Life Interest Trust Factsheet

Life Interest Trusts (Immediate Post-Death Interest)

A Life Interest Trust, also known as an Immediate Post-Death Interest (IPDI), is a well-established estate planning structure designed to protect assets while ensuring financial provision for a chosen beneficiary. It offers clients a balanced approach: the life tenant receives financial benefits or occupation rights during their lifetime, while the capital value of the estate is preserved for the ultimate beneficiaries (often children). Life Interest Trusts are commonly used in Wills, particularly for couples, blended families, and individuals seeking to maintain control over how their assets are eventually distributed.

Life Interest Trusts are highly versatile. They can apply to the residuary estate or to selected assets such as property, investments, or bank accounts, although frequently drafted to last for the lifetime of the life tenant, they can also be set to terminate earlier on specified triggers. This flexibility allows clients to tailor the trust to suit their family structures and long-term goals.

1. What a Life Interest Trust Does

A Life Interest Trust gives a named beneficiary, the life tenant, the right to benefit from the trust assets. Most commonly, this means they are entitled to all of the income generated by the trust for the duration of the trust. They may also receive a right to occupy property, usually a marital home or residence previously shared with the testator.

Crucially, the life tenant does not own the underlying capital. The trust assets are legally owned and administered by the trustees, who hold them for the benefit of both the life tenant and the remainder beneficiaries. Once the life interest ends, the capital passes to the remaindermen, either absolutely or under continuing trusts.

Although termed a “life” interest, the trust does not have to last for life. It may be drafted to:

- Continue until remarriage or cohabitation of the life tenant.
- Last for a specified number of years.
- End upon the life tenant reaching a certain age.
- Terminate upon the sale of a trust property.
- End on another defined event.

Including a power to advance capital (whether fully at trustees’ discretion or subject to conditions) introduces additional flexibility. This may allow trustees to support the life tenant with capital payments or loans where necessary, while still protecting the bulk of the estate for the remaindermen.

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2. Key Benefits and Reasons to Use a Life Interest Trust

Life Interest Trusts can address a wide range of family, financial, and succession concerns. Their advantages include asset protection, certainty of inheritance, and favourable tax treatment.

Protecting Assets for Children or Other Beneficiaries:

Clients frequently use Life Interest Trusts to ensure their spouse or partner is cared for while preserving capital for their children. This is particularly valuable in blended families. Without such a trust, assets given outright to a spouse may pass to a new partner or that spouse's own children, contrary to the testator's wishes.

Safeguarding Against Remarriage Risks:

If a surviving spouse inherits the deceased's assets outright and later remarries, those inherited assets could form part of the new marital estate. They might be redirected under a new Will or lost through divorce proceedings. A Life Interest Trust prevents this by ring-fencing the assets.

Protection from Long-Term Care Fees

Where a survivor may later require residential care, assets owned by a Life Interest Trust are generally not treated as part of their capital for means-testing purposes, subject to the deprivation of assets rule. This protects the estate from erosion through long term care fees, ensuring the capital passes to the intended beneficiaries.

Protection Against Bankruptcy or Credit Action

Because the life tenant does not legally own the trust capital, it is usually difficult for creditors or a trustee in bankruptcy to claim those assets. This protection can be particularly helpful where there are concerns about the financial stability of a beneficiary.

Reducing the Risk of Claims Against the Estate

Providing a spouse or partner with a right to income or occupation reduces the likelihood of a claim under the Inheritance (provision for Family and Dependants) Act 1975. Excluding them entirely increases the risk of litigation. A Life Interest Trust therefore supports both protection and fairness.

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3. How the Trust Works in Practice

In practice, Life Interest Trusts operate through a balance of fixed rights for the life tenant and administrative responsibilities for the trustees.

Trustees' Duties and Responsibilities



Trustees take legal ownership of the trust assets and must administer them prudently. Their duties include managing investments, arranging property maintenance, preparing trust accounts, ensuring income is correctly distributed, and filing relevant tax returns. Trustees must balance the immediate needs of the life tenant with the long-term interests of the remaindermen.

Fixed Interest vs Discretionary Powers

A Life Interest Trust is fundamentally a fixed interest trust, meaning the life tenant is legally entitled to the income generated by the trust assets. Trustees do not have discretion to withhold income. However, many trusts are drafted with additional discretionary powers, such as discretion to pay capital to the life tenant or to remaindermen if appropriate.



The Life Tenant's Rights

The life tenant may:

- Receive the full income produced by the trust assets.
- Live in a property owned by the trust (sometimes with conditions attached).
- Request capital if the trustees have discretionary power to advance it.
- Expect trustees to act fairly and in accordance with the trust deed.

What Happens When the Life Interest Ends



When the life interest ends, whether by death or an earlier event, trustees distribute the capital to the remaindermen or into new trusts. They must also prepare final accounts and ensure all tax liabilities are settled.

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4. Inheritance Tax (IHT) Consequences

Life Interest Trusts have distinct IHT treatment which differs significantly from discretionary trusts.

Immediate Post-Death Interest (IPDI) Treatment

Where a Life Interest Trust is created by Will for an indefinable individual, it will usually constitute an IPDI. This means the life tenant is treated as inheriting the trust assets for IHT purposes. As a result, the value of the trust funds is included in their estate when they die.

Spousal or Civil Partner Exemption

If the life tenant is a surviving spouse or civil partner, the spousal exemption applies on first death. This avoids IHT at that point and preserves the Nil Rate Band for later use. IHT is therefore typically payable only when the surviving spouse dies.

Termination of the Trust During the Life Tenant's Lifetime

If the trust ends before the life tenant's death, the passing of assets to the remaindermen is treated as a Potentially Exempt Transfer (PET) made by the life tenant. The seven-year rule will apply, potentially creating tax implications if they die within that period.

No Period or Exit Charges

Because IPDIs are not within the relevant property regime, there are no ten-year anniversary charges or exit charges, an advantage compared with discretionary trusts.

Resident Nil Rate Band (RNRB)

If the trust contains a qualifying residential interest, RNRB may apply. If the life tenant is a spouse or civil partner and the remaindermen are direct descendants, RNRB can apply on second death. Alternatively, if the life tenant is themselves a direct descendant, RNRB may apply on first death. However, RNRB is not available where the ultimate beneficiaries are not direct descendants.

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5. Capital Gains Tax (CGT) Position

On death, there is no CGT charge. Trust assets generally benefit from an uplift to market value at the date of death.

Resident Nil Rate Band (RNRB)

Trustees are liable for any CGT due on disposals of the trust assets. Trusts benefit from only half the individual CGT annual exempt amount, and trustees pay CGT at higher trust rates. Therefore, trustee investment decisions should take CGT into account.

Resident Nil Rate Band (RNRB)

If a property is held within the trust is occupied by the life tenant as their main residence, trustees may be eligible to claim Principal Private Residence Relief on disposal, provided the statutory conditions are met.

6. Income Tax Position

Income Allocation and Taxation

Income generated by trust assets belongs to the life tenant. Trustees must pay income tax at the basic rate on trust income and then account to the life tenant using the R185 tax certificate. The life tenant declares the income on their personal tax return and may reclaim or pay additional tax depending on their own tax position.

Types of Trust Income

Trust income can include dividend income, rental income, bank interest, and other investment returns. The tax treatment varies depending on the source of income, and trustees should maintain accurate records for reporting purposes.

Summary

Life Interest Trusts can provide a flexible and protective estate-planning option for those wishing to safeguard capital while providing support for loved ones. They offer clarity, control, and effective tax planning opportunities. Proper drafting and experienced trusteeship are essential to ensure the trust operates smoothly and achieves the Testator's long-term objectives.

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