WHOLE OF LIFE INSURANCE AND ITS ROLE IN INTERITANCE TAX PLANNING

28 May 2013

With the changes made by the Chancellor in a recent Budget, which removed some of the benefits of trusts as a method of Inheritance Tax Planning, the focus for many has swung back onto Whole of Life Insurance. This tried and tested method of funding for the liability of inheritance tax is making a very competitive comeback and can be even more effective when used in conjunction with a nil rate band discretionary will trust (see our article 'Practical Will Planning to Minimise Inheritance Tax).

Whole of Life joint life/second death insurance is especially relevant to the growing number of couples whose assets are now worth more than the inheritance tax free band – but who cannot effect any worthwhile inheritance planning through gifts of cash or property because most, if not all of their assets are tied up in their home.

The new generation of Whole of Life insurance policies are much improved over the previous generation. The old policies were reliant on investment returns – which meant that the end value of the policy could vary dramatically dependent on the performance of the portfolios. (The best example of the danger of this is the endowment policy). They were also subject to policy reviews, which brought the risk of premiums being substantially increased in order to counter the shortfall of the policy value through poor investment performances. Good quality, new generation Whole of Life policies are guaranteed not to be reviewed or altered during the life of the policy – which means that the premiums and the sum assured, agreed at the outset will stay the same for the duration of the policy.

The sum assured is payable on the death of the last of the policyholders – so in the case of the husband and wife joint life policy, whichever of the couples dies first, the surviving spouse must maintain the premium payments until their own death.

It is vital to make the sum assured the subject of a Trust, which ensures that the proceeds can be paid to the beneficiaries outside of the estate for inheritance tax purposes and avoiding probate. The beneficiaries can, in turn, use the proceeds of the policy to pay any inheritance tax liability that becomes due.

Premiums obviously vary considerably for many reasons. The client's age and state of health, and the amount to be insured are the major factors, but also, premiums can vary a great deal from insurance company to insurance company, so it is best to use an independent financial advisor to find you the best deal. However, it would be reasonable to expect a husband and wife, in good health and in their early 60's, to obtain £100,000 of cover for premiums equivalent to 1.8% per annum of the sum assured (circa £154 per month). This means that unless one or both of them live for a further 50 years, which even in today's age is highly unlikely, the Whole of Life policy will return substantially more then has been paid in. More likely, this couple may well live into their late 80's or early 90's, putting their investment in the policy in the region of £50,000, with a return of £100,000 and peace of mind for their beneficiaries.