For financial advisers only

Pilot trust guide

In this guide we look at the pilot trust and how you can use it. We offer an English Law and a Scots Law version of our Pensions Death Benefits Trust – which is a pilot trust.

This communication is for financial advisers only. It musn't be distributed to, or relied on by, customers. The information contained in it reflects our understanding of current legislation, taxation law and practice (as at September 2023), which may change.

This guide isn't a substitute for legal or other specialist advice. The laws governing trusts and their taxation are complex and we strongly recommend that specialist advice should be sought before establishing a trust, settling funds into a trust, or making changes to an existing trust, including appointing funds in favour of selected beneficiaries.

Trusts establish legal rights and entitlements, and might have material financial and tax implications for the settlor, trustees and beneficiaries. We aren't authorised to provide legal advice, so you and your client should take your own legal advice before setting up a trust, to make sure that it meets your client's requirements. Our trusts have been drafted for use by UK-domiciled individuals.

The value of any tax relief depends on individual circumstances.

What is a trust?

Before we get into the detail of a pilot trust, let's first cover the basics.

A trust is an arrangement to give money or assets to a third party to look after, on behalf of another group of people. The people involved are:

The settlor

The person who creates the trust and gives the money or assets to the trustees. The settlor must be aged 18 years or over and of full mental capacity. For tax purposes, the settlor is anyone who gifts assets to the trust either directly or indirectly, whether or not they actually set up the trust.

The trustees

The people who look after the trust fund. The settlor appoints the trustees when the trust is set up. The settlor can also be one of the trustees. Beneficiaries of the trust can also be a trustee. The important thing is to choose people that will act impartially.

The beneficiaries

These are the people who benefit from the trust fund.

About the pilot trust

When can a member use our pilot trust?

It can be set up for receiving lump-sum benefits arising on death under any of the personal pension schemes we list below. These are all registered pension schemes under the Finance Act 2004.

- The Scottish Equitable Self-administered Personal Pension Scheme.
- The Scottish Equitable Personal Pension Scheme.
- The Scottish Equitable Stakeholder Scheme.
- The Aegon Self-invested Personal Pension Scheme (available on Aegon Retirement Choices and Aegon Platform).

This applies whether the benefits under the scheme are insured benefits, self-invested funds, or both.

And, whether they arise on death before taking any pension benefits or on death while taking income withdrawals.

The death benefit funds must be subject to provisions allowing for discretionary disposal of benefits. It's not possible to use the pilot trust in connection with any lump-sum benefits payable on death that have been placed in trust. Typically, this could apply where a member applied for a new policy and requested the provider to issue the policy to the trustees rather than to the member. Or, where the member assigned an existing pension policy to a trust.

So as long as it meets the above criteria, the member can use the pilot trust in connection with any existing or new pension plan taken out under any of the schemes we mention.

How does it work?

Under the scheme rules for the pension schemes we list above, where the member hasn't assigned their pension policy to a trust during their lifetime, the scheme administrator has discretionary disposal powers over any lump sum death benefits. The scheme administrator will select the beneficiaries, to pay the benefits to and/or for whose benefit the benefits are to be applied, from a list of discretionary beneficiaries that are set out in the scheme rules. They include persons (including trustees) who've been named or identified as beneficiaries, to the scheme administrator, by the member before their death. This allows the member to add a trust as a potential beneficiary of any lump sum death benefits and to express their wish that the scheme administrator should pay any lump sum death benefits to the trust. This wish isn't binding on the scheme administrator, but will be taken into account by the scheme administrator.

If drawdown is allowed under the scheme, it's also possible for a beneficiary, who under the scheme has opted for drawdown, to name or identify a trust as their preferred beneficiary. The trust would then benefit from any lump sum death benefits from the drawdown funds on their death if the scheme administrators exercise their discretion in favour of the trust. The beneficiary in drawdown may have inherited the funds from a deceased member of the scheme or, if they're a beneficiary under the Aegon Self-invested Personal Pension Scheme, from a deceased member or another beneficiary who died in drawdown.

The member, or relevant beneficiary, can use our form to nominate a trust, for example our pilot trust, (or any person or persons) as their preferred beneficiary. You can find out more details on the form on how you can use it – there are different forms depending on the pension scheme your client is a member of – the form is normally called death benefit nomination/expression of wish form or death benefits nomination form. A nomination must be made in writing and the scheme administrator must receive it during the member's (or relevant beneficiary's) lifetime. The trust has to exist before the member or relevant beneficiary nominate it – so it's important to set up the trust (see How is the trust set up below) before completing, signing and returning this form to us.

If the member or relevant beneficiary change their mind about who they previously nominated, they can complete a new death benefit nomination/expression of wish form or death benefits nomination form and send this to us. Just remember, the scheme administrator must receive it in the lifetime of the member or relevant beneficiary.

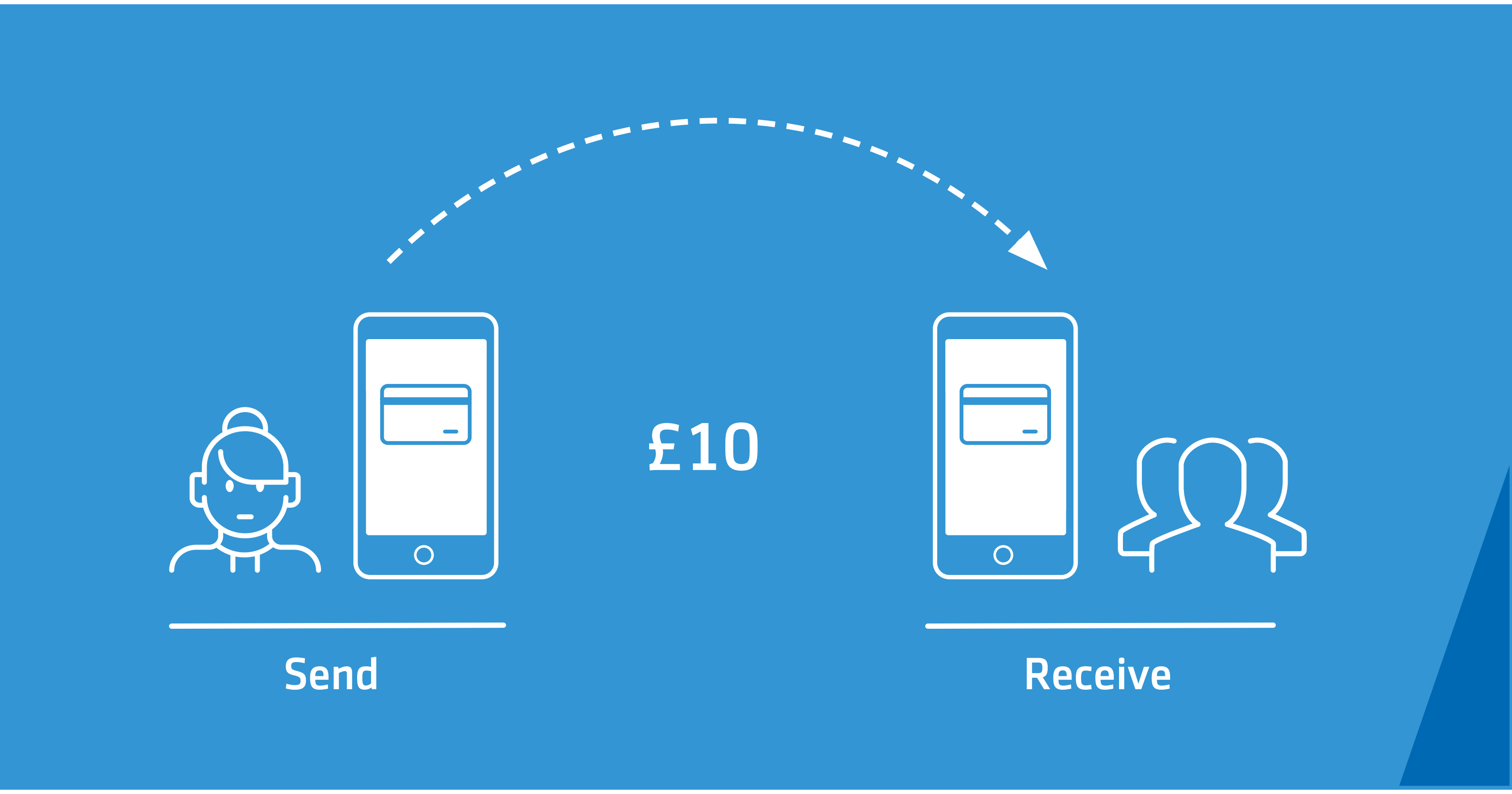
The settlor

The settlor of a pilot trust will normally be the member of the pension scheme. It's possible for a beneficiary who's taking income withdrawals to be the settlor of a pilot trust (see the section How does it work? earlier in this guide for more details). The settlor chooses the initial trustees, and the trustees must sign the trust document to confirm acceptance of office.

How is the trust set up?

Once the Declaration of Trust has been completed and signed by all parties, the settlor must make a cash gift of £10 to the trustees to create the trust.

The settlor can attach the £10 to the trust deed with the trustees storing it in a secure place. Alternatively, the trustees can pay this into a trustee bank account.



The trustees

Can a settlor change the trustees they previously appointed?

Yes. A pilot trust allows a settlor, during their lifetime, to appoint new trustees and/or remove existing trustees. It's important to note that a settlor can only remove a trustee as long as there are still two trustees in place.

If the trust is governed by English law, the settlor can appoint a new trustee by a Deed of appointment of additional trustees. It's also possible in certain circumstances to remove a trustee by Deed of Removal of a Trustee

If Scots law applies to the trust, it may be possible to change the trustees by completing a Deed of Assumption and Conveyance which is covered in our Changing trustees form.

What happens after the settlor's death?

The trustees have powers to appoint new or additional trustees.

Can a trustee of a pilot trust retire?

Yes, as long as:

- The trustee wishing to retire gives 30 days' notice to the person who has the power to appoint new trustees.
- And, there are at least two trustees left.

A trustee can retire by completing a Deed of Resignation as a Trustee.

The beneficiaries

Who are the discretionary beneficiaries of the pilot trust?

These include:

- The settlor's surviving spouse or registered civil partner.
- The settlor's children, grandchildren, great-grandchildren and their spouse or registered civil partner.
- Anyone entitled to benefit under the terms of the settlor's will or under the intestacy rules.
- Anyone who, in the opinion of the trustees, was financially dependent on the settlor.

The settlor can add other beneficiaries at any time during the trust period.

The trustees have the power, subject to certain conditions, to exclude any person as a beneficiary.

Can the settlor benefit from the trust fund?

No, they can't benefit under any circumstances, either directly or indirectly.

What entitlement do the beneficiaries have?

No one beneficiary has any automatic rights to either the capital of the trust or the income generated by it.

It's up to the trustees to decide who gets what and when. They have the power to pay income, capital or make loans, interest free or otherwise, to any of the beneficiaries, including any of the settlor's family. They also have the power to make appointments of the trust fund in favour of any of the beneficiaries.

If for any reason the trust can no longer continue, the default beneficiaries will have an entitlement to their respective shares of the trust income and capital.

Flexibility

How long can a trust pilot last?

If the trust is subject to English law, it depends when the settlor became a member of the scheme.

- Before 6 April 2010 – the maximum trust period is 21 years from their death.
- On or after 6 April 2010 – the trust period can last for 125 years from the date when they became a member, or until any earlier date which the trustees specify by deed.

If the trust is subject to Scots law, there's no limit but the trustees can specify an end date for the trust.

At the end of the trust period, the trust fund must become payable to the beneficiaries.

Do the trustees have to pay out the income?

Under Scots law, the period for which income can be accumulated in the trust is 21 years from the settlor's death.

Under English law, it depends when the settlor became a member of the scheme.

- Before 6 April 2010 – the period the income can be accumulated in the trust is 21 years from the settlor's death.
- On or after 6 April 2010 – there's no restriction to the period that income can be accumulated.

What investment powers does the trust have?

The trustees have wide investment powers, allowing them to invest in a wide choice of assets.

Can a settlor make more gifts to the trust after it's set up?

Yes as long as they do this during their lifetime. For example, they could gift further cash or an investment bond.

They can add an investment bond by completing a Deed of Assignment (or Assignation under Scots law). A sample deed is available from us.

Inheritance tax

This is a basic summary of the way inheritance tax (IHT) is likely to apply to the pilot trust.

This is a complex area and members should take their own advice on their specific circumstances.

The summary only applies to settlors that are both tax resident and domiciled in the UK (and continue to be, up to and including the date of death). If other circumstances apply, the analysis is likely to be different.

On creation of the trust

The £10 gift that the settlor makes to set up the trust is covered by the £3,000 yearly exemption if available. If the exemption isn't available, then it may fall within the settlor's nil-rate band (£325,000 until April 2026). If it doesn't, an IHT charge may arise on the same principles that we cover at Additional gifts below, but as the gift is only £10, any charge will be small.

Additional gifts

If the settlor adds additional assets to the trust through their lifetime, they may also be covered by the £3,000 yearly exemption or their available nil-rate band.

An IHT charge may arise if the yearly exemption isn't available and this gift, when added to the settlor's other chargeable lifetime transfers in the seven years preceding this gift, is more than the nil-rate band. The IHT charge is calculated at 20% of the excess, assuming that the trustees are meeting the charge. If the settlor dies within seven years of making the gift, then the value of the gift falls back into the their estate and the IHT liability will be calculated at 40%.

When the death benefits pass to the trust

The normal discretionary trust charging regime for IHT purposes shouldn't apply to the registered pension scheme. The actual payment of the lump sum death benefits from the scheme to the trust won't normally have immediate IHT implications. But, once the funds are held in the pilot trust, they'll be subject to the normal discretionary trust charging regime as in the periodic charge and exit charge sections.

Periodic charge

Assets held within the trust are subject to a periodic charge on the relevant 10-year anniversary.

Generally, the periodic charge calculation is based on the value of the trust fund immediately before the 10th anniversary. There won't be any IHT to pay providing the settlor hasn't:

- Made any other chargeable transfers in the seven years prior to the pilot trust being set up.
- Set up any other trusts on the same day.
- The value of the trust fund is less than the prevailing nil-rate band on the tenth anniversary.

It's important to understand when the 10-year anniversary occurs.

If death benefits are paid into the pilot trust and these have come from a registered pension scheme that allows for discretionary disposal of death benefits, they'll be treated as a separate settlement different from any other funds settled in the pilot trust.

The date of the 10-year charge in relation to this tranche of the trust is the 10-year anniversary of the date the member joined the original pension scheme not when they set up the pilot trust. In other words, this element of the trust fund won't have a 10-year anniversary based on the date the pilot trust was set up.

Let's look at an example.

- Member joined the scheme in January 2013.
- Death benefit was paid to the pilot trust in January 2017.
- The 10-year charge would arise in January 2023. It would be apportioned to reflect that only six years have passed since the death benefits were paid to the trust.

Any other assets held in the trust will have the anniversary date of the pilot trust starting with the original £10.

Exit charges

An IHT charge may arise when funds are distributed to the beneficiaries from the pilot trust. These charges can apply either before the first 10th anniversary or between 10-year anniversaries.

The rate of tax that applies is a proportionate amount based on the tax due at the start or paid at the previous 10th anniversary and the number of quarters that have passed since then.

Transferring death benefits from more than one registered pension scheme

If death benefits are passing into the pilot trust from more than one registered pension scheme – operating discretionary disposal – it could result in multiple anniversaries for the purpose of calculating periodic charges and exit charges.

This could be complex to manage and for ease, the settlor may wish to create a series of pilot trusts – one for each registered pension scheme.

The member should get tax advice before setting up multiple pilot trusts to make sure they're comfortable with the possible future implications.

Other tax charges

If the member, or the relevant beneficiary in drawdown, dies after having reached age 75, the payment of the lump sum to the pilot trust will normally be subject to a special lump sum death benefit tax charge. This is currently 45%.

There is no charge if the member or relevant beneficiary in drawdown dies under age 75.

If the 45% tax charge applies, any part of the lump sum paid by the trustees to a beneficiary will be subject to special tax treatment.

Reporting requirements

If any IHT is due on the initial gift to set up the trust, or any additional gifts to the trust during the settlor's lifetime, HMRC need to know about this.

You can do this on forms IHT100 and IHT100a – you can download these forms from gov.uk.

Income tax and capital gains tax

Income tax and capital gains tax treatment of the pilot trust isn't covered in this guide.

HMRC trusts online service

Where the pilot trust is created on or after 6 October 2020, the trustees will have to register the trust on the HMRC trusts online service regardless of the size of the trust fund and/or whether there is a UK tax liability or not.

The trustees of a pilot trust created before 6 October 2020 have to register the trust on the HMRC trusts online service if the trust fund is more than £100 and/or the trustees incur a UK tax liability.

Trusts are a complex matter and as we said at the beginning of this guide we strongly recommend you and your client seek specialist advice. If you'd like more information on pilot trusts and what we offer, please get in touch with your usual Aegon contact.