

The Spousal Bypass Trust

In the event of your death, your pension benefits will be paid out as a lump sum to the beneficiaries you have nominated on your death benefit form. However, this can be taken a step further by setting up a discretionary trust or 'spousal bypass trust' which provides a number of advantages for both you and your beneficiaries.

Reducing Inheritance Tax Charges

If your nominated beneficiary is your spouse, he/she will receive the lump sum death benefit from your pension thereby increasing the value of his/her estate. This can create a potential inheritance tax (IHT) liability on their subsequent death when the assets are passed to the next generation (i.e. your children). However, establishing a spousal bypass trust ensures the lump sum death benefit does not pass directly to your spouse and does not form part of their estate.



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Consider this example:

John and Sarah are married with two children, their home is worth £500,000 and they have savings and investments valued at £500,000. John also has a pension fund with a death benefit of £200,000. Unfortunately, John dies suddenly and Sarah receives all his assets including the full £200,000 death benefit so that she now has an estate worth £1,200,000. When she subsequently passes away, assuming the Nil Rate Band is £325,000 and Residence Nil Rate Band is £175,000 and that she also has the transferrable Residence/Nil Rate Band, £1,000,000 of the estate will be taxable at 0% with the balance of £200,000 (pension benefits) taxed at 40%, resulting in an IHT liability of £80,000.

If, however, John had nominated his pension lump sum death benefit to be paid to a spousal bypass trust, the £200,000 would have been kept out of Sarah's estate and would not have been subject to the £80,000 IHT charge.

Control over who receives the benefit and when

A spousal bypass trust also gives you an element of control over the distribution of your death benefits. For example, you can choose the initial trustees (which could include your spouse) and provide them with a letter of guidance for distribution of your fund. You can specify several different beneficiaries and even request for the funds to be distributed in stages. This is particularly useful in the case of a young beneficiary who could otherwise have unfettered access to a lump sum.

Estate Planning Advantages

If your spouse needed access to some of the capital, the trust can provide funds as an interest free loan. This creates a debt on his/her estate, repayable on death, thereby further reducing the value of their estate for IHT purposes. It also has the added benefit of reducing the value of your spouse's assets when assessing their financial means for long term care costs.

Costs and Charges

There may be a cost involved in setting up the trust and IHT charges may still arise on ten yearly anniversaries and/or where capital distributions are made from the trust. The trustees may also incur costs if they appoint a professional adviser in respect of their accounting and reporting duties and all of these potential costs need to be considered when deciding whether to set up a bypass trust.

What Next?

For more information please call us on 01789 263257 or email justask@jifsltd.com.

Information in this document is valid for tax year 2023/24