Putting Your Protection Policy in Trust

A plain-English guide to discretionary trusts

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1. About this guide

This guide explains, in plain English, what a discretionary trust is and how it can be used to hold a life insurance or protection policy. It is intended as general information to help you understand your options. It is not legal or tax advice, and it does not replace a conversation with a qualified adviser.

Trusts are normally set up using the trust deed provided by your insurer, so the exact wording, options and claims process will follow that provider's own documents. Where this guide and your provider's trust documents differ, your provider's documents apply. We will always talk you through the specific trust that suits your policy and circumstances.

> *The tax information in this guide is based on our understanding of UK law and HMRC practice as at August 2026, using 2025/26 tax-year figures. Tax rules can change, and how they affect you depends on your individual circumstances.*

2. What is a discretionary trust?

A discretionary trust is a legal arrangement that lets the owner of a policy (the settlor) place it into the care of a small group of people they trust (the trustees). The trustees look after the policy and, at the right time, decide how any money paid out is shared among a group of potential recipients (the beneficiaries) chosen by the settlor.

The word "discretionary" refers to the flexibility the trustees have: within the rules of the trust, they decide which beneficiaries receive money, how much, and when. A policy held this way is said to be "in trust". The policy, together with any money it pays out, is known as the trust fund.

3. Why put a protection policy in trust?

Placing a policy in trust is straightforward and, for many people, brings real practical and financial benefits.

3.1 Inheritance Tax efficiency

Money paid out from a policy held in trust generally falls outside your estate, so it is not usually counted when Inheritance Tax is worked out on your death. This can help reduce or avoid an Inheritance Tax bill on the payout. There are some limited situations in which a trust can create its own Inheritance Tax charges — these are explained in section 8.

3.2 A faster payout

When someone dies, their personal representatives usually need to obtain probate before they can deal with the estate, which takes time — longer still if there is no will. Because the trustees already legally own a policy held in trust, they can normally claim and pay out without waiting for probate, getting money to the right people more quickly.

3.3 Control over who benefits

A trust lets you signal who you would like to benefit and allows the trustees to control when money is paid out. For example, it can make sure children are supported without handing them a large sum before they are ready to manage it.

4. Who is involved?

4.1 The settlor

The settlor is the person who places their policy into trust. Once they have done so they no longer personally own the policy and have only limited say over it, although they usually continue to pay the premiums and are normally one of the trustees. A policy in joint names can have joint settlors. The settlor chooses the trustees and the potential beneficiaries, and can leave the trustees informal guidance through a letter of wishes.

4.2 The trustees

The trustees take legal ownership of the policy from the settlor and look after it. After a valid claim they arrange payment to the beneficiaries. They can decide which beneficiaries benefit and when, but must always act in the beneficiaries' best interests and only within what the trust allows.

4.3 The beneficiaries

The beneficiaries are the people who may receive money from the trust. They are described in the trust, but no one is guaranteed to receive anything — that is for the trustees to decide.

5. The key documents

Three documents usually matter:

- **The trust deed —** the legal document that creates the trust. The settlor and trustees sign it. It names everyone involved, sets out their roles, and identifies the policy being placed in trust. The trustees must act within it.
- **The letter of wishes —** an informal, non-binding note from the settlor explaining how they would like the trust fund used. Trustees do not have to follow it, but usually find it a helpful guide.
- **The policy documents —** the paperwork for the policy itself, which forms the trust fund.

The trust deed is normally the one supplied by your insurer for use with their policies. We will make sure the right deed is used for your plan.

6. Setting up the trust

Setting up a trust is usually a case of completing your insurer's trust deed alongside your policy — for a new policy or, in many cases, an existing one. Some policies are not suitable for a personal discretionary trust, including business protection arrangements such as key person or shareholder cover, relevant life plans, and certain pension-related plans. We will tell you if that applies to yours.

6.1 Choosing your trustees

You can usually appoint almost anyone aged 18 or over and of sound mind, and you can normally be a trustee yourself. It is sensible to have at least two trustees besides yourself, so the trust can keep running if something happens to one of them. Trustees are often family members or friends the settlor trusts; professional trustees such as solicitors can also act, though they will charge. You can usually add further trustees later.

6.2 Critical and terminal illness benefits

If your policy also pays out on critical or terminal illness, a discretionary trust will normally let you keep those particular benefits for yourself — so you can use the money while you are alive — while the death benefit is held in trust. Your provider's trust deed will set out how to choose this, and we will explain the options for your policy.

7. Being a trustee

Being a trustee is an important responsibility, but for a policy held in trust there is usually little to do until a claim is made. Trustees must understand the terms of the trust, keep to them and to the law, act honestly and in the beneficiaries' best interests, keep basic records, and make sure any tax the trust owes is paid. They do not need to be experts in trust law and can take professional advice if needed. If premiums stop being paid the trustees are not obliged to pay them, and the trust comes to an end if the policy lapses with no value.

8. Inheritance Tax in outline

A policy held in a discretionary trust is usually outside your estate, but discretionary trusts have their own Inheritance Tax rules, and in some situations a charge can arise. The main points are set out below, using 2025/26 figures. This is a general outline only — please speak to us or a tax adviser about your own position.

8.1 Placing the policy in trust

Placing a policy in trust is a gift for Inheritance Tax, but a charge rarely applies in practice. A life policy with no cash-in value usually has little or no value for tax purposes while the person insured is in good health. In addition, everyone has an annual gift exemption of £3,000 (any unused amount can be carried forward one year), and regular premiums paid from surplus income can often be exempt as "normal expenditure out of income". A charge would generally only arise if the value gifted, added to other chargeable gifts in the previous seven years, exceeded the nil-rate band (currently £325,000); tax would then be due on the excess at the lifetime rate of 20% (or 25% if you, rather than the trustees, pay it). Some policies, such as whole-of-life plans, can carry a higher value for this purpose.

8.2 The ten-year charge

Discretionary trusts are reviewed for Inheritance Tax on each ten-year anniversary. Before any claim, the policy usually has little or no value while the insured person is in good health, so there is typically nothing to charge. Where a charge does apply, it is on the value above the trust's available nil-rate band, at a maximum rate of 6%.

8.3 Payments out of the trust

A charge can also arise when money leaves the trust — for example, when trustees pay a claim to a beneficiary — but usually only if a charge applied at the last ten-year anniversary or when the trust started. Again, the maximum rate is 6%, applied only to value above the available nil-rate band.

8.4 If you die within seven years

If you die within seven years of making a chargeable gift into the trust, that gift is reassessed against the nil-rate band as at the date of death; any excess is taxed at up to 40%, reduced by taper relief for gifts made more than three years before death, and less any lifetime tax already paid. Chargeable gifts made in the seven years before death also reduce the nil-rate band available to your estate.

8.5 Exemptions that often apply

- The £3,000 annual gift exemption, with one year's carry-forward.
- Normal expenditure out of income, where regular premiums come from your income and do not affect your standard of living.
- The nil-rate band of £325,000, currently frozen until at least April 2030.

A reduced Inheritance Tax rate of 36% (instead of 40%) can also apply to an estate where 10% or more of the net estate is left to charity.

> *Illustrative example: Priya takes out a £250,000 life insurance policy with a monthly premium of £120 and places it in a discretionary trust so the payout does not form part of her estate. As she is in good health, the policy has negligible value when the trust is created, and her premiums fall well within the £3,000 annual gift exemption. There is no entry charge, and while she remains in good health the ten-year anniversaries pass with nothing to charge.*

9. How TopQuote can help

We can talk you through whether placing your policy in trust is right for you, help you choose suitable trustees, and make sure the correct trust deed is completed alongside your policy. If you would like to discuss this, please get in touch:

- **Phone:** 0161 974 3710 (Monday to Friday, 8:30am–5:00pm)
- **Email:** hello@topquote.uk.com
- **Post:** Alderley Park, Suite 3, Glasshouse, Congleton Road, Macclesfield, SK10 4TG

10. Glossary

Some of the terms used in this guide are explained below.

Term	What it means
Annual gift exemption	The amount you can give away each tax year (currently £3,000) without it counting for Inheritance Tax. Any unused part can be carried forward one year.
Beneficiary	A person who may receive money from the trust. Beneficiaries are described in the trust, but none is guaranteed to receive anything.
Chargeable lifetime transfer	A gift made during your lifetime (that is not otherwise exempt), for example into a discretionary trust, which may count towards Inheritance Tax.
Estate	Everything you own — property, savings, investments and possessions — less what you owe, valued on your death.
Inheritance Tax	A tax that may be payable on the value of your estate when you die, and on certain lifetime and trust-related transfers.
Letter of wishes	An informal, non-binding note from the settlor guiding the trustees on how they would like the trust fund used.
Nil-rate band	The amount of an estate that is taxed at 0% for Inheritance Tax (currently £325,000).
Potentially exempt transfer	A lifetime gift to an individual (or certain trusts) that becomes free of Inheritance Tax if you survive seven years.
Probate	The legal authority given to your personal representatives to deal with your estate after you die.
Settlor	The person (or people) who places a policy into the trust.
Taper relief	A reduction in the Inheritance Tax payable on a gift where you die between three and seven years after making it.
Trust deed	The legal document that creates the trust, signed by the settlor and trustees, setting out the roles and the policy held.
Trustee	A person who legally owns and looks after the trust fund and decides how it is shared among the beneficiaries.

Version & update history

Version	Date	Details of update	Author	Approved by
1.0	27/08/2026	New document — first published version.	TopQuote	James, Principal