



**When analysing a person's wealth it is imperative to consider the value of a death in service benefit and any other lump sums which may be payable on death, such as a pension benefit. It is often forgotten that these sums may have a detrimental effect on the estate of the surviving spouse / civil partner upon their death, as opposed to the beneficial one that was intended.**

**It is common place for people to nominate these lump sums to a spouse or civil partner and a result of the nomination is that the lump sum payment does not normally form part of the estate of the first to die. The main exception to this rule is under statutory schemes, such as NHS Pensions, when nominated they are still included within the estate of the deceased for Inheritance Tax purposes.**

**If the nomination is successful, the downside will be that the amount recovered swells the survivor's estate by, quite often, a considerable sum which, on their death, may possibly lead to an unnecessary charge to Inheritance Tax and possibly other (non-tax) implications.**

### What is a Pilot Trust?

A Pilot Trust is a trust (usually discretionary) set up in a person's lifetime to receive lump sum pension payments and/or death in service benefits. It is established with a nominal sum i.e. £10.00. Very simply this is a trust which is very flexible. The capital or investment is managed by a number of trustees for the benefit of others at the discretion of the trustees.

A list of potential beneficiaries is included within the trust which may include the widow/widower, surviving civil partner, children, grandchildren and so on. These beneficiaries are not guaranteed to benefit from the trust as it is a decision for the trustees as to who benefits, when they benefit and in what proportion. A letter of wishes is usually drawn up to assist these trustees in making their decisions. The trust will sit dormant until such

time as the settlor (the person making the trust) dies and the lump sum payments are made to the trust.

When the trust is established the scheme provider is notified and a nomination is completed requesting that any future payment be paid directly to the trust.

### Who are the Trustees?

When the trust is established two or more trustees need to be appointed. They are often members of the family or friends. A professional may be appointed but they can charge for the work that they undertake.

### The benefits of a Pilot Trust

- In essence, all of the assets in the trust are protected from the changing circumstances or whims of any of the named beneficiaries
- It prevents the value of the lump sum payment being received into the survivor's estate
- If the payment is not in the survivor's estate then it cannot be taxed on the death of the survivor as part of his or her estate
- As a survivor does not have a guaranteed right to receive money from the trust, the capital is protected from assessment for long term care
- Should the survivor remarry, the capital is protected from any future relationship and remains within the family
- The trust assets are protected from any bankruptcy proceedings of the beneficiaries
- The trust assets are in general protected from any divorce proceedings of the beneficiaries
- Flexibility in the trust for payments and loans to be made which may assist with Inheritance Tax planning for beneficiaries

### Example

Mr and Mrs Thornton have a combined estate of £950,000 which includes a death in service benefit payable on the death of Mr Thornton to the value of £300,000. Mr Thornton dies, leaving all of his estate

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by his will to his wife and having nominated his death in service benefit in her favour. Mrs Thornton then dies and leaves her estate (£950,000) to the children. In accordance with the current Inheritance Tax rules, Mrs Thornton's estate will suffer an Inheritance Tax charge of £120,000. However, if Mr Thornton has established a Pilot Trust in his lifetime to receive his lump sum death in service payment then the entire £300,000 payment would have not been within the estate of either Mr or Mrs Thornton.

As a result, the Inheritance Tax charge on Mrs Thornton's estate would have been nil as her tax free allowance of £325,000 combined with the tax free allowance of Mr Thornton (£325,000) allows the remaining £650,000 value of Mrs Thornton's estate to be taxable at 0%.

## Can I still use a discretionary trust if I have a pension in drawdown?

The simple answer to this question is yes. If a pension is in drawdown and the person receiving the benefit dies then there is an option for the surviving spouse to receive an annuity, continue in drawdown or, alternatively, a lump sum benefit can be paid to the Pilot Trust subject to a tax charge of 35%. This would avoid the capital sum being lost upon the survivor's death.

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