the Default Beneficiaries of the PT and, if there are more than one, you need to specify the percentage share of each. These are the persons who will benefit at the end of the Trust Period if no other appointment is made. Potential Beneficiaries (the persons to whom trust benefits can be appointed) are listed in the Trust Deed. You are amongst them. You can add other Beneficiaries later.

You will be one of the initial Trustees and you must appoint at least one additional Trustee (preferably two) to act with you. The Trustees have the legal control over the trust assets (the Plan), so they are the persons who are authorised to deal with Zurich Life Assurance plc (Zurich) in respect of the Plan. It is important that you choose your Trustees carefully. Anyone over 18 and of sound mind can be a Trustee. You may wish to appoint a professional person, such as your solicitor, but be aware that such persons are likely to charge a fee. Remember that the Trustees must act unanimously and so all the Trustees will need to agree if any payments are to be made to any of the Beneficiaries, including to yourself.

Inheritance tax (IHT)

(i) Setting up the Trust

By creating the Trust you will be making a chargeable lifetime transfer (CLT) equal to the value of the gift. For a new Plan this will be your initial investment. For an existing Plan, it will usually be the surrender value.

If the value of the gift (after taking account of any available annual exemptions) plus any CLTs you have made in the seven years before you set up this Trust is below the nil rate band (currently £325,000), there will be no IHT to pay. If the gift is more than your available nil rate band, IHT will be payable on the amount that exceeds the nil rate band at the rate of 20%.

The PT gives rise to a gift with reservation for IHT purposes which means the value of the Trust Fund effectively remains in your taxable estate for IHT purposes.

In addition to the possible tax implications, there may be a need to report the transaction to HM Revenue & Customs (Inheritance Tax). If the value of the gift into Trust, when added to other CLTs you have made in the previous seven years, causes you to exceed the nil rate band (see above) and so tax is due, you must report the transfer to HM Revenue & Customs (Inheritance Tax) on forms IHT100, IHT100a and D34. You should discuss this with your professional adviser.

As this Trust involves a chargeable lifetime transfer which is also a gift with reservation, it is strongly recommended that you should restrict your gift so you do not exceed your nil rate band in order to avoid an immediate IHT charge and later IHT charges on the Trustees.

(ii) Making additional payments

Any additional payment(s) made into the Plan will be a further gift, with the same tax implications as the initial transfer. Additional investments into the Trust can also have an impact on the periodic and exit charges – see later.

(iii) Death of the Settlor

It is strongly recommended that any gift to the PT is well within the Settlor's nil rate band to avoid an immediate IHT charge (at 20% of the excess) and reduce the likelihood of later IHT charges on the Trustees. If, for some reason, the amount of the initial gift to the PT causes the nil rate band to be exceeded and is not covered by an available annual exemption(s), and the Settlor dies within seven years of creating the Trust, there could be a further IHT liability (a further 20%) although taper relief will be available to reduce the tax due if the Settlor survives for at least three years.

If the amount of the initial gift is within the available nil rate band, no liability will arise on the gift itself. However, the nil rate band available to determine the liability arising on the Settlor's estate on his death will be correspondingly reduced for the seven years immediately following the gift.

On the death of the Settlor (whilst the Settlor is a potential Beneficiary under the Trust), the value of the Plan will be included in the Settlor's estate for IHT purposes because this represents a gift with reservation of benefit.

In these circumstances there could be a potential double tax charge by virtue of the Settlor having made a chargeable lifetime transfer to the Trust and because the Settlor has reserved a benefit in the Trust Fund because of his inclusion as a Beneficiary.

To deal with this situation, the Inheritance Tax (Double Charges Relief) Regulations 1987 give relief from a double charge to tax in circumstances such as the above.

The Regulations mean that two tax calculations need to be made, one to determine the IHT on the basis of the gift with reservation (but ignoring the lifetime gift), and the other to determine the IHT on the lifetime gift (but ignoring the gift with reservation). Whichever method yields the most tax is the one that applies for IHT purposes.

You should discuss this aspect with your adviser if it is of concern to you.

(iv) Other IHT charges

As the PT is a discretionary trust, special IHT charging rules apply during the Trust's existence. There may be 'periodic charges' every ten years from the setting up of the Trust as well as 'exit charges' (also called 'proportionate charges') whenever property leaves the Trust. In most cases, if the gift was within your nil rate band and the value of the Plan remains below the nil rate band, there should be no IHT charges. If a charge does arise, the maximum rate of tax will be 6%.

The rules on the taxation of discretionary trusts are quite complex. You should discuss them in more detail with your professional adviser if you think they may apply in your situation. The IHT rules are explained fully in the Adviser Guide to this Trust which is available to your adviser.

Income tax

Under the Plan an income tax charge can only arise when what is known as a 'chargeable event' occurs. Chargeable events include a surrender of the Plan, death of the last life insured to die (under the life insurance version), maturity (under the capital redemption version) and withdrawals in excess of 5% each year of the amount originally invested up to a cumulative total of 100%. In other words, each year, for 20 years, up to 5% of the amount originally invested will be treated as a return of capital.

If a chargeable event occurs while you are alive and UK resident for tax purposes, the amount that exceeds the available cumulative total of 5% yearly allowances (or the whole of each amount received after 100% of the capital has been returned) is deemed to form part of your income for the tax year in which the chargeable event occurs. If the whole Plan is encashed (or a part of it represented by a whole policy(ies)) then any gain will also be treated as forming part of your income for the tax year in which the encashment takes place. Liability to tax will be at your marginal rate(s).

As the Plan is an offshore investment plan that will not have been subject to any UK tax on its growth, there is no UK tax deemed to have been paid on any gain, with the result that the full amount of the gain is subject to UK income tax when a chargeable event occurs. However, for the purposes of the liability to higher rate or additional rate (income over £150,000) tax only, top-slicing relief will apply which means that the gain will be divided by the number of whole years the Plan has been in force in order to determine how much tax is payable at the higher or additional rate. You are entitled to recover the tax on any chargeable event gain from the Trustees.

If you are not alive in the tax year in which the chargeable event occurs, or not resident in the UK for tax purposes, the Trustees, if they are UK resident, will be liable for any tax on the gain. The gain will be taxed at the trust rate – currently 45% – except for the gains falling within the £1,000 standard rate tax band available to the Trustees, when the tax charge will be at the rate of 20% only.

If the Trustees are not UK resident, the gains will be assessed on any UK ordinarily resident Beneficiaries when, and to the extent that, they receive any benefits from the Trust.

The taxation of chargeable events under the Plan is relatively complex and is covered in a separate Adviser Guide to this Trust which is available to your professional adviser. It is recommended that you discuss this aspect of taxation with your adviser.

Key points to remember when setting up a PT

- You are the Settlor of the Trust and you gift your Plan to the Trust. If you are effecting a new Plan, the cheque should be made payable to Zurich.
- You and your additional Trustee(s) must complete the Trust Deed.
- You must name the Default Beneficiaries of the Trust and, if more than one, their shares. These are the persons who will benefit only if no other appointment is made by the end of the Trust Period.
- As the gift to the PT is a chargeable lifetime transfer, there may be immediate inheritance tax implications – you must discuss these with your financial adviser.
- The PT offers no inheritance tax advantages.

Important notes

Creating a trust is an important matter and has lasting legal and tax consequences. This guide is for your general information only and cannot cover every situation. If you are in any doubt about the purpose or effect of this Trust, or any actions after it has been created, you should consult your own professional advisers such as a solicitor or an accountant.

The Trust, once created, is irrevocable and the Plan and its benefits must be held according to the terms of the Trust. The Trustees will be in control of the operation of the Trust, which means that they may need to set up a Trustee bank account. Any benefits arising because of the exercise of options available under the Plan will also be held subject to the Trust.

Taxation law is subject to change. Such changes cannot be foreseen. The information in this guide is based on our understanding of current law and HM Revenue and Customs' practice (January 2015). Although every care has been taken in the preparation of this guide and the draft Trust Deed, neither Zurich Life Assurance plc nor any of its officers, employees or agents accept responsibility for the operation of the Trust. Before proceeding with this Trust, you are recommended to refer the Trust to your own legal advisers to ensure it meets your needs.

Your attention is drawn to the 'Important information for the Settlor' section of the Trust Deed.

Zurich Life Assurance plc does not provide individual advice – please contact your relevant financial professional.

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