

Flexible Life Interest Trust (FLIT)

Flexible Life Interest Trusts (FLITs) are sometimes described as “the ideal modern family trust.” The reason for this is because it allows a person to benefit immediately on the death of the testator while at the same time protecting the assets for others i.e. the children.

A FLIT arises when a beneficiary, normally a surviving spouse, is given a life interest in the assets contained in the estate. The trustees have the power to pay income and often capital to the life tenant. While the life tenant is alive, the trust is treated as an interest in possession trust. However, on the death of the life tenant, the trust automatically turns into a discretionary trust and is therefore treated as a relevant property trust.

These types of trusts are therefore very flexible and ideal where the testator wants to provide for their surviving spouse during their lifetime whilst offering ongoing protection of trust assets for the other beneficiaries, up to a period of 125 years.

How does a FLIT work?

On the death of the testator, the residue of the estate is put into trust. The life tenant will be entitled to receive all income of the trust during their lifetime and will be treated as the main beneficiary. Trustees will still have discretion with regards to capital which can be given absolutely or loaned to the life tenant.

It is important to add that the flexibility of giving or lending capital does not extend to just the life tenant but the other beneficiaries also. For example, the trustees could exercise their discretion to use some of the trust funds to pay off a child's mortgage if they request this.

As we have illustrated, given the flexibility with this type of trust, where the testator would like the trust funds to be distributed in a certain way or have concerns that they would like their trustees to be aware of, this should be set out in a letter of wishes.

Advantages of a FLIT

- Ideal for protecting the assets of the estate on first death but also on second death as the trust turns into a discretionary trust and can therefore has the ability to benefit future generations.
- Protects the estate in the event the surviving spouse goes into care or bankrupt as the assets are owned by the trust and not the surviving spouse. The trust also protects the assets from passing to a new spouse by either being gifted to them, as part of divorce proceedings or being left to the new spouse by Will or intestacy.
- The assets are protected for the benefit of the other beneficiaries from third party claims similar to that mentioned above as the trust turns into a discretionary trust and therefore the assets still belong to the trust and not the individual beneficiaries.
- Where IHT is an issue for some beneficiaries, the trustees have the ability to loan the money to the beneficiary so it does not have any effect on the size of their own estate.
- No anniversary or exit charges apply during the lifetime of the life tenant and therefore the life tenant can make gifts during their lifetime to reduce IHT payable.
- The FLIT allows for the trustees to convert some or all of the trust fund into another type of trust. So if IHT laws change in the future, the trustees can change how the fund is held. The trustees could choose to end the trust early and distribute the assets to the beneficiaries if they wish to.

Disadvantages of a FLIT

The main disadvantage of a FLIT is the future IHT liability that this creates since assets in the FLIT would be treated as part of the life tenant's estate for IHT purposes.

What happens when the life tenant dies?

On the death of the life tenant, the trust will end and no longer qualify as an Immediate Post Death Interest trust. Instead, it will automatically become a discretionary trust and be treated as a relevant property trust, therefore anniversary and exit charges may apply.

How is a FLIT taxed?

Inheritance Tax

For inheritance tax (IHT) purposes, the life tenant of the trust is treated as inheriting the trust assets on the death of the testator.

If the life tenant is the deceased's surviving spouse or civil partner, the spousal exemption will apply and there will be no IHT due when the assets pass to the FLIT. This means the NRB will not be used and can be transferred to the surviving spouse so it can be used on second death.

During the life of the life tenant, no anniversary and exit charges will apply.

Whilst the life tenant is alive, the trustees and life tenant may make some gifts from the trust to other beneficiaries to mitigate IHT. It is important to add that these gifts will be considered as PETS and therefore the 7 year rule will apply for it to not form part of the life tenant's estate for IHT purposes.

On the death of the life tenant, the trust becomes a discretionary trust and is taxed with reference to the relevant property regime which means anniversary and exit charges may apply.

Availability of RNRB

Where a main residence is left to a FLIT, the RNRB will not be available as on second death, the assets pass to a discretionary trust and not to direct descendants absolutely.