Business Protection Guide to trusts

We have written this guide to explain how trusts work for Aviva Protection UK Limited Business Protection policies. We cannot advise on whether putting any particular policy into a trust would be suitable for your particular circumstances and would recommend that you take professional legal advice on this.

This guide only explains how trusts work in England and Wales; it does not cover trust law in Scotland or Northern Ireland. This does not mean that Aviva Protection UK Limited trusts cannot be used in Scotland or Northern Ireland but it does mean that the law of England and Wales will apply to any such trusts. In light of this, if you are resident in Scotland or Northern Ireland, you may wish to take your own legal advice on the suitability of our specimen trust documents for you.

Trust law may be subject to change in the future. Aviva Protection UK Limited cannot be held responsible for any information given or any changes in tax provisions or legislation that may affect the life insurance policy within a trust, the tax treatment of it, the provisions of a trust, or the rules applying to gifts for Inheritance Tax planning purposes.

Business protection trusts

A flexible approach to shareholder/member/partnership protection is to arrange for business protection insurance to be written in trust from inception, or start, of the policy.

What is a trust and why use one?

A trust is a legal arrangement. It allows the owner of property (the settlor) to transfer legal, and/or beneficial, ownership of that property to other persons or a company (the trustees). The person or company receiving the property holds onto it for the benefit of third parties (the beneficiaries). These roles are explained in more detail below and in our 'Guide to Trusts'.

The reasons for putting a life insurance policy (such as a business protection policy) into a trust include:

1 The settlor can direct who benefits and how

When a trust is set up, the settlor lists all the people they want to be able to share in the benefits payable under the life insurance policy that is subject to the trust.

Under the Aviva Protection UK Limited Business Trust, this will be the shareholders/members/partners in the business at the time of the claim. The amount each beneficiary receives will be in proportion to their share in the business (unless there are reasons to distribute the trust funds differently).

Without a trust, the benefits payable under the policy would be payable to the settlor's estate and he/she would need to leave directions under the terms of his/her Will to ensure the benefits pass to the people and in the manner intended.

2 It can allow the settlor's share of the business to be bought out

Where a business protection policy is subject to an Aviva Protection UK Limited Business Trust, the benefits will be payable to the trustees who in turn distribute the funds to the beneficiaries, such as the surviving shareholders/members/partners. Usually, an 'option agreement' is also put in place, which enables the surviving shareholders/members/partners to use these funds to purchase the deceased's share of the business. This avoids family members or other third parties becoming interested in the business where it is not intended for them to be so. Further information on this type of arrangement is set out below.

3 Beneficiaries can receive policy benefits more quickly

If a life insurance policy is written in trust, it is no longer part of the settlor's estate. So if they die, the trustees claim on the policy and the death benefits are paid directly to the trustees.

If a life insurance policy is not written in trust, the benefits payable on death are payable to their estate if they die during the policy term. This means a grant of probate, or letters of administration if the deceased had no Will, would be needed before the insurance company could pay out any money to the deceased's personal representatives. This can take several months.

4 It can mitigate Inheritance Tax

If covers under a business protection policy are written in trust, the value of the benefits payable under them are not included in the settlor's estate for Inheritance Tax purposes when the settlor dies (as long as neither they nor their estate or personal representatives are a beneficiary).

There is therefore no Inheritance Tax to pay with respect to the policy when the settlor dies (unless the policy reverts to them under the terms of the trust, e.g. in the event that they cease to be a shareholder/member/partner).

However, if the money is kept in the trust long term, some Inheritance Tax may be payable and a charge could arise when money leaves the trust.

Before considering a trust, we recommend that you speak to a professional tax adviser who can look at your specific circumstances and explain how Inheritance Tax might affect you, as well as any other tax considerations in putting a business protection policy into trust.

The Aviva Protection UK Limited Business Trust

The Aviva Protection UK Limited Business Trust is a flexible trust designed for use where a shareholder/member/partner in a business intends to effect a business protection policy on their own life in trust, to provide funds on their death, a diagnosed critical or terminal illness, or a total and permanent disability for the other shareholders/members/partners on the basis that the other shareholders/members/partners will likewise effect cover in corresponding trusts. The Aviva Protection UK Limited Business Protection policy does not permit any benefits payable under it to be retained and so all benefits payable under it will be gifted to the trust at inception.

In an Aviva Protection UK Limited Business Trust, the settlor will name the other shareholders/members/partners in the business as beneficiaries, but because the trust is in a flexible 'discretionary' form, the beneficiaries and their entitlements can be changed once the trust is created, to reflect any change in circumstances for the settlor or changes in the ownership of the business. This is because the decision as to who benefits, in what amount, and at what time, is at the absolute discretion of the trustees.

For example, new shareholders with a shareholding over a certain percentage can benefit from the trust automatically without revising the share purchase arrangement. Similarly, shareholders leaving the business will be automatically removed from being beneficiaries of the trust.

Often in conjunction with a business protection trust, the shareholders/members/partners of the business will sign an 'option agreement', which provides for the surviving shareholders/members/partners to purchase and (on the settlor becoming terminally/critically ill) the settlor (or the settlor's personal representatives after the settlor's death) to sell the settlor's share of the business.

The key people involved in a trust

There are three roles in any trust. These are:

- the settlor;
- the trustees; and
- the beneficiary.

This section explains what these roles are, their responsibilities and their rights.

1 Settlor

The settlor is the person who sets up the trust and transfers assets to it. All Aviva Protection UK Limited trusts are set up using a declaration of trust by the policyholder who themselves becomes a trustee, together with additional trustees who they simultaneously appoint at the outset to administer the trust.

In the case of all Aviva Protection UK Limited trusts, the settlor will be regarded as the 'lead trustee' in relation to all aspects of the policy (or covers under it) held in trust, as the terms of the trust confer various powers on the settlor including those powers conferred on them as the original policyholder and the ability to appoint and remove trustees during their lifetime. Aviva Protection UK Limited trusts in a discretionary form also permit the settlor to nominate beneficiaries to be added or to be excluded under the trust.

Under the law of England and Wales, anyone over the age of 18 who is mentally capable can be a settlor.

2 Trustees

The trustees become the legal, and/or beneficial, owners of the trust property. They must administer the trust in accordance with the terms of the trust document and the law that governs the trust, manage the trust's assets and distribute these (or an income from these) to the beneficiaries when appropriate.

Aviva Protection UK Limited requires an Aviva Protection UK Limited Business Trust to have at least two trustees - the settlor and at least one trustee who is not the settlor. It is recommended (but not mandatory) to appoint more than one additional trustee to ensure that there will always be two trustees to look after the trust.

It is important to choose the right trustees. They need to have good financial knowledge and be someone the settlor can trust. Under an Aviva Protection UK Limited Business Trust, the settlor will usually choose their fellow shareholders/members/partners both as trustees and beneficiaries and may also wish to include a company secretary or company lawyer to act as trustee. Professional trustees will usually charge for their services.

A trustee should be mentally capable and have a sound financial history. Under the law of England and Wales a trustee must be over the age of 18.

3. Beneficiaries

The beneficiaries are the people the settlor wants to receive the benefits from the trust. As explained above, the Aviva Protection UK Limited Business Trust is fully discretionary and the beneficiaries will usually be other shareholders/members/partners of the business participating in the business protection policy agreement. The trustees then have absolute discretion to decide how the proceeds are distributed and those shareholders/members/partners who are not party to the business protection policy agreement can be excluded.

The trustees are given a discretionary power of appointment to choose which beneficiaries are to receive trust assets and in what proportions. They can use this power to ensure the business protection policy proceeds are paid to the shareholders/members/partners who, subject to the terms of any option or other agreement in place, have an interest in acquiring the share of the deceased shareholder/member/partner.

The beneficiaries will not usually receive anything from a trust holding a life insurance policy until the settlor dies and a payment is made to the trustees. The trustees then look after the money, investing it if necessary, and distribute it amongst the beneficiaries in accordance with the terms of the trust.

Guide to being a trustee

The duties and powers of a trustee are set out in trust law as well as in the trust document. Below is a guide to the main trust law duties and powers, but it is also important to read the trust document to make sure you understand the responsibilities that you are taking on. In fulfilling their role, a trustee is also expected to exercise such care and skill as is reasonable in the circumstances and manage the trust assets prudently as if they were the trustee's own assets.

If a trustee fails to comply with the terms of the trust or their duties as trustee, they will be personally liable to make good the financial loss suffered by the trust fund. The liability of a trustee for breach of the trust shall be limited to breaches arising from the trustee's own fraud, wilful misconduct or gross negligence except in the case of a trustee acting in a professional capacity.

The trustees shall not be liable for the default of a person acting under a delegated power, provided they took reasonable care in the selection and supervision of such person.

1 Duties of trustees

Duty to invest the trust fund

The property in the trust is called the 'trust fund'. A trustee is responsible for making sure that the trust fund is invested and managed for the beneficiaries until the money is distributed. If the only property in the trust is an insurance policy, there will be no fund to invest until the benefits under the insurance policy become payable. At that point, the money will need to be invested and managed until such a time as it is right to distribute it to the beneficiaries of the trust.

Duty to act impartially

If there is more than one beneficiary, the trustees must not act in a way that will benefit one of them over the other. For example, if one beneficiary is to receive income from the trust but another one will receive the capital, the trustees should invest the fund to produce both an income and capital growth. The trustees must act in the best interests of all the beneficiaries at all times.

Duty to take appropriate advice

Trustees should take professional advice before investing the trust fund, unless the fund is so small that the cost of the advice would outweigh any benefit, or one or more of the trustees is qualified to give investment advice. Trustees can ask a professional, such as an investment manager, to act on their behalf in investing the fund, but the responsibility for the investment would still lie with the trustee, so the trustee should keep their appointment under review.

Duty to distribute the trust property

The trustees should ensure the trust fund is transferred to the beneficiaries at the appropriate time, in accordance with the trust deed (e.g. by deed) and before the end of the 'trust period'. All Aviva Protection UK Limited trusts have the statutory period of 125 years from the date of the trust deed, but the trustees are able to (and will almost certainly) distribute the trust assets much sooner.

Duty to keep the trust's property secure

Trustees are responsible for making sure that the trust fund is secure. So, if the fund includes something tangible like a house, they are responsible for making sure that it is insured.

Duty to keep the trust's records

Trustees must keep a record of any decisions they make, actions they take, advice they have taken and any costs the trust has had to pay. They should also keep annual accounts, although these can be very simple if the trust fund consists purely of cash or the right to receive benefits from a life insurance policy.

Duty to not profit from the trust

Trustees acting in a professional capacity can claim reasonable fees for their services, but they must not manage the trust in such a way that they or their firm will get extra work.

2 Trustees' powers

The trustees have a number of powers to enable them to effectively manage and distribute the trust's assets. These are either expressly set out in the trust deed or operate under trust law, including wide powers to invest the trust fund, insure it or borrow against it. The trustees of a discretionary trust also have the power to lend the trust fund to potential beneficiaries of the trust. We recommend that the trustees seek appropriate legal and other professional advice before exercising this power.

The trust document may also set out additional powers, for example, regarding the distribution of trust assets or changing the beneficiaries.

A trustee is able to delegate their administrative duties to an agent or a co-trustee and all Aviva Protection UK Limited trusts give the trustees this power (either singly or jointly). This, for example, would enable them to appoint a fund manager to manage trust assets (if necessary) or for practical reasons, e.g. to delegate all administrative functions to a 'lead trustee' (such as the settlor during his or her lifetime). This is in addition to any other powers already conferred on the settlor by the policy or under the terms of the trust.

Trustees cannot generally delegate their dispositive powers and decisions (including the distribution of trust assets or amendments to the trust terms or beneficiaries) unless they do so formally, usually on a temporary basis, and legal advice would be required.

3 How trustees make decisions

With all Aviva Protection UK Limited trusts, and under general trust law, the trustees should all be in agreement on decisions relating to the trust. So, if most of the trustees want to pay a beneficiary, but one does not, the beneficiary cannot be paid. This is another reason why trustees should be carefully chosen to minimise the risk of conflict. As explained above, most trustee functions (particularly day to day administrative functions) can be delegated to a single trustee, but all the trustees would need to agree to this. Decisions regarding the policy and/or level of cover will in most cases be carried out by the settlor as the terms of Aviva Protection UK Limited trusts permit these powers to be retained by them during their lifetime.

Frequently asked questions

1 Who pays the premiums when a policy is in trust?

Under an Aviva Protection UK Limited Business Trust, it is the responsibility of the settlor to ensure premiums continue to be paid on the insurance policy. The claim proceeds are for the benefit of other shareholders/members/partners. Should premium payments cease, the settlor should inform other parties who benefit from the business insurance agreement.

If the business is a company and pays the premiums on behalf of the settlor, tax advice should be taken on the tax and National Insurance implications for the business.

Please note: Aviva Protection UK Limited is not able to provide advice on the tax implications of paying the premiums on a policy that is written in trust and would recommend that you take professional tax advice on this.

2 What happens if a trustee wants to retire?

A trustee can retire provided there would be at least two continuing trustees following their retirement, with a new trustee being appointed to replace the retiring trustee if necessary.

3 Can trustees be removed?

The settlor can remove trustees in certain circumstances as long as this would not leave the trust with less than two continuing trustees. The continuing trustees can exercise this power after the settlor's death.

A Deed of Appointment and Retirement of Trustee form is provided in the Aviva Protection UK Limited trust section for use with all Aviva Protection UK Limited trusts.

4 Does a trust always need to be written by a solicitor?

You can have a trust written by your solicitor, but many insurance companies, like us, have 'ready-made', adaptable specimen trusts available for the life insurance policies they offer. These trusts are not usually suitable for anything other than life insurance policies.

We would recommend that you take legal advice before setting up a trust, particularly if you have any questions on the application of the trust to your particular circumstances.

5 Is a trust right for me?

The main reasons that people use trusts for business protection are set out above under 'Why use a trust?' and 'Business protection trusts', but a trust is not right for everyone. In particular, if you want to be able to benefit from something that you're thinking of putting into a trust or if you think you might want to have access to it in future, then a trust may not be right for you. It is a good idea to get advice from a financial, tax and/or legal adviser before you make a decision.

6 Does Aviva Protection UK Limited need to see the completed trust deed?

Aviva Protection UK Limited will not need to see the trust deed before the insurance policy starts, but you (or your financial adviser) will be asked to send a copy of the trust deed once it has been executed. We will only need to see the original executed trust deed when a claim is made. If the Aviva Protection UK Limited electronic trust form has been submitted electronically, this record will automatically be retained on the Aviva Protection UK Limited system.

WARNING: Once you have put a life insurance policy or the covers under the policy (e.g. terminal illness) into trust, you are no longer the legal owner and do not have control or any access to it. Even though you have a cooling-off period for a policy you take out with Aviva Protection UK Limited, you do not have a cooling-off period when you set up a trust.

Once you have signed the trust form and the trustees have agreed to act, then you have given away the policy (and any benefits payable under it).

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