The Sanlam Bypass Trust

Your guide

Sanlam
Wealth

Contents

Introducing the Sanlam Bypass Trust

Welcome to your guide for the Sanlam Bypass Trust.

This is for use with Sanlam pension plans, such as the OneSIPP and Sanlam Portal personal pension.

The aim of the Sanlam Bypass Trust is to provide a flexible structure to receive death benefits from a pension plan so that payment can be made to a wide range of beneficiaries including your widow(er) and dependants without forming part of the beneficiary's estate.

The trust is called a Bypass Trust because the pension death benefits are not paid directly to the surviving spouse and do not form part of your taxable estate on death. Instead, they are paid to the trust (at the discretion of the scheme administrator) from which your spouse and a wide range of potential beneficiaries could benefit.

Before coming to any final decision about whether you should set up a Bypass Trust, you should discuss this with your financial adviser and seek independent legal advice to ensure that this is suitable for your needs and requirements.

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Personal pension plans and inheritance tax

The impact of inheritance tax

Inheritance tax (IHT) can significantly diminish the amount of a person's estate. On death, IHT is applied at a flat rate of 40% to the total value of your personal assets that have not been left to your spouse (or held in trust) which exceed the available nil rate band currently set at £325,000 and are not otherwise IHT relievable.

Married couples and registered civil partners are allowed to pass assets to each other during their lifetime or when they die without having to pay IHT. It does not matter how much they pass on as long as the person receiving the assets has their permanent home in the UK. This is known as spouse or civil partner exemption.

Any unused IHT threshold from a late spouse can be transferred to a surviving spouse when they die. This can increase the IHT threshold for the second partner from £325,000 to as much as £650,000 depending upon individual circumstances.

To transfer the unused threshold, the executors or personal representatives of the second spouse need to send certain forms and supporting documents to HM Revenue and Customs (HMRC) to claim the transfer of one nil rate band from one partner to another. Further information on this can be found on the HMRC's website.

Pension schemes and inheritance tax

Where you, (as a member of a registered pension scheme) have a lump sum payable on your death, normally these payments are free of IHT if paid within two years of your death.

The payment of these benefits to your surviving spouse or beneficiaries would mean that it would be part of their own estate and unless this money is spent, potentially this would be subject to IHT, depending upon the other personal assets held by that person at the time of their death and the nil rate band available.

The Sanlam Bypass Trust seeks to overcome this problem. By establishing a Bypass Trust during your lifetime, you can nominate that the lump sum death benefit (either before you have taken benefits or once you started taking benefits) be paid to the Bypass Trust rather than a specific person. By doing so, it should be possible to mitigate any future IHT liability on the lump sum, without denying the surviving spouse access to the trust assets.

Payment of pension death benefits

Lump sum death benefits can be paid under a personal pension either before you have taken any benefits or while you are in receipt of pension benefits. The amount of the death benefits will depend upon the rules of your pension scheme and the type of benefit being taken, such as an annuity or a drawdown pension.

Generally, the scheme rules will allow death benefit payments to be paid to:

- one or more of your dependants (including your spouse) who will be able to select how they would like to receive it (as annuity, drawdown pension or lump sum);
- as a lump sum; or
- as a combination of the above.

If a dependant wishes to receive a lump sum, they can request that the scheme administrator pay this to the Bypass Trust instead of directly to them.

The scheme administrator is not obliged to follow your wishes. They will take your completed *Nomination/Expression of wishes* letter into consideration when they are exercising their discretion regarding the recipients of the lump sum payment. The scheme administrator will need to be satisfied that the payment is made to the most appropriate person.

If you do not make a nomination, the scheme administrator will decide how these benefits will be paid having taken into consideration all the facts of the case.

If you die without taking any benefits and are under the age of 75, the lump sum is normally payable tax free.

If you had taken benefits from your pension or you are over 75 when you die, any lump sum received would have an automatic tax charge of 55%. There will be no separate IHT charge on this payment as it is made at the discretion of the scheme administrator.

You should consider how you wish any death benefits to be paid. If you have taken benefits and/or are over 75, a lump sum payment might not be the most appropriate option due to the 55% tax charge. A dependant's annuity or drawdown pension may be more suitable, as the income received by the recipient will be taxed at their own marginal rate of income tax, which will be less than 55%.

If you are currently in serious ill health, you should speak to your financial adviser before setting up any type of trust.

Benefits of a Bypass Trust

By setting up a Sanlam Bypass Trust to allow pension death benefits to be paid to it there are several benefits that you can achieve, some of which are listed below.

- Where death benefits are paid to a Bypass Trust, it will be at the discretion of the trustees of the Bypass Trust who benefits in the future and when. This gives you control in so much that you select the trustees who will be looking after this money after your death.
- Flexibility over who can benefit from the trust.
- Where there are issues with making death benefit payments to minor children or those who are incapable of managing their own financial affairs, normally a trust would need to be established for this payment to be made. This may create delays on making the payment to the beneficiary. A Bypass Trust established during your lifetime may avoid this problem.
- The payment of these monies will not be in the beneficiary's estate for IHT purposes.

Potential risks of a Bypass Trust

Before setting up a Sanlam Bypass Trust, the potential risks and limitations should be considered and discussed with your financial adviser as well as seeking independent legal and tax advice to ensure that this type of trust is suitable for your personal circumstances.

Factors that should be taken into consideration before entering into this type of trust:

- The settlor cannot access the trust or any of the assets held there within. If the settlor was to access the trust assets then the HMRC could deem this to be a gift of reservation of benefit, which could affect how much of the settlor's estate is liable for IHT on their death
- The trust is subject to English law, and the laws governing it could change in the future.
- This type of trust cannot be used for all pension lump sum death benefits. Pension schemes such as a Section 32, deferred annuity and other retirement annuity contracts do not have the necessary discretionary provisions written in to the scheme rules to allow the scheme trustees/administrators to make payments as they deem fit.
- The nominal £10 gifted to establish the trust will normally be within the settlor's available £3,000 annual exemption(s) (or £6,000 if the previous year's allowance has not been used). However, if the value of the gift (less any annual exemption) plus the value of all chargeable transfers made by the same settlor in the seven preceding years does not exceed the nil rate band (currently £325,000), there is no immediate liability to tax. If the nil rate band is exceeded, there is a liability to IHT at 20% on the amount of the gift that exceeds the nil rate band.

Frequently asked questions

What is a Bypass Trust?

A discretionary trust established in your lifetime to allow lump sum death benefits to be paid to it from a pension scheme, subject to the pension scheme administrator's discretion.

How is the Sanlam Bypass Trust established?

It is established during your lifetime by placing £10 in the trust with no other additions until after your death, when death benefits from your pension scheme could be paid to it. As this is a draft trust deed, Sanlam Investments and Pensions does not charge for the use of it, though independent tax and legal advice should be sought to ensure its suitability for the individual circumstances.

What is the nature of the Bypass Trust?

It is a discretionary trust, which gives the trustees wide powers to grant benefits to any of the classes of beneficiaries named in the trust deed. It should be noted that to ensure any tax benefits are not lost during your lifetime, neither the settlor nor their spouse are allowed to benefit from the trust during the settlor's lifetime. The trustees also have the power to lend money to the beneficiaries from the trust fund. This loan can be interest free or interest bearing. From an IHT planning perspective, providing the spouse or other beneficiary with an interest-free loan from the trust would mean that on their death there would be a debt against their estate and this would need to be paid back to the trust before any potential IHT would have to be paid, thus reducing the value of their estate.

How long can the monies be held in trust?

A Sanlam Bypass Trust can continue for a maximum of 125 years. However, if benefits have previously been transferred to the Sanlam pension scheme from other schemes of which you have been a member before 6 April 2010, the trust may have a shorter term.

Can a Bypass Trust be used with all pension schemes?

A Bypass Trust can only be used if the pension scheme has the necessary discretionary powers to make payments of death benefits of the scheme member. This is usually a personal pension. Pension schemes such as a Section 32 buy-out scheme, deferred annuity and retirement annuity contracts do not usually have the necessary discretionary provisions written in to the scheme rules. You should discuss whether your pension plans are suitable for the death benefits to be paid to a Bypass Trust with your financial adviser.

Glossary of terms used

Annuity: a fixed sum of money paid to someone each year, typically for the rest of his or her life.

Appointor: the person who sets up the trust during their lifetime and after their death this will be the trustees.

Beneficiary: for IHT purposes, a beneficiary is a person or organisation that receives property or gets some benefit from a trust.

Default beneficiaries: the individual(s) that will benefit from the trust in the unlikely event that the trustees do not make appointments of the trust fund during the lifetime of the trust.

Dependant: a person who at the time of the scheme member's death is:

- the spouse or civil partner of the member
- a child of the member who is under 23; or
- a child of the member who is over 23 and in the opinion of the scheme administrator was dependent on the scheme member because of physical or mental impairment.

Discretionary beneficiaries: the list of individuals referred to in the trust deed.

Discretionary trust: a trust under which no individual has a right to the property held within the trust. The trustees have the power to decide who should receive the capital or income from the trust.

Domicile: generally, a person's domicile is where they have their fixed and permanent home and to which, when they are absent, they always have the intention of returning.

Estate: all of your possessions, especially all the property and debts left at the date of your death.

Inheritance tax (IHT): a tax on the value of a person's estate on death and on certain gifts made by an individual during their lifetime.

Lump sum death benefits: benefits paid on the death of a scheme member in the form of cash.

Nil-rate band: the amount of an estate on which there is no IHT to pay. For the tax year 2018/19, this is £325,000. Where the value of an estate exceeds the nil-rate band, only the amount above the nil-rate band is taxed at 40 per cent. Certain gifts made within seven years of your death could also take up some of your nil rate band.

Drawdown pension: allows you to take income from your pension pot while the pot remains invested. You can choose how much pension you want to be paid each year within certain limits set by the Government Actuary's Department.

Retirement annuity contract (RAC): a defined contribution pension plan. Since June 1988, no new contracts can be started but contributions can be made to existing contracts.

The value of the ultimate benefits payable from the contract depends on the level of contributions paid, the investment return achieved and the cost of buying the benefits. Although similar in many ways to personal pensions, there are some differences:

- To be eligible to make a contribution, an individual had to be in receipt of net relevant earnings (the £3,600 rule did not apply). Benefits could only be taken between ages 60 and 75 (under a personal pension, benefits can be taken between ages 50 and 75).
- Section 32 buy-out scheme: an individual pension plan that lets you transfer benefits from an occupational pension scheme and any other Section 32 buy-out plan. The plan belongs to the scheme member.

Settlor: person making the gift into trust.

Spouse or civil partner exemption: gifts made between spouses or civil partners are exempt from IHT.

This exemption is limited to the amount of the nil rate band that applies at the time of the transfer if the deceased (or donor) was domiciled in the UK and their spouse or civil partner was not domiciled in the UK. If the transfer was before 6 April 2013, the exemption is limited to £55,000.

Where the transfer was made on or after 6 April 2013, a spouse or civil partner who is not domiciled in the UK can elect to be treated as if they were domiciled in the UK.

If they make such an election, they are treated as domiciled in the UK for IHT purposes and so can qualify for full spouse exemption. However, their worldwide estate will also be liable to tax.

The election may be made by the spouse during their lifetime or within two years of the UK-domiciled spouse's death. The election must be in writing by the person not domiciled in the UK to HM Revenue and Customs (HMRC).

Trust: an obligation binding a person who holds the legal title, the trustee, to deal with the property for the benefit of another person, the beneficiary.

Trustee: the person who holds the legal title to property held in the trust and who is obliged to deal with the property for the benefit of the beneficiaries.

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