Life Assurance and Inheritance Tax
Summer 2009

Life assurance is often arranged to give financial protection for families, to cover the death of one parent while the children are young. This is normally either term or whole life assurance, which should be put into a simple discretionary trust, to avoid inheritance tax (IHT) being levied on the policy proceeds.

Such policies should be written so that the sum assured is no more than the amount of the nil rate IHT band when the policy is issued. (At the moment, this is normally £325,000). For example, if it is desired to insure a husband's life for say £500,000, two policies should be issued for £250,000 each. Each policy should then be subject to a separate discretionary trust, often using forms supplied by the insurance company. If the trust deeds show different dates, they will be treated as separate trusts for IHT purposes, but the trustees can be the same (usually the life assured, his spouse and his executors named in his Will) and the two trusts can be treated as one for administration and investment purposes.

The procedure is then for the life assured to sign a letter addressed to the trustees setting out his wishes. Typically, this will say that the surviving spouse should be treated as the primary beneficiary, though not to the entire exclusion of the children, with a request for distribution of the trust fund to the children equally when the surviving spouse has died and the children have reached a certain age, not exceeding 25 years.

The monthly premiums for these policies are usually ignored for IHT purposes, under the "normal expenditure out of income" exemption.

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Note:
This article is for general guidance only and specific legal advice should be obtained in each case.