first direct

Running your trust

A trustee guide to our Flexible Trust

Contents

The purpose of this guide

At **first direct**, we believe that a trust can provide a valuable way of getting much-needed money into the right hands, quickly and simply.

The purpose of this guide is to give the facts, in a plain and straightforward way, to help you make a decision. It deals only with our Flexible Trust. We have designed this for use with our life policies if placed in trust on or after 22 March 2006. It does not cover other types of trust, or other policies you may have.

This booklet is the second half of our Customer Guide to Trusts. Its aims are to:

- Set out the duties and responsibilities of the trustees
- Help you in choosing your trustees
- Guide the trustees in administering the trust
- Do all this in a clear and uncomplicated way so that you are able to run your trust.

The first half of the Customer Guide to Trusts can be found in a separate guide called 'Using Trusts with Life Policies'. The Customer Guide to Trusts (part 1 and 2) are only applicable to trusts established on or after 22 March 2006.

If you have any questions not covered in this guide, please speak to your Financial Adviser.

We use the expression 'you' to mean the person(s) who set up the trust.

Legal Disclaimer

The contents of this guide are based on our understanding and interpretation of current UK tax Law and HM Revenue & Customs practice. As both are subject to change, the accuracy of the guide cannot be guaranteed, particularly over the longer term. Neither HSBC Bank plc nor HSBC Life (UK) Limited can be held responsible for the actions of yourself and your trustees based on the contents of this guide. If you are in any doubt, please seek professional advice.

The duties and powers of the trustees

All trustees should be aware of their duties and powers under general law. The following are the key legal points to remember:

- The trustees are the legal owners of the trust assets (also called the ‘trust fund’)
- The trustees’ main duty is to look after the trust fund for the benefit of the beneficiaries in accordance with the trust document and general trust law.

Trust beneficiaries have rights:

- They can ask questions; for example, they might ask the trustees for copies of the trust accounts
- They can sue the trustees for breach of trust if they lose out because of trustees’ action.

The trustees are also subject to a duty of care. This means that a trustee must show such skill and care as is reasonable in the circumstances of the case allowing for his or her special knowledge, experience or professional status. This means that greater care is expected from professional trustees.

Duties

In practice a trustee must:

- Familiarise himself or herself with the trust document
- Understand the objectives of the trust for each beneficiary
- Be fair to all beneficiaries
- Invest the trust fund in an active but prudent manner
- Use trust income and capital in accordance with trust terms and objectives
- Keep proper records of all transactions and if there is any trust income or gains, make tax returns as required.

For trust investments the trustees have some extra duties but this will only become relevant once the policy proceeds have been paid to the trustees (assuming the trustees decide not to distribute them immediately). The trustees will then need to seek investment advice.

Powers

Power of Appointment

During the trust period (up to 125 years) the trust benefits (capital or income) may be appointed to any of the potential beneficiaries from the list in Schedule A of the trust. These include your spouse, civil partner, children and grandchildren. They also include any person added by you later.

Named (Schedule B) Beneficiaries

You name the people you wish to benefit from the trust in default of any appointment by the trustees. If there is more than one such beneficiary, you should specify the shares in which they are to benefit.

Power to appoint trustees

You have this power during your lifetime. After your death it passes to the trustees. A form to appoint trustees is available on request.

Power to dismiss trustees

You have the power to remove a trustee if necessary. However, it is advisable when removing a trustee to appoint a new trustee in their place. A form to dismiss a trustee is available on request.

Power to advance capital

The trustees can advance capital from the trust to the beneficiaries if they choose. The trustees can choose to cash in assets themselves or to give assets to the beneficiaries intact. This will be a commercial decision for the trustees to make.

The trustees should always consider the tax position of the settlor and beneficiaries before deciding.

Power to invest trust money

The trustees have wide powers to invest and deal with trust property. Whilst the policy is in force and is the only trust asset, this power is of little importance. But it is likely to become important after the policy pays out or the policy is surrendered or encashed.

Other powers

The Flexible Trust has various extra powers to make sure the trustees can manage the trust fund in the best possible way. These powers include:

- Power to borrow - for example to maintain premiums under the policy should this be necessary
- Power to transfer trust property - the trustees can transfer the asset to a beneficiary rather than encashing it themselves
- Power to charge fees, although this only applies to professional trustees
- Power to transfer assets to another trust - this may be suitable in some circumstances
- Power to lend to any beneficiary.

Some typical questions

Q: Who can be a trustee?

A: Any adult person of sound mind may act as a trustee. In practice, you would usually choose trustees from your friends or family. It is important to ensure the person being appointed is happy to accept the appointment to act as trustee. Occasionally someone may want to appoint a professional such as their solicitor. They will charge fees for acting as a trustee.

Q: Who cannot be a trustee?

A: Individuals under the age of 18 and those lacking mental capacity may not act as trustees.

Q: Can the beneficiary be a trustee?

A: There are no legal objections to a beneficiary also being a trustee. However, the inherent conflict of interest places a heavy burden on the trustee and you should recognise this when making your choice. You can mitigate the inherent conflict of interest issue by ensuring there is a second trustee who is not a beneficiary. Under our flexible trusts, if a trustee wishes to exercise the power of appointment for his or her own benefit there must also be an additional trustee who is not benefiting directly or indirectly as a result of such exercise.

Q: How can the beneficiaries be changed?

A: There are two main reasons for making a change of beneficiary under a flexible trust:

1. The trustees have decided that a particular beneficiary should be absolutely entitled to the trust fund from a certain date, or
2. The trustees cannot follow your choice of beneficiaries under the trust e.g. due to the death of a beneficiary.

   To change the beneficiaries the trustees must complete a deed of appointment. You can obtain this from us.

Q: Do the trustees need a bank account?

A: The trustees do not usually need a bank account while the policy is in force. However, when payment is made following a valid claim, it is usually done so by either a joint cheque payable to all trustees or by direct payment to a joint trustees bank account.

Q: How do the trustees make a claim for benefits under the policy?

A: If the trustees need to make a claim on the policy they should contact us. The trustees will need to complete a claim form which will be provided and return it to us with the trust documents and the policy. In the case of a death claim the death certificate will also be required. The money will be made available as quickly as possible. As part of the claim process HSBC Life (UK) Limited will need to confirm the identity of the claimant(s) which may include electronic database searches. Please be assured that this will not affect your credit rating.

Q: How long can a trust last for?

A: The term of the Flexible Trust is 125 years - the longest period allowed by English law. In practice a trust will run until the trustees decide that they wish to distribute the trust assets to the beneficiaries, who must be over 18. Alternatively, the trustees could make a payment to a child's parent or guardian.

Q: Will the trustees or anybody else have to make a tax return?

A: If the life policy produces neither income nor capital gains, annual tax returns are not generally necessary. However, a tax return may be necessary if a chargeable event occurs. The tax implications of chargeable gains for policies held under trust are explained on page 7 of this guide. If a chargeable gain arises, the person on whom it is assessable will have to include it in their tax return. However, there may be a requirement for the trustees to make periodic Inheritance Tax returns to HM Revenue and Customs (HMRC), see part 4 titled 'HMRC Returns' of the section 'Inheritance Tax' on page 9.

Q: When the trustees receive the money from a policy, do they have to pay it straight out?

A: The trustees will first have to consider the circumstances of all the beneficiaries and decide who should receive the proceeds. If they are able to decide, and the potential recipient is over the age of 18, then they can simply pay the money out of the trust. But they may need to withhold some to pay any tax bill. The trustees can keep the money in the trust if they decide that it will be better for the beneficiaries, for example if the intended beneficiaries include children under the age of 18. Please note that if the proceeds are not distributed and remain held on trust this could lead to periodic and exit charges arising from the 10th anniversary of the trust. See parts 2 titled 'Periodic Change' and 3 titled 'Exit Charge' of the section 'Inheritance Tax' on page 8.

Q: What do the trustees do if the policy proceeds are not paid out immediately?

A: See above for an explanation of the trustees' powers and duties. If the trustees decide that they do not wish to pay out the proceeds immediately, they will have to invest them for the benefit of the beneficiaries as explained above. The trustees should seek investment advice from a competent financial adviser at that time.

Q: Might the appointed trustees be responsible for paying any periodic and exit charges due?

A: Yes, if such charges are due it will be the responsibility of the trustees to pay them from the assets held in trust. If the asset is an investment based life policy, or if the sum insured is being paid from a life insurance policy with no investment value, then the trustees would normally make arrangements to use some of the value to meet the tax charge. If however the charge is a periodic charge and the asset is an in-force life insurance policy with no investment value (this might arise due to the ill health of the life assured – see part 2 of the section 'Inheritance Tax') then the trustees will need to make arrangements to fund the tax liability. For example, this may need to come from other resources, or they may need to consider selling the policy on the open market as it may have acquired a value as a result of the ill health of the life insured. This would however be an unlikely occurrence.

Q: Will a solicitor or other professional adviser need to be involved in making a claim, or later?

A: If the trustees are unclear about any points about the trust then they should seek advice.

Q: Can trustees be personally liable?

A: The trustees can be liable if beneficiaries lose out financially because of trustees being in breach of trust particularly if they act imprudently.

Q: Can trustees delegate their responsibilities?

A: Under the Flexible Trust the trustees can delegate certain roles such as investment management. However they cannot delegate key decisions, such as who is entitled to trust income or capital.

Q: Should the trustees be insured?

A: It is unlikely that trustees of a flexible trust holding a life assurance policy would need insurance against their potential liabilities. However, if this is of concern you should take individual advice.

Q: The most important question for a trustee - Do I want the job?

A: You have been asked to be a trustee because you can be trusted to do the right thing. To do this, you are expected to use your knowledge of the relevant personal circumstances and your common sense. If something isn't covered in this guide then you should take professional advice.

A trustee should always ensure that he or she:

- **is familiar with the trust document**
- **knows who the named (or default) beneficiaries are**
- **knows who the other trustees are, and**
- **knows the location of the policy document, the trust document and any deeds appointing or retiring trustees.**

Inheritance Tax

Inheritance Tax (IHT) is a tax on all assets on your death, and possibly also on assets you give away in your lifetime. It is levied at 40% on all assets over a certain limit (known as the 'nil rate band') other than those passing to a legal UK domiciled spouse or civil partner or held in trust.

For IHT you need to know about:

- Placing a policy in trust (see 1, below);
- Payment of premiums to a policy which is in trust, (see 1b, below);
- Payment of benefits under a trust policy (see 1b, below); and
- Periodic and exit IHT charges levied against the trust (see 2 and 3 , below) and HMRC returns (see 4, below).

1. Entry Charge

- Putting a policy into a trust will result in a gift (or transfer) by the settlor for IHT purposes
- The tax implications will depend on whether the trust fund consists of an existing regular premium policy, or a new regular premium policy.

a) Existing regular premium policy

Where an existing regular premium policy is placed in trust, the IHT value of the gift will be the market value immediately before making the gift (or the total premiums paid if greater). Where a policy has a surrender value, the market value will normally be similar to that surrender value. Where a policy does not have a surrender value, its market value will normally be negligible. However, where the life insured is in poor health the market value may be substantially more.

For IHT purposes the transfer of value (the gift) may be:

- exempt; or
- chargeable immediately to IHT as a chargeable lifetime transfer (CLT).

- A gift will be exempt if the total amount transferred (including previous gifts in the same tax year) is within the donor's annual allowance for gifts, which is currently £3,000
- If the amount of the CLT exceeds the prevailing IHT nil rate band, or, if when it is added to the cumulative amount of CLT over the preceding 7 years, the total exceeds this level, the excess over the nil rate band will be immediately chargeable to IHT at the lifetime rate of 20%. If the value is below the nil rate band there will be no immediate IHT consequences. However, there is a requirement to report the transfer to HM Revenue and Customs (HMRC) within 12 months of the date of the transfer if it causes total chargeable transfers in a tax year, or over a cumulative 7 year period, to exceed specified levels.

b) Paying regular premiums

- Usually the regular premiums payable by the donor will fall within the donor's annual exemption (currently £3,000) or the normal expenditure exemption, so there will be no IHT implications. If the premiums are too large to be exempt in this way they will be Chargeable Lifetime Transfers.
- On your death the sum assured will be paid to the trustees of the trust. Such payment itself will not be subject to IHT and will not affect the IHT calculations on your estate.

2. Periodic Charge

The trust will be assessed for a possible IHT charge on each 10th anniversary of its creation. In the most straightforward situation, the value of the trust fund is compared to the prevailing nil rate band and any excess is liable to IHT at a rate of 6%.

For a term life policy the value of the trust fund is the market value of the policy. In straightforward cases this 6% periodic charge is only likely to arise in two circumstances:

- When the life assured is in serious ill health at the 10th anniversary and the sum assured exceeds the prevailing nil rate band. The appropriate market value would be agreed between the trustees and HMRC and would depend on the individual circumstances; or
- When the sum assured, in excess of the prevailing nil rate band, has been paid to the trustee prior to a 10th anniversary and remains in the trust at the 10th anniversary.

The trustees may need to submit a return to HMRC on each 10th anniversary even if no IHT is payable. Whether or not a return is required depends on the exact circumstances.

The tax position becomes more complicated (and is outside the scope of this guidance) if the Settlor had made any Chargeable Lifetime Transfers in the preceding 7 years, the Settlor had created other trusts on the same day as the trust under review, property had been added to the trust since its creation, distributions were made that were subject to an 'exit charge' (see below), or the trust holds accumulated income. The trustees should seek their own specialist legal and/or tax advice if they are in any doubt about their tax positions.

3. Exit Charge

Any trust distributions may be subject to a further IHT charge, the proportionate or 'exit' charge. This is only applicable:

- to distributions in the first ten years if an entry charge arose; or
- to distributions in any subsequent ten year period if a periodic charge arose at the preceding 10th anniversary.

The exit charge will not exceed 6% of the amount distributed. The trustees may need to report to HMRC any capital distributed from the trust.

Summary

Most regular premium term life policies will not give rise to entry, periodic or exit charges. However, it is recommended that when the sum assured exceeds the nil rate band, or when the Settlor's position is complicated by the factors described above, or for large single premium investments, or if you are in any doubt as to the tax position, independent specialist legal and/or tax advice is obtained.

4. HMRC Returns

In connection with the IHT chargeable events that can arise under a trust subject to the discretionary trust regime, the main account to be submitted to HMRC Capital Taxes is the Form IHT 100.

It is a requirement that an event form accompanies the Form IHT 100. For a trust subject to this discretionary trust regime, the relevant event forms are

- 100a - for gifts into the trust;
- 100c - for an exit charge on property leaving the trust eg. when capital is paid out to a beneficiary. This form may be needed even if no tax is payable; and
- 100d – for the ten-year anniversary (periodic) charge. The form may be needed even if no tax is payable.

In certain circumstances a Form IHT 100 will need to be accompanied by Form D34 which is supplementary to Form IHT 100 and which deals with life assurance policies and annuities. Form D34 has to be completed if any transfer, which includes the payment of premiums, is linked in any way with a life assurance policy or annuity. The form is very short and requires only limited information.

Capital Gains Tax

There are unlikely to be capital gains tax implications unless the policy is sold to another party, which is not usually relevant to policies subject to trust, or the policy proceeds are invested in a different type of asset.

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