Business Protection
Guide to Trusts

We have written this guide to explain how trusts work for AIG business protection policies. We cannot advise whether a trust would be suitable in your particular circumstances. We would recommend you take professional advice before setting up a trust.

This document only explains how trusts work in England and Wales; AIG business trusts are under the law of England and Wales and this document does not cover trust law in Scotland or Northern Ireland or other territories. This does not mean that AIG business trusts cannot be used in other countries or jurisdictions. If this is a concern to you, you should take independent legal advice on the suitability of setting up a trust.

Trust law may be subject to change in the future. AIG cannot be held responsible for any information given or any changes in tax provisions or legislation that may affect the life cover within trusts or the tax treatment of them or the provisions of trusts or the rules applying to gifts for inheritance tax planning purposes.

A. What is a trust?

A trust is a legal arrangement. It allows the owner of property to transfer legal ownership of that property to another person or company.

The person or company receiving the property holds onto it for the benefit of a third party called a beneficiary.

The person transferring the property (the owner of the life cover), is called the settlor.

The person or company holding onto the property is called a trustee.

These roles are explained in section C.

B. Why use a trust?

Advantages of putting a life assurance plan into a trust include:

1. It ensures the money paid out from the plan goes to the people the settlor wants to benefit from it.

   When a trust is set up, the settlor (the owner of the life cover) identifies the people they want to benefit from the trust. Under an AIG business trust, the amount each beneficiary receives will be in proportion to their share in the business.

2. The life insurance company can usually pay a death claim more quickly than they could if it were not in trust.

   If a life assurance policy is held in trust, it is no longer part of the settlor's estate. If they die, the trustees submit a claim on the life assurance and the death benefit money is paid directly to the trustees, so they may distribute it to beneficiaries.

   If a life assurance plan is not held in trust, the benefit has to be paid to the deceased's estate. The people who distribute the estate, if there is no trust, would need to gain a grant of probate before the insurance company could pay out any money. And this can take several months.

3. The money an insurance policy pays out may be free of inheritance tax.

   If the insurance plan was put into trust, it is not considered to be part of the settlor's estate when the settlor dies, so there is no immediate inheritance tax to pay. However, some inheritance tax may be payable if the money is kept in trust until the next 10th anniversary of the trust or when the trust fund is paid out of the trust. To find out more, please speak to your professional adviser who can look at your specific circumstances and explain how inheritance tax might affect you.

4. Where life cover is subject to an AIG business trust, the benefits will be payable to the trustees who in turn distribute the funds to the beneficiaries, such as the surviving shareholders or partners. If an 'option agreement' is also put in place, it can give the surviving partners/shareholders the opportunity to use these funds to purchase the deceased's share of the business.

C. The people involved in a trust. There are three main roles in any trust arrangement:

- settlor;
- trustees; and
- beneficiary.

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

Settlor

The settlor is the person who sets up the trust and transfers the property into it. The settlor will appoint the trustees to administer the trust and decide who the beneficiaries will be. In an AIG business trust, the trustees are given discretion to decide who the actual beneficiaries will be when they distribute the trust assets.

If the settlor wants to put a business protection policy in trust, it must be a policy that they own.

Under the laws of England and Wales, anyone over the age of 18 and who has the mental capacity can be a settlor.

Trustees

The trustees become the legal owners of the trust fund. They administer the trust for the sole benefit of the beneficiaries. AIG requires an AIG business trust to have at least two trustees - the settlor and at least one trustee who is not a settlor. They must administer the trust in accordance with the terms of the trust document and the law that governs the trust.

It's important to choose the right trustees. They need to have good financial knowledge and be someone the settlor can trust.

Under an AIG business trust, the settlor will select their fellow shareholders/partners both as trustees and beneficiaries and may also wish to include a company secretary or company lawyer to act as trustees. Professional trustees will usually charge for their services.

Under the laws of England and Wales, a trustee must be over the age of 18. They should have mental capacity and have a sound financial history.

You can find out more about being a trustee on pages four and five of this document: Business Protection – Guide to trusts.

Beneficiaries

The beneficiaries are people or businesses who the settlor decides should receive the benefits of a successful insurance claim. There can be different types of beneficiary within a trust, depending on the exact wording of the trust deed.

Once the settlor has put an insurance policy into trust, trustees effectively need do nothing more until a benefit has to be paid (e.g. when the person covered has died). Trustees then look after the money, investing it if necessary, and distribute it amongst the beneficiaries.

Under an AIG business trust, the beneficiaries will be other shareholders and/or partners participating in the business protection insurance agreement. Trustees will have the discretion to decide how the proceeds are distributed and those shareholders/partners who are not party to the protection agreement will be excluded.

D. AIG business trusts

A flexible approach to shareholder/partnership protection is to arrange for business protection insurance to be written in trust from inception.

Each shareholder/partner in the business takes out insurance, also known as cover, on their own life and completes an AIG business trust. The AIG business trust is discretionary - written for the benefit of the other shareholders/partners but allows the beneficiaries and their entitlements to be changed once the trust is created, to reflect any change in circumstances for the settlor. The remaining partners or shareholders mentioned in the trust deed are to have the opportunity to use the trust's assets to purchase the settlor's share of the business, should the settlor die or suffer a critical illness and subject to an option agreement.

Writing business protection insurance under an AIG business trust allows new shareholders to benefit from the trust without revising the complete share purchase arrangement. It also allows shareholders leaving the business to be removed from the whole share purchase arrangement with the minimal amount of legal administration.

AIG will not need to see the trust deed before the insured life goes on-risk, but your financial adviser will be asked to confirm whether a trust deed has been completed. We will only need to see the original trust deed when a claim is made. Once the AIG electronic trust form has been submitted, this record will automatically be retained on the AIG system.

E. Who pays the premiums when a plan is in trust?

Under an AIG business trust, it is the responsibility of the settlor to ensure premiums continue to be paid on the insurance plan. The claim proceeds are for the benefit of other shareholders/partners – should premium payments cease, the settlor should inform other parties who benefit from the business agreement.

If the company pays the premium on behalf of the shareholder, it may be able to deduct the expense for corporation tax purposes unless it is seen to be increasing the value of the company. However, these may then be treated as part of the shareholder's gross salary and be subject to an income tax charge.

The company could also incur a liability to national insurance (NI) contributions paid on behalf of the shareholder, though this may also be a deductible expense.

The claim proceeds from an AIG business protection policy - when effected as part of a commercial share protection arrangement written under an AIG business trust - will normally be payable to the trustees free of inheritance tax. Funds or monies from the trust are intended to allow the purchase of shares held by the deceased's estate.

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

We would recommend you take legal advice if you intend to set up a trust. You can have a trust deed written by your solicitor but many insurance companies, such as AIG, provide 'ready-made' trust deeds to accompany the life insurance policies they offer. These trusts are not usually suitable for anything other than life insurance plans.

Trusts are not for everyone

The reasons we have listed for putting all or part of a life cover into trust do not mean that a trust is right for everyone. It's a good idea to get advice from a financial or legal adviser before you make a decision.

A trust may not be right for you if you want to be able to personally benefit financially from something that you're thinking of putting into trust or if you think you might want to access it in the future.

WARNING: Once you have put a plan or part of a plan into trust you do not have any access to it. Even though you have a cooling-off period for a life cover you take out with AIG, you don't have a cooling-off period when you set up a trust. Once you have completed the trust deed you have given away the life cover.

The responsibilities of a trustee

The exact responsibilities of a trustee and the powers they hold vary, depending on the type of trust and the contents of the trust deed. As well as reading this guide, it's important to read the trust deed to make sure you fully understand the responsibilities a trustee is taking on. However, a trustee is also expected to exercise such care and skill as is reasonable in the circumstances.

Anything a trustee does must be authorised by the terms of the trust deed and the law governing trusts. If any of the beneficiaries or other trustees considers that a trustee is not acting in their best interests, they can take legal action against a trustee if the trustee is acting outside the terms of the trust deed.

The main duties and powers of a trustee

Duty of Care
The trustee must exercise such care and skill as is reasonable in the circumstances, having regard in particular to any special knowledge or experience that he has or holds himself out as having.

To invest the trust fund
The property in the fund is called the trust fund. A trustee is responsible for making sure the trust fund is invested for the beneficiaries until all of the money is distributed. If the only property in the trust is an insurance plan, there will be no trust fund to invest until after any claim on the insurance policy. Money from the insurance plan will need to be invested until such time as it is distributed to the beneficiaries of the trust.

To act impartially
The trustees of a discretionary trust must distribute the trust fund among the beneficiaries honestly, impartially and as they see fit in good faith.

To take appropriate advice
Trustees should seek 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 advice. Trustees can ask a professional person to act on their behalf when investing the trust fund, but the responsibility for the investment would still lie with the trustees.

To distribute the trust fund
Trustees should ensure the trust fund is passed to the beneficiaries at the appropriate time.

To keep the trust fund secure
Trustees are responsible for making sure the trust fund is secure.

To keep the trust's records
Trustees must keep a record of any decisions they make and any actions they take. This includes decisions such as investments they make and any money they pay out to a beneficiary. Trustees should also keep records of the advice they have taken and any costs the trust has had to pay.

To not profit from the trust
Trustees acting in a professional capacity can, if permitted by the trust deed, claim reasonable fees for their services but they must not manage the trust in order to generate additional work for themselves or their firm.

Duty to act personally and not delegate
Each trustee must act in his personal capacity except to the extent that delegation is authorised, either by law or specifically by the trust deed. For example, the trustees may wish to delegate investment management functions to an investment manager.

Other powers
The trust deed may set out other powers a trustee has, for example, changing the beneficiaries. This can be very useful if the settlor's circumstances change, for instance if a person leaves or joins the business. Trustees of a discretionary trust often have the power to lend the trust fund to potential beneficiaries of the trust. However, we recommend the trustees seek appropriate legal and other professional advice before exercising this power.

Settlors can hold some powers other trustees do not have, such as the power to appoint or remove trustees. These powers may be passed to other trustees if the settlor dies.

How trustees make decisions
When using AIG business trusts, all trustees must agree any decision the trust makes. If most trustees want to pay a beneficiary but one disagrees, the beneficiary should not be paid.

What happens if a trustee wants to retire?
Under an AIG business trust a trustee can only retire if there would be at least two continuing trustees following their retirement.

Can trustees be removed?
Under an AIG business trust the settlor can remove trustees as long as this would not leave the trust with less than two continuing trustees.

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