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SOME PRACTICAL ASPECTS OF LIFE ASSURANCE

by

D. Munro

SOME PRACTICAL ASPECTS OF LIFE ASSURANCE

Introduction.

Many papers have been presented to the Society dealing with various aspects of Life Assurance as they affect a Life Office, e.g. mortality experience, interest earnings on the Fund, capital appreciation of the investments, taxation in its many forms etc. and how these factors influence for instance the choice of a premium basis or a valuation basis. The complex problems arising from the consideration of such aspects are of great importance and certainly deserve all the attention they have been given. I hope I will be excused if I turn my attention to another aspect of life assurance, namely the aspect of life assurance as considered from the man in the street, the policyholder. In particular, I wish to consider how the policyholder's own financial position and the incidence of Estate Duty and Income Tax influence his decision whether to effect an assurance contract or make other provision to meet his requirements. As these factors do have a great influence I propose to consider Estate Duty and Income Tax Relief on life assurance Premiums in some detail.

Acknowledgement.

This paper is based on a series of lectures prepared by the author and his ex-colleague, Mr. I. M. Graham, M.A., L.L.B., and the author is greatly indebted to Mr. Graham on whose researches and method of presentation Part I of the paper dealing with Estate Duty is largely based.

PART I

Estate Duty Fundamentals

(1) Estate Duty was, of course, first introduced by the Finance Act 1894 and this Act still forms the basis of most claims paid to-day.

(2) We are principally concerned only with three sections of the Act, i.e. Sections 1, 2 and 4. These Sections form the basic tools of the trade and an understanding of them is essential and are shown in Appendix A.

(3) Section 1 provided quite simply for Estate Duty to be payable on all the property which passes on the death of a person on the principal value, i.e. in general, the market value at the date of death. Section 1, therefore, levies duty on property passing which in fact means all property which the deceased owns in the normal way and includes settled property which passes on his death.

(4) Examples of property dutiable under Section 1 (i.e. property passing):-

(a) an ordinary policy payable to the deceased Life Assured;

(b) a joint annuity purchased by the deceased, the other annuitant surviving the deceased; and

(c) a settled liferent previously payable to the deceased.

(5) The next section we are concerned with is Section 2 and sub-section (1) is divided into four parts as far as we are concerned and deems certain property to pass so that property described in Section 2 is charged with Estate Duty just as though it actually passed under Section 1 on the death of the deceased. The first of these four parts, i.e. Section 2(1)(a) deals with property of which the deceased was, at the time of his death, competent to dispose.

(6) Example of property dutiable under Section 2(1)(a) (i.e. property of which the deceased is competent to dispose) - the Sum Assured under a group life assurance scheme if payable to Member's estate as of right.

(7) The second part, Section 2(1)(b), deals with an interest ceasing on the death of a deceased person to the extent to which a benefit accrues.

(8) Example of property dutiable under Section 2(1)(b) (i.e. an interest ceasing on death) - an annuity under a settlement payable to the deceased.

(9) The third part, Section 2(1)(c), is for our purposes very much more important than the two preceding parts and indirectly brings gifts and settlements into charge. The application of the section is in the first instance quite straightforward and makes dutiable any gift or settlement made by a person within five years of his death.

(10) Example of property dutiable under Section 2(1)(c), (i.e. property gifted) - any policy gifted or settled as for example any "Act" policy.

(11) The fourth part, Section 2(1)(d), deals with an annuity or policy purchased by a deceased to the extent of the beneficial interest accruing on death.

(12) Examples of property dutiable under Section 2(1)(d), (i.e. an interest arising on death) - Act policies where the entitlement of a beneficiary is dependent on survival and only becomes a vested interest on the death of the assured.

(13) /

(13) The third section we are concerned with is Section 4 and this provides that for the purposes of determining the rate of duty, property will be aggregated. Now the rate of duty is, in the first instance, governed by a sliding scale heavily weighted against large estates and one has, of course, to apply this scale to the aggregated value of all property passing including property deemed to pass. Thus, for example, to determine the rate of duty all such property as cash investments, the deceased's house, his personal effects and policies require to be valued and the various values aggregated. The section, however, includes a provision which is extremely important. This proviso provides that property which passes on death and in which the deceased never had an interest will not be so aggregated but will be treated as an estate by itself. An "Act" policy, for example, does not normally fall to be aggregated.

(14) To summarise, therefore, so far Estate Duty is chargeable

(i) on property passing on death;

(ii) on property of which the deceased was competent to dispose;

(iii) on an interest ceasing on death;

(iv) on a gift or settlement made within five years of death; and

(v) on an interest arising on death.

Further, the value of all property is aggregated together except in respect of property in which the deceased never had an interest.

Married Women's Property Act, 1882.

(1) General

Under Section 11 of the Married Women's Property Act 1882, shown in Appendix B, a man can effect a policy for the benefit of his wife or children or a woman can effect a policy for the benefit of her husband or children. The original intention of the Section was, by means of the creation of a statutory trust, to give the beneficiaries protection against the creditors of the assured in the event of bankruptcy provided the policy was not effected with the intention to defraud the creditors of the assured.

When the Act was passed, and for many years after, Death Duties were not so onerous and it was only in more recent times that policies effected under the Act have been used as a device to reduce the amount of Estate Duty payable on the death of the assured. This is achieved by writing the policy in such a way that the assured has no interest in the policy which thus forms a separate estate for Estate Duty purposes on the death of the assured. It should be noted that this non-aggregation for Estate Duty purposes is a result not of any wording in Section 11 of the Married Women's Property Act 1882, but by Section 4 of the Finance Act 1894.

(2) Non-Aggregation

As we have already seen, property in which a deceased person never had an interest will be treated as non-aggregable, i.e. as an estate by itself. The estate duty advantage of an Act policy does, of course, largely arise because it falls to be treated as an estate by itself provided, of course, the policy is properly written. It is not sufficient that the deceased did not as it happened have an interest; it must also be the case that whatever the circumstances might have been he could not have had an interest.

Thus /

(2) Non-Aggregation, cont'd.

Thus, a policy for the benefit "absolutely and indefeasibly of my wife, Jean Smith" is clearly one in which the deceased never had nor could have had an interest. If the assured's wife predeceases him, the sum assured is, of course, payable to his wife's estate. Note that it does not affect non-aggregation that the husband could or does in fact benefit from his wife's estate for such a benefit arises not out of the policy but from the wife's Will or out of the law of intestacy. If the policy does in fact pass to the assured out of his wife's estate it will then, of course, be aggregable on his death. If, however, the policy passes to someone else it probably remains effective as an Act policy irrespective of the relationship of that person to the life assured or even if there is no relationship at all.

Contrast the case of a policy for the benefit of a named wife with one for the benefit of "such of my sons A, B and C as shall survive me". Such a policy is clearly aggregable since if all the named children predecease the life assured there will arise under the policy a resulting trust in favour of the life assured. The policy will be aggregable irrespective of whether or not any of the named childred do in fact survive the life assured.

The point, of course, is that the destinations in the policy must be exhaustive and certain if the policy is to be non-aggregable.

(3) Non-Aggregation where several beneficiaries and policies - limited aggregation.

So far it has been assumed that (i) the Act policy is for the benefit of one person only and (ii) the life assured has effected one policy only.

Now where a policy is for the benefit of several persons and their share is determined on or before the death of the life assured, the share of each beneficiary will form an estate by itself. Where there are several Act policies effected by the deceased the shares of each beneficiary under each of the policies will be aggregated together so that there will be as many estates by themselves as there are beneficiaries.

Suppose therefore a life assured has effected -

(i) Policy A for the benefit of X with a sum assured of £10,000,

(ii) Policy B for the benefit of X and Y equally with a sum assured of £15,000.

Because there are two beneficiaries X and Y, there will be two estates by themselves. Y's estate will consist of his interest under policy B, i.e. £7,500 and X's estate will consist of his interest under both policies, i.e. £10,000 under policy A and £7,500 under policy B equal to £17,500.

If in the example just given policy B had been written for the benefit of X and Y not in equal shares but at, say, the discretion of trustees or their interest arose on their attaining age 21 and they had not attained that age on the death of the life assured, i.e. in general the shares of the beneficiaries X and Y were not determinable on or before the death of the life assured, the rate of duty payable on X's and Y's shares under policy B would be determined by the value of all Act policies effected by the deceased, i.e. duty would be payable at the rate applicable to £10,000 + £15,000 = £25,000.

It /

(3) Non-Aggregation where several beneficiaries and policies - limited aggregation, (cont'd.)

It should be noted that however extensive is the effect of limited aggregation, it does not involve aggregation with the assured's free estate, or alter the rate of duty payable on a beneficiary's share which has been determined on or before the death of the life assured.

(4) Basis of Claim for Duty

If estate duty is payable under an Act Policy, it will be so because the policy (a) constitutes a gift and/or (b) represents an interest arising on death. If the policy is dutiable as both, then duty can be claimed by the Estate Duty Office on one basis only. If the amount of the claims differs the Estate Duty Office will claim the higher amount and this will arise in respect of the policy as an interest arising on death.

(5) Gifts

(a) This is the most common basis of claim for duty. We will refer in this section to "the sum assured" but where there are several beneficiaries involved then a reference to each beneficiary's share will require to be substituted.

(b) The payment of a premium under an Act policy is treated as a gift or part of the sum assured so that as with gifts generally only those made in the five years before the donor's death are subject to duty and the value of the gift of those parts of the sum assured made more than two, three and four years before death is subject to certain percentage reductions. The position in detail is as follows:-

(i) Duty is payable in the first place on the proportion of the sum assured attributable to premiums paid in the five years before death. Thus if the sum assured is £10,000 and 8 annual premiums have been paid, the value of the policy for duty purposes is $\frac{5}{8}$ x £10,000. Thus the proportion of the sum assured attributable to premiums paid more than five years before the death of the life assured is not taken into account. The reduced value will therefor come about as soon as the policy has been in force for five years. This proportionate reduction was introduced by Section 34, Finance Act 1959.

(ii) A further reduction is however available. The value of that part of the sum assured attributable to premiums paid in the 3rd, 4th and 5th years before death is reduced by 15%, 30% and 60%. These percentage reductions were introduced by Section 64, Finance Act 1960.

Thus again assume a sum assured of £10,000 and 8 annual premiums to have been paid; the value of each part of the sum assured attributable to each premium will be reduced as regards the 3rd, 4th and 5th premiums paid before death by the above percentages. The value as regards the last five premiums, the only ones we are interested in, will therefore be as follows:-

	last	premium	-	100%	of	$\frac{1}{8}$th	of	£10,000
2nd	"	"	-	100%	"	"	"	"
3rd	"	"	-	85%	"	"	"	"
4th	"	"	-	70%	"	"	"	"
5th	"	"	-	40%	"	"	"	"

The reduction will therefore become available as soon as the policy has been in force for two years.

(c) /

(5) Gifts, cont'd.

(c) After five years have passed, the value for duty purposes can be found by multiplying the sum assured by $\frac{3.95}{n}$ where 'n' is the number of annual premiums paid.

(6) Exemptions

(a) There are four exemptions from duty on a policy as a gift and a policy to which any one or more of the exemptions applies will be exempt from duty. The exemptions are -

(i) the £5,000 limit;

(ii) the £500 limit;

(iii) the normal and reasonable expenditure rule; and

(iv) the in consideration of marriage exemption.

(i) £5,000 Limit

Since, in accordance with the current scale of duty, no duty is payable where an estate is valued at under £5,000, no duty will be payable under a policy on a benefit payable to a person entitled thereto on or before the death of the life assured where that benefit together with all other similar non-aggregable benefits for the same person amounts to less than £5,000, i.e. an estate by itself of less than £5,000 will not be dutiable.

(ii) £500 Limit

Where gifts, whether aggregable or non-aggregable, made by a deceased within five years of his death to a particular donee total less than £500 in value the gifts are exempt from duty. An Act policy, of course, forms a gift to which the £500 limit applies and a special method of calculating the value of a policy for the purposes of this limit is provided by statute. A rough guide to such is normally in practice sufficient. If, therefore, the premiums paid in the five years before the death of the life assured together with other gifts in favour of the particular donee do not substantially exceed £500, the exemption will normally apply. For the purposes of this rough guide, the amount of the sum assured is irrelevant.

A simple case would be of an Act policy in favour of the assured's daughter with annual premiums of, say, £25. The total amount of premiums paid in the five years before the death of the life assured would, assuming the policy had been in force for at least that period, amount to £125, so that as long as any other gifts by the life assured in favour of his daughter made in the five years before his death did not exceed or substantially exceed £500 - £125, i.e. £375, the policy and incidentally the gifts also would not be subject to duty.

It must, of course, be kept in mind that if the rule is found not to apply, the policy must be valued in the normal way.

(iii) Normal and Reasonable Expenditure Rule

Where the premiums paid by the deceased can be said to be part of his normal and reasonable expenditure, the policy will not be subject to duty. Each case is treated on its merits by the Estate Duty Office and while the exemption can be mentioned to persons proposing it must on no account be stated that the exemption will apply in any particular case. Once again, the amount of the sum assured is not relevant.

"1882 Act", cont'd.

(iv) In consideration of marriage exemption

A policy effected under the Act (or otherwise gifted or settled) in consideration of a marriage is completely exempt from duty irrespective of the amounts of the sum assured and premiums. The beneficiary must be one of the prospective spouses and/or the children of the marriage to be. (The policy need not be under the Act; any trusts are sufficient as also is the gifting of an existing policy by assignment.) The policy must be effected before the marriage takes place. The policy will also either require to be assigned or effected in trust in such a way that the assured retains no interest in it.

The above four exemptions are important since obviously one or other of them will in many cases completely exempt an Act policy from duty.

It should be noted that although the £5,000 limit applies to all Act policies, the £500 limit, the normal and reasonable expenditure rule and the in consideration of marriage exemption will apply only where duty is claimed on the policy as a gift and not where duty is claimed on the policy as an interest arising on death nor, of course, where the policy actually passes on the death (i.e. is dutiable under Section 1).

(7) Policy as an interest arising on death

An Act policy is dutiable as an interest arising on death where the interest of the beneficiaries becomes vested by surviving the date of the death of the life assured or some other event which in fact does not occur until after the death of the life assured.

Clearly, if a policy is for the absolute benefit of A, no benefit arises on death since A's entitlement arises as soon as the policy was effected. The same applies if for the benefit of named children in equal shares absolutely. Each child in this case will be entitled even if he predeceases his father. In policies of this type, therefore, duty cannot be claimed as an interest arising on death. If, however, a policy is for such of his children as are alive on the death of the assured or if none of the children be alive then to the estate of the last survivor of the children, none of the children will have a vested interest (but see Kilpatrick Case) during the lifetime of the assured and the policy be dutiable and Section 2(1)(d) as an interest arising on death.

Whether or not duty can be claimed as an interest arising on death is important in that as already stated a policy so dutiable is not subject to the proportionate and percentage reductions and the £500 limit, the normal and reasonable expenditure rule and the in consideration of marriage exemption do not apply.

(8) The Kilpatrick Case

(Re Kilpatrick's Policies Trusts. Kilpatrick and another v. I.R. Commissioners (1966) 2 All. E.R. 149)

As a result of the above case which was decided by the Court of Appeal, Section 2(1)(d) of the Finance Act 1894 will have limited application as regards Act and other trust policies which are subject to the law of England and Wales.

The case concerned a number of policies written under the Married Women's Property Act 1882 for the benefit of the Life Assured's wife if she should survive him for a period of one month and otherwise for the benefit of his two sons in equal shares. The Life Assured died and his wife duly survived him for the required period. The Estate Duty Office claimed duty under the Finance Act 1894, Section 2(1)(d) on the basis of an interest arising at a date referable to death. The claim for duty was quite conventional and expected and arose on the basis that until the survival actually /

(8) The Kilpatrick Case (cont'd.)

actually occurred one could not know who was to receive the benefit under the policy, i.e. that the interest arose on death or at a date referable to death.

However, the claim by the Estate Duty Office on this basis was disputed and it was argued that no interest arose on death or at a date referable to death because the policy vested in Mrs. Kilpatrick at the date each policy was effected though the vesting was subject to her being divested if she failed to survive. It will be appreciated that if the vesting of the policy in Mrs. Kilpatrick was delayed until she survived then Section 2(1)(d) would apply but if vesting occurred when the policy was effected then Section 2(1)(d) could not apply. The Court held that the policy vested in her at the earlier date so that the claim of the Estate Duty Office was lost.

As a result of this decision any policy effected by the assured in trust and subject to English Law in which the assured never had an interest will on the death of the life assured be subject to Estate Duty under Section 2(1)(c) and not Section 2(1)(d) with normally a significant saving in Estate Duty where it can be shown that the beneficiary or beneficiaries had at the date of death a vested interest in the policy even although it may have been subject to defeasance in the event of some contingency which might have occurred before the date of death of the life assured, e.g. a policy for the benefit of a named wife whom failing for the absolute benefit of named children A, B, C in equal shares will be dutiable under Section 2(1)(c) on the death of the life assured whether the sum is payable to the wife or to the children or their estates, but a policy for the benefit of a named wife whom failing for the benefit in equal shares of such of the children of the assured who are alive at the date of death of the assured or if there be no children alive, then for the benefit of the estate of the survivor of the wife and children will be dutiable under Section 2(1)(c) in the event of the assured predeceasing the named wife but will be dutiable under Section 2(1)(d) if the wife predeceases the assured as any child or children will not have a vested interest until the death of the life assured. In many cases the decision will depend on the wording in the policy and, therefore, care should be taken to ensure that the beneficiaries are given an interest which will vest before the death of the life assured. It should be noted that where a beneficiary who has a vested interest in a policy predeceases the assured the value of the interest in the policy at the date of death of the beneficiary will form part of his or her Estate for Estate Duty purposes.

The Kilpatrick case decision does not hold in Scotland.

Married Women's Policies of Assurance (Scotland) Act 1880.

(1) Comparison with the English Act

The Married Women's Property Act 1882 is an English Act and would not govern any contract or trust subject to Scots Law. However, it is possible to effect a policy which is to be subject to Scots Law under the provisions of the Married Women's Policies of Assurance (Scotland) Act 1880, shown in Appendix C, which will have broadly the same effect as the English Act.

There are differences between the English and the Scottish Acts. Under the English Act any person, male or female, married or single, can effect a policy for the benefit of the wife or husband, or children whereas under the Scottish Act only a married man can effect a policy for the benefit of his wife or children. A married woman or a single person cannot effect a policy in terms of the Scottish Act for another's benefit.

There /

"1880 Act", cont'd.

(1) Comparison with the English Act.

There is also a difference between the Acts regarding the protection against creditors in bankruptcy. Under the Scottish Act there is no protection against creditors in the event of bankruptcy within two years.

If a policy is effected under the Scottish Act the interpretation of the policy and in particular the nature of any trust created by the policy will be governed by Scots Law which differs in many respects from English Law and can give rise to different treatment for Estate Duty purposes (see following section).

(2) Estate Duty Position.

Taxation Statutes are imperial and apply both in England and Scotland and the same interpretation is given to these Statutes in both countries. On a point of law arising in connection with these Statutes the Scottish Courts will give respect to a decision by the English Courts and vice versa. Clearly an impossible position would arise if the principles of taxation were to differ in each country. Thus under similar situations the same amount of tax will be levied.

The nature of any trust created by a Policy governed by the 1880 Act will be decided by Scots Law and thus the interests of the beneficiaries under such a trust may well differ from the interests of the beneficiaries under a similar policy effected under the 1882 Act.

In particular, the decision in the Kilpatrick case does not apply to Scotland. The reason why it does not apply to Scotland is not because of any difference in the interpretation of Section 2(1)(c) or 2(1)(d) between England and Scotland, but because of the difference under Scots and English Law on when an interest of a beneficiary vests. In the Kilpatrick case it was decided that the interest of the beneficiaries vested before the date of death of the life assured and thus there was no liability under Section 2(1)(d). The position under Scots Law is more obscure but it would appear the interest of the beneficiaries in similar circumstances would vest, if at all, on the death of the assured and thus there would be a liability under Section 2(1)(d). The position in fact may be worse as it is held by some authorities that there would be no vesting in the beneficiaries in such circumstances and the policy would revert to the assured and form part of his estate.

Until the position has been clarified it is probably preferable except in straight forward cases where the intended beneficiaries have an absolute and indefeasable interest in the policy from the outset that the policy should be issued subject to English Law and written under the 1882 Act. Where a married woman is effecting a policy for the benefit of her children it would require in any event to be issued under the English Act.

Non-Act Trust Policies

(1) This type of policy is, of course, used where it is desired to write a policy subject to trusts and it is not possible to write it under "the Act". There are various ways of writing such policies so as to be non-aggregable. One or two of these methods are not free from doubt as to their effectiveness but one can be reasonably sure that the two methods normally recommended will achieve non-aggregation. These methods are -

(a) the trust addendum method under English Law; and

(b) the formal deed method under Scots Law.

(2) Method (a) is, of course, the simpler of the two and only a special addendum to the proposal form is required. Although English Law will apply to the trust and the policy this method can be used by Scottish branches of a Life Office. Where the destination of the benefit is simple an office will normally be able to supply a suitable addenda on receipt of full information but if complex the proposer requires to consult his solicitors. The addendum is stamped at 10/-. The addendum must be stamped within thirty days of its date. It must, of course, be properly completed and signed before the proposal is accepted and the premium paid.

In terms of this method, the proposer appoints himself initially as sole trustee. When the policy is issued, however, he can appoint other persons as trustees either remaining a trustee himself or resigning. "Probate delay" is, of course, involved on his death if he remains the sole trustee. Specimen deeds of appointment can again be supplied normally by the Life Office.

(3) Method (b) certainly necessitates that the proposer consults his solicitors to draw the necessary deed, a specimen of which may be supplied by the Office. In terms of the deed, the proposer appoints others (not himself) as trustees and the deed is followed by a minute of acceptance by the trustees. The proposal form with special additions is then completed and signed by the proposer and a special acceptance letter issued. The policy is delivered to a named trustee, never the proposer.

The deed is stamped at 10/-, the stamping normally being arranged by the proposer's solicitors.

The position under Scots Law regarding vesting of the policy in the trustees or the policy being effective is not absolutely clear and again, where possible, it is recommended that the policy be effected subject to English Law and method (a) adopted.

(4) The determination of Estate Duty liability in respect of non-Act trust policies is as for Act policies. Where the destinations are complex, care must be taken to ensure that they are certain and exhaustive.

Life of Another Policies as an alternative to an Act Policy

As we have seen, an Act policy by virtue of it being non-aggregable, has a considerable Estate Duty advantage. Further, such a policy is often completely non-dutiable as a result of one or other of the exemptions applying.

However, an Act policy is not always the best answer and in many cases a life of another policy is more advantageous.

A simple case of this occurs where a husband would normally effect an Act Policy on his own life for the benefit of his wife absolutely. Such a policy will, of course, at worst be non-aggregable and may be non-duitable. If, however, instead of the policy being effected in this way, it were effected by the wife on her husband's life, there would never be any question of the policy being dutiable on the husband's death. If the wife predeceased her husband, then duty would be payable on her death on the then market value of the policy but this would be the case anyway if the policy were effected under the Act.

The question arises, of course, as to payment of premiums. If the wife can meet these out of funds of her own, then she will no doubt do so. If, however, such funds are not available, her husband can make cash gifts to her equal to the premiums and these gifts she uses, of course, to pay the premiums. It is probably preferable for this to be done than for the premiums to be paid by the husband direct to ourselves.

In any event, the cash will be dutiable on an aggregable basis as a gift to the wife to the extent gifted within five years of her husband's death, although it may be exempt under the £500 limit or as a result of the normal and reasonable expenditure rule and, of course, the percentage reductions of the Finance Act 1960 will apply.

It will be noted in respect of the husband's death that under an Act policy duty is payable (if at all) on the policy on a non-aggregable basis and never on the premiums while under a life of another policy, duty is payable (if at all) on the amount of the premiums on an aggregable basis and never on the policy.

Let us consider a policy for a sum assured which is substantial. Now, if the policy is written under the Act, the maximum amount of duty will be payable if the life assured dies before the percentage reductions of the Finance Act 1960 apply, i.e. before two years have elapsed. Thereafter, as the further percentage reductions apply and as the proportionate reductions come into force, the amount of duty for which the policy can be liable will reduce gradually as its value for Estate Duty purposes decreases. Eventually in many cases under a whole of life policy the value will reduce to under £5,000 so that if that is the only Act policy which has been effected for that beneficiary no duty will be payable.

Contrast, now, the different liability of a life of another policy in relation to the duty payable on the premiums assuming these have all been gifted by the life assured. As each of the first five premiums is paid, the liability to duty increases because the amount gifted increases (although after two years the percentage reduction will apply). When five premiums have been paid the amount of duty on them reaches a maximum and remains at that level during the currency of the policy.

(It is assumed that premiums are payable annually).

If the Act policy, therefore, is effected the amount of the duty liability thereon will gradually decrease while if a life of another policy is effected and the premiums are gifted, the liability on the premiums will increase during the first five years and thereafter remain at the maximum level.

The advantage of a life of another policy is, of course, that, in many cases, the actual amount of duty payable under the policy if written under the Act is at its maximum much greater than the actual maximum amount of duty payable on gifted premiums under a life of another policy. This, of course, is the case because a premium is normally a very small fraction of a sum assured.

Consider /

Life of Another (contd).

Consider a normal whole life without profits policy for £20,000 with annual premiums of £400 payable throughout life. Assume that the policy is for one beneficiary absolutely and that no other Act policies have been effected. The liability of the Act policy can be compared with the liability of the premiums under a similar life of another policy (where the amount of the premiums is gifted) as follows -

	Liability	
Year of Assurance	Act Policy (on Sum Assured)	Life of Another Policy (on premiums) (Assuming a "free" estate of £20,000)
1	£2,400	£ 48
2	2,400	96
3	1,899	136
4	1,725	165
5	1,580	189
10	316	189
15	51	189
20	0	189
25	0	189

As will be seen from the above table, the value of the sum assured reduces below £5,000 after 16 years so that thereafter the policy is free of liability. The liability on the life of another policy, assuming a "free" estate of £20,000 remains constant at £189 after the fourth year and it can be calculated that under the Act policy the duty in the 11th year is £215 and in the 12th £134. The Act policy, therefore becomes more advantageous after the 11th year.

Which type of policy is selected, therefore, depends on whether the husband is prepared to meet in the later years an inevitable amount of £189 or to risk a much more substantial liability if death occurs in the early years. The life of another basis would, no doubt, be selected.

One can contrast this whole life assurance with an Endowment Assurance for the same sum assured 10 year term with a premium of, say £10%, i.e. of £2,000 per annum. The duty, of the policy is under the Act will be as for the whole of life policy in accordance with the above table except, of course, that the term is only 10 years. The liability will, therefore, reduce from £2,400 in the first two years to £316 in the 10th year. On the other hand, assuming a free estate of, say, £40,000, the duty in the first year on the premiums if gifted would amount to £480 and after five years would remain constant at £1,896. In such a case, the Act policy would probably be preferable.

It should be noted in respect of the examples for a whole life and endowment assurance just given, that if the premiums do not require to be gifted, the life of another basis will undoubtedly be the more advantageous.

It will be clear that in many cases the comparative amounts of duty have to be calculated before a decision can be reached on which method is the more advantageous. However, it is normally advantageous to write the following types of policy on a life of another basis, always assuming that the amount of duty on an alternative Act policy is substantial -

(a) short term temporary assurances;

(b) family income benefit policies;

(c) whole life policies effected at earlier ages.

A short term endowment assurance and a whole life policy effected at a later age is a less attractive proposition to write on a life of another basis.

Overriding /

Life of Another (Contd.)

Overriding this, of course, are the considerations that if the proposer is meeting the premiums out of his or her own funds then the life of another basis will always be the more advantageous if any duty would be payable on an Act policy and the contrary case that an Act policy will often be more advantageous if the sum assured or appropriate separate estate is under £5,000 and the premiums would have to be gifted.

It must always be remembered that the situation will vary with the amount of the assured's "free" estate but that in some cases the £500 limited or the normal and reasonable expenditure rule will exempt premiums from duty.

As a general rule, however, where the assurance is for the benefit of wife absolutely, the life of another basis is the one to opt for. From the point of view of initial documentation, it is, of course, also the simpler to deal with since, of course, an addendum to the proposal form is not required.

So far we have been considering assurances on the life of a husband for the benefit of his wife. However, the relationship of the assured and the proposer is not, of course, significant as far as the assurance is concerned and the method can be applied if the proposer is a son or daughter, grandchild or of no relationship at all to the life assured, (i.e. in some cases where an Act policy could not be effected anyway and the only other alternative would be a non-Act trust) provided the proposer is over the age of 21. If, therefore, the position is that, say, the wife, son and daughter are to benefit either, three separate life of another assurances can be effected or (especially where the children are minors) one assurance can be effected by the wife who will hold a certain proportion of the sum assured unofficially for the son and daughter and she can provide in her Will for this to cover the possibility of her predeceasing her husband. Alternatively, she can split the assurance into two, one being effected in the normal way for herself and in respect of the other for the son and daughter, complete a Non-Act addendum (English Law) or a trust deed (Scots Law). It is recommended that the adoption of an addendum or trust deed only where the premium income is substantial.

By way of summary, it may be said -

(a) Under an Act Policy, duty is payable, if at all, on the policy on a non-aggregable basis and never on the premiums, while, under a life of another policy, duty is payable, if at all, on the premiums on an aggregable basis and never on the policy.

(b) From the estate duty liability point of view, whether an Act policy or a life of another policy would be the more advantageous will in some cases have to be determined by calculation but the following general rules may be stated -

  (i) if the premiums can be met out of the proposer's own funds - life of another basis;

  (ii) if the premiums would require to be gifted and the assurance is a short term temporary, a family income benefit type or a whole life effected at an early age - life of another basis; and

  (iii) if the premiums would require to be gifted and the assurance is an endowment assurance (especially if short term) or a whole life effected at a later age- probably Act basis.

(c) If Estate Duty is not at issue, the life of another basis can sometimes avoid the necessity for an addendum (whether Act or non-Act) or a trust deed.

(d) The life of another basis can be used whatever the relationship of the proposer to the assured but the proposer must be over age 21.

(e) Where there are to be several "beneficiaries", the assurance will have to be split and one or more parts may have to be held in "trust".

It /

Life of Another (Contd.)

It will be clear that the life of another basis can be extremely useful and the possibility of effecting non-dutiable policies can no doubt be a very significant selling point in the case of substantial policies of all types where the premiums do not require to be gifted and where premiums would require to be gifted in the case of temporary and family income policies and (where effected at an early age) whole life assurances.

Insurable Interest: In many cases where a life of another policy would be useful for estate duty saving purposes, there will be strictly no legal insurable interest in the life as far as the prospective effector is concerned. Nonetheless, in many such cases, offices may be prepared to issue the required policy provided there appears to be a reasonable cause for the policy being effected by the proposer, i.e. provided he can show there is a reasonable likelihood of a pecuniary loss to him on the death of the proposed life assured.

A declaration of insurable interest, either on a separate form provided for that purpose or as part of the proposal form where the form so provides, will be required in all life of another cases except where the relationship is that of husband and wife.

Annuities

(1) The Estate Duty liability of annuities can be fairly complex but some of the simpler cases can perhaps be usefully considered.

(2) Very often, the value of an annuity at the death of the effector is nil so that no duty is payable in respect of it, and this is so even if the annuity has been gifted within five years of death. Where, however, further sums remain payable or become payable on or after the death of the effector then the annuity will be subject to duty.

(3) If the payments due are payable to the effector's estate the value at the date of the effector's death will, of course, be dutiable under Section 1; if, however, the annuity was gifted or settled, it will be dutiable under Section 2(1)(c) subject to the usual five year rule.

(4) Payments can, of course, arise on or after the death of the effector if his death occurs during a guarantee period or if the annuity is on the life of another or is capital protected.

(5) The question of aggregation arises, of course, and it is possible to effect an annuity for the benefit of another under trusts either formal or by using a non-Act trust addendum so that the annuity will be non-aggregable on the death of the effector. However, the normal way of obtaining non-aggregation is by using the gift of annuity procedure which simply involves a special proposal form. The premium is, of course, paid by the effector and is not itself dutiable and the value of the annuity at the date of death of the effector is dutiable on a non-aggregable basis.

(6) The estate duty liability of a joint annuity can be complex and in practice it is preferable to split such an annuity into two parts, i.e.

(i) an immediate annuity on the life of the effector; and

(ii) a reversionary annuity on the other life.

The increase in premium can normally be regarded as negligible. The immediate annuity will not, of course, be dutiable and the reversionary only so if the effector dies within five years of effecting it. The reversionary annuity would, of course, be effected so as to be non-aggregable.

(7) A non-aggregable annuity will be subject to limited aggregation if a lump sum is payable on the death of the effector or if an annuity commences on that death.

PART II

Income Tax Relief on Life Assurance Premiums

(1) Income tax relief can normally be obtained on premiums under a policy effected by a person on his own life or the life of his wife. The relevant sections of the Income Tax Act 1952 are Sections 219 and 226. It is not proposed to quote them but the general effect is that where the total premiums eligible for relief in any year exceed £25 and do not exceed one-sixth of income, relief is granted by way of an allowance to be set against statutory income for tax purposes of two-fifths of the premiums paid, excluding any premiums paid under a policy in excess of 7% of the sum assured under the policy payable in the event of death.

No relief will be granted under policies effected by a person on the life of another person who is not his wife, nor will relief normally be granted in respect of a policy such as a deferred annuity or pure endowment where there is no capital sum on death.

(2) A Whole of Life Assurance or a Temporary Assurance provides a capital sum payable in one sum or in instalments on the death of the life assured and even ignoring the question of tax relief and estate duty saving, fills a need which cannot be met with the same facility by any other form of saving or investment. Similarly an Endowment Assurance with Profits containing both an element of life cover and an element of saving provides an investment which can compare with most other forms of regular saving again without taking into account the question of relief of income tax and capital gains tax. Indeed in many countries no tax relief is granted and Life Assurance prospers even although not perhaps on the same scale.

When, however, account is taken of the relief of tax and in certain circumstances the avoidance of estate duty, the value of a life assurance policy becomes greatly enhanced and becomes a very attractive form of contract. In recent years the Unit Trust movement have realised the benefits of income tax relief on life assurance premiums and have combined the purchase of units with various forms of life assurance and not to be outdone, many life offices have combined life assurance with the purchase of units.

(3) A sur tax payer is not generally interested in an investment which produces mainly income which will suffer tax at a high rate. He will be more interested in a low yielding investment with a high growth potential where much of the benefit will appear in the form of a capital gain. The introduction of a capital gains tax has reduced the attractiveness of this form of transaction to some extent but nevertheless at the present rates of sur tax and capital gains tax, it is still beneficial to a sur tax payer.

A short-term endowment assurance with profits offers just such a form of investment with added benefits. There is no income to suffer a high rate of tax; in effect the income is accumulated in the life fund and only suffers tax at a reduced rate. The sum assured at maturity is normally free of capital gains tax. The life office will have suffered corporation tax on any realized capital profit in respect of the underlying investments and this will be reflected in the amount of surplus available for distribution in the form of bonuses. The assured will have the benefit of tax relief in respect of the premiums.

The effective rate of interest earned by the policyholder is much higher than the yield obtained by the life office on its funds or the rate of interest it would normally charge on policy loans and it became obvious to certain classes of agents and brokers that they could recommend their clients, particularly those who were liable for sur tax, to effect a large short-term policy on which it was the intention to pay only the first two or three premiums and then borrow to pay all future premiums and loan interest. In effect they are borrowing at a comparatively low rate of interest on which they will be able to claim income tax and sur tax relief and investing to earn a very much higher rate of interest. The effective yields calculated in respect of the first two or three premiums paid in cash is very high indeed. This practice was considered by most offices to be an abuse of the tax privileges enjoyed by life offices and of the tax relief granted to policyholders under life assurance policies and most offices have by voluntary methods tried to restrict these abuses.

(4) /

(4) There are many occasions where the type of policy to be effected is influenced by the question of tax relief on the premiums, e.g.

A married man in pensionable employment but where there is little life cover and no widow's benefit on death during service may wish to effect a contract to provide an income for his wife on his death before pension age. The theoretical answer would be a temporary reversionary annuity but the premiums under such a contract would not be eligible for tax relief and it would probably be cheaper to effect a combination of temporary assurance with a family income benefit.

Or a person wishing to supplement his pension and not being eligible to effect a "self-employed" contract would probably be better advised to effect an endowment assurance with profits maturing at the selected pension age even although he has no need for additional life cover rather than a deferred annuity where there is no tax relief.

Partnership Assurances
(including assurances on the lives of Directors of registered companies)

(1) The first point with regard to partnership assurances is what exactly is meant by that term. Partnership assurances fall broadly into two types determined by the object of the assurances. There are

(a) assurances to provide funds for a deceased partner's estate or his family to enable them to meet the estate duty on the deceased partner's interest in the partnership; and

(b) assurances to provide funds for surviving partners to enable them to buy out the interest of a deceased partner.

It is quite evident that the above distinction is important in that to discuss partnership assurances other than with this distinction in mind tends to be meaningless and the two types of partnership assurances pose different problems.

(a) Dealing first with the provision of funds to meet estate duty on a deceased partner's interest, it can be said that there are no special problems to be considered. In the normal case there is no question of reducing the estate duty liability in the partnership interest; the problem can only be solved by the effecting of an Act policy by each partner for the benefit of his wife and/or children or by the wife and/or children effecting "life of another policies" on the life of their husband/father.

The situation in the case of Directors of a registered company can be more complex in that it may be possible to reduce the duty payable on the Directors death by the creation of a discretionary settlement of the shares. The estate duty on the settlement can, of course, be taken care of by a five year decreasing temporary assurance either under the Act or on a life of another basis and the retained interest similarly but preferably on a whole life basis.

(b) By and large, it can be said that the provision of funds to meet estate duty is a matter between a partner and his family which does not involve the remaining partners. The situation is, of course, entirely different where the question is of the provision of funds to purchase the share of a deceased partner.

In the normal case, the interest of a partner in the firm passes to his estate or an arrangement is made btween the partners, either in the partnership deed or by a separate instrument whereby his interest passes to the surviving partners at their option in respect of a certain consideration to be paid to the deceased partner's estate or his family. The surviving partners will normally wish as the case may be to purchase the interest from the deceased partner's estate or to take up the relevant option. The object of the assurances is, of course, to provide the appropriate funds.

There are **four** main objects to be attained -

(a) that the sums assured pass to the appropriate parties,

(b) that estate duty on the death of the relevant partner is avoided or minimised,

(c) that life assurance relief is available in respect of the premiums, and

(d) that capital gains tax on the death of the relevant partner is avoided.

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Partnership Assurances (contd.)

Now, the three main ways of effecting partnership assurances of this type are as follows (it is assumed there are only two partners)

(i) Life of another method - Each partner simply effects a policy on the life of his partner. The sum assured is, of course, payable to the surviving partner. Estate duty is not, of course, payable on the policy on the life of the deceased partner but duty will be payable on the policy effected by the deceased partner on an aggregable basis on its market value (normally surrender value). This, of course, will normally be a small amount. Since the policy is not own life, life assurance relief is not available. There is no liability for capital gains under this method. Thus objects (a) (b) and (d) are met but not object (c). This method is ideal where the loss of life assurance relief is not significant.

(ii) Trust method - Each partner effects a policy on his own life for the benefit of his partner using a non-Act addendum (English Law) or a trust deed (Scots Law). The trust, of course, makes the policy monies payable to the surviving partner and since each policy is own life, life assurance relief is available. Subject to the usual exemptions estate duty is payable on a non-aggregable basis on the policy effected by the deceased partner. However, complete or partial exemption may be obtained if the Estate Duty Office agree that there has been mutual consideration between the partners. If this is allowed, the policy with the smaller premium is completely exempt and the policy with the larger premium will be valued as per an Act policy but as if the premiums paid under the policy were equal only to the excess of the larger of the two premiums over the smaller.

Thus objects (a) (c) and (d) are met and (b) may be met.

This method is the one to use where life assurance relief is important in relation to maximum estate duty liability.

(iii) Cross assignment method - Each partner effects a policy on his own life and assigns it to the other partner. The situation is as in (ii) above except that if the policy is dutiable it will be so on an aggregable basis but there may be a liability for capital gains tax under this method.

Thus objects (a) and (c) are met but the method is risky as to (b) and doubtful as to (d).

In general there is not a great deal that can be said in favour of this method.

Summing up the methods, we would recommend the life of another method, if life assurance relief is not important and the trust method where it is important but in the latter case the estate duty position must be kept in mind.

(2) Where more than two partners

So far we have been considering the situation where there are two partners only. The same principles apply where there are more than two partners but certain complications do occur.

The life of another method can be used but it, of course, becomes fairly cumbersome because of the large number of policies required.

This /

This makes the trust method rather more attractive and the policy on each life is held in stated shares by trustees for the benefit of each partner other than the Life Assured. If trust deeds (Scots Law) are issued the same two partners can be appointed trustees of all the policies. If the trust addendum method is used, the original trustees can, where appropriate, resign and the same two partners appointed trustees of all the policies. This simplifies matters a little when a reorganisation of the policies is required on the death or withdrawal of a partner.

The situation can become quite complex on the death or withdrawal of a partner and in such cases it will frequently be simplest to surrender the various policies and reconstitute the whole arrangement taking into account, where necessary, the taking on of a new partner. Medical evidence would not normally, of course, be required in respect of the new sums assured to the extent of the original amount on the life of each partner.

(3) Types of Policy

The type of policy selected will depend mainly on two factors, the object of the assurance and the cost. In the following paragraphs the advantages and disadvantages of the various types of policy available are discussed. More than one type of policy could be effected on each life as the type of policy to provide for the payment of estate duty may differ from the type of policy to provide for the repayment of a partners interest.

(i) Joint Life Assurances

This type of policy which on the face of it appears a relatively cheap method of obtaining a sum assured payable on the first death has little to recommend it as the premiums payable under such a policy are not normally eligible for income tax relief as as there will most probably be a liability for estate duty on an aggregable basis on first death. It is possible for each partner to obtain life assurance relief on his portion of the premium by making the sum assured payable to the deceased's partner's estate (which often defeats the purpose of the assurance) and by endorsing the policy showing the portion of the premium in respect of each life. The problem of an estate duty liability on an aggregable basis in respect of the policy proceeds remains and cannot be overcome.

There is also the disadvantage that the assurance terminates on first death and, therefore, that new arrangements will require to be made at that time when the surviving lives may be of advanced age and the cost of further assurance substantial or it may be that one or more of the lives be ineligible for life assurance.

(ii) Contingent Assurances

This type of assurance provides a sum assured payable on the death of A if B, C etc. are alive. A separate policy on each life would be effected. Taking all the policies together they provide a sum payable only on the first death. The policies could be for differing amounts and, therefore, the amount of the sum payable would depend on which life died first. The total cost would be higher than under a Joint Life Assurance providing similar benefits but individual policies would be effected and the various income tax and estate duty advantages obtained depending on the method chosen to effect the policies.

As this type of assurance would only provide a sum payable on the first death it suffers from the same disadvantage as a Joint Life Assurance in that fresh arrangements for life assurance may require to be made at that time.

Contingent Assurances are very inflexible and on a partner withdrawing or retiring the remaining partners may be left with unsuitable forms of contract which it may be difficult to vary. The policies do not acquire a surrender value and on a policy being discontinued it would lapse.

(iii) Whole of Life Assurances

This type of assurance provides a sum payable on the death of each life and thus offers a more permanent solution to the problems than the other types of assurance previously considered. A separate policy would be effected on each life for an appropriate amount. The total cost of the assurances would, of course, be higher than the cost of contingent assurances. Again depending on the method chosen to effect the assurances the various income tax and estate duty advantages will be obtained.

Whole of Life Assurances are very flexible and may be altered to meet changing circumstances. On a partner withdrawing or retiring any policy on his life held for the benefit of the other partners could be assigned to him and he could assign his interest in their policies to the various partners, although it may be necessary to make some cash adjustment in respect of the differing values under each policy.

Whole of Life Assurances acquire a surrender value and on a policy being discontinued it could be surrendered or converted to paid up.

(iv) Endowment Assurances

Endowment Assurances may be suggested where a partner's interest is to be repaid either on death or survival to a certain date.

The advantages attaching to Endowment Assurances are similar to those attaching to Whole of Life Assurances.

(v) Temporary Assurances

Where the immediate cost of Whole of Life or Endowment Assur:ances is too great Temporary Assurances or preferably Convertible Temporary Assurances can be suggested. The immediate cost will be reduced but of course when the policies are converted the cost will be greater than if Whole of Life or Endowment Assurances had been effected at the outset.

Where a partner is a bachelor with no dependents it may not be thought necessary to effect a policy to provide for payment of estate duty but to cover the possibility of marriage a Convertible Temporary Assurance could be suggested in appropriate circumstances.

(4) Allocation of Cost

Where the life of another method is used each partner, of course, pays by way of premiums for the benefits to which he is entitled and no adjustment is therefore required. However where the trust method or cross-assignement method is used each partner is paying premiums under a policy for the benefit of the other partners. It is therefore suggested that in these circumstances the remuneration that each partner draws from the firm be adjusted to take into account the amount of the premiums paid by the other partners for his benefit compared with the amount of the premium which he pays for their benefit.

If in calculating the adjustment in remuneration their respective rates of income tax and sur tax and the income tax relief on premiums can be ignored, the adjustment to be made to gross remuneration taking into account gross premiums can be calculated as follows.

Thus to take a simple case, suppose there are three partners, A, B, and C their respective shares in a partnership being £1,000, £2,000 and £3,000 and that each partner effects a policy using the trust method for an amount to repay his share, the premiums being £20, £50 and £80 per annum respectively. On the death of a partner it is assumed that each of the surviving partners will benefit to an extent in proportion to their partnership share, e.g. consider the case of A. His interest in the policy in the life of B is one-quarter $\left(\frac{1,000}{(1,000 + 3,000)}\right)$ and his interest in the policy on the life of C is one-third $\left(\frac{1,000}{(1,000 + 2,000)}\right)$. One-quarter of £50 is £12.10. - and one-third of £80 is £26.13. 4, totalling £39. 3. 4. A is paying a premium of £20 per annum and is entitled to benefits costing £39. 3. 4 per annum. Therefore his remuneration should be reduced by £19. 3. 4 per annum.

The adjustment for B and C would be calculated in a similar manner.

Where there are more than three partners the calculations tend to become laborious and the calculations can be done in a systematic manner as shown in the following example.

Example -

Partners	Amount of Share	Proportionate Share x	Factor 1-x	Sum Assured	Premium	Premium divided by Factor
A	40,000	.4	.6	40,000	2,400	4,000
B	30,000	.3	.7	30,000	1,400	2,000
C	20,000	.2	.8	20,000	640	800
D	10,000	.1	.9	10,000	180	200
	100,000	1.0		100,000	4,620	7,000

A should pay .4 (7,000 - 4,000) = .4 x 3,000 + 1,200
B should pay .3 (7,000 - 2,000) = .3 x 5,000 = 1,500
C should pay .2 (7,000 - 800) = .2 x 6,200 = 1,240
D should pay .1 (7,000 - 200) = .1 x 6,800 = 680

4,620

Adjustment to A's Remuneration = 2,400 - 1,200 = + 1,200
Adjustment to B's Remuneration = 1,400 - 1,500 = - 100
Adjustment to C's Remuneration = 640 - 1,240 = - 600
Adjustment to D's Remuneration = 180 - 680 = - 500

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Partnership Assurances (Contd.)

In the above examples it has been assumed that a policy is effected to provide sufficient funds to purchase the whole of a partner's interest. This may prove too costly and therefore it might be suggested that the sum assured in each case be sufficient to purchase a constant proportion of a partner's share, e.g. one-half in which event the allocation of cost would be calculated in a similar manner. If the sum assured in each case is not a constant proportion of the partner's share the cost could not be allocated by the method described.

(5) Additional Life Assurance for Individual Partners

The provision of funds to meet estate duty and for the repayment of a deceased partner's interest is a matter of concern common to all the partners but even although full provision is made by life assurance or otherwise to meet estate duty and for the repayment of a deceased partner's interest in the partnership this may not completely meet the problems that might arise on the death of an individual partner and it should be considered if further policies to meet the special requirements of that partner might be suggested, e.g. the income earned by a partner in respect of his interest in the firm will probably be very much higher than would be obtained by the investing of his capital in stock exchange securities and thus of his death his dependents might have to face a reduction in their standard of living. In the case of a partner who is a married man with infant children this problem would probably be overcome by the effecting of a Family Income Benefit either on its own or in conjunction with a Whole of Life or Endowment Assurance, the policy or policies being effected by the partner for the benefit of his wife and/or children under the Act or effected by the wife herself.

Conclusion

Income Tax relief on premiums is probably allowed to encourage saving out of income by way of life assurance. Apart from this aspect a Life Office is only liable for tax at a reduced rate on the interest income of the Life Funds and the proceeds of a policy are not liable in the hands of the policyholder for income tax and sur-tax. Thus an Endowment Assurance with Profits when full account is taken of the various tax reliefs and tax saving offers a very fine yield. It soon became obvious to sur-tax payers and others that a Life Assurance contract offered an excellent method of avoiding sur-tax and various schemes have been devised and are still being devised to take full advantage of all the various reliefs often incorporating the use of policy loans to meet premiums after the first two or three. In this way the policyholder obtains income tax relief on premiums even although they are paid in effect out of capital or by means of loans and while he obtains sur-tax relief on any interest he pays, he does not in effect suffer sur-tax on the investment secured by these loans as the premiums are invested by the Life Office which does not suffer sur-tax. Life Offices have voluntarily tried to curb these practices as they do not wish legislation introduced which would adversely affect the bona fide forms of life assurance.

Another form of tax avoidance coupled with Estate Duty avoidance is the effecting of so called "Back to Back" contracts which are a com-:bination of Immediate Annuity and Whole of Life Assurance. A proposer with a large amount of capital which would be subject to Estate Duty effects an Immediate Annuity and replaces his capital in whole or in part by effecting a Whole Life Assurance often with limited medical evidence. The Annuity will be eligible for "Purchased Life Annuity" treatment under the 1956 Finance Act and accordingly the Capital Content will be free of tax and only the balance subject to tax and sur-tax. The policy or policies will normally be effected under the "Act" or some other trust for the benefit of the parties who would normally benefit under the proposer's Will and the policies would be drafted to secure non-aggregation for Estate Duty purposes. The premiums under the policies would also be eligible for tax relief with normal limits. Variations are often introduced e.g. a Temporary Annuity with an Endowment Assurance with Profits, the latter being split into a combination of Temporary Assurance under the Act, and a Pure Endowment with Profits for the proposer's own benefit. The variations are legion.

The /

Conclusion (Contd.)

The objects are nearly always the same to obtain an increased income for the Proposer and an increased net estate on his death for distribution on his death. These intentions are laudable and the methods are legal but they use the statutory provisions and reliefs in a way they were not intended. Again Life Offices have voluntarily tried to curb these practices and to restrict the worst of the abuses but these restrictions are very difficult to operate and new devices are continually being thought up.

What is the answer and what steps can be taken by Offices? I think it is right to encourage long-term saving and to allow some Estate Duty saving in respect of a proceeds of policies which represent the accumula-:tion by a prudent man of saving during his lifetime to provide for his dependents on his death and it would be unfortunate if these privileges were lost.

The method of voluntary restriction by the Life Offices has been operated with only a qualified success and is very difficult to operate. There are also fairly new Offices who are concerned probably rightly so in trying to build up their funds and, therefore, less concerned with introducing restrictions which would tend to reduce their flow of new business. The scope and extent of voluntary restrictions by Life Offices is thus very limited even with the best of goodwill and intentions and it may be that the eventual answer will be legislation by the Authorities.

What form might it take. One can only guess and all sorts of possibilities suggest themselves. Income Tax relief on premiums might be restricted to relief on premiums not exceeding say £100 or £1,000. The lower limit might be too drastic, but would certainly be very effective. We have a capital contract under Immediate Annuities and it would be possible to allow only tax relief in respect of the "life assurance element" of a premium calculated on a theoretical basis. This would limit the attractiveness of short term Endowment Assurances and also prevent the practice of asking for a sum assured to be paid in instalments to get round the 7% limit being effective. To prevent the avoidance of sur-tax the excess of policy proceeds over premium paid on maturity or surrender could be made liable for sur-tax on a basis of say n times the sur-tax liability of $\frac{1}{n}$th of the excess of proceeds over premiums paid where n is say 10 or the number of premiums paid.

As regards Estate Duty avoidance one could adopt the practice in the Republic of Ireland and remove the principle of non-aggregation in respect of policies effected by a deceased on his own life. This would be coupled with increasing the lower limit which is at present £5,000 before an estate becomes liable for duty, or the limit might be fixed in accord-:ance with the number of children and whether the spouse is alive at date of death. There are other methods of avoiding Estate Duty and such as Gifts Inter Vivos and Voluntary Settlements and there has been mooted in various circles the question of a Gift Tax. If such a tax is introduced it will be a matter of speculation how it would affect Trust policies. Would the premiums or the sum assured form the subject matter of the tax. These questions are unanswerable at the moment and we will have to wait and see.

In this paper I have tried to give a fairly full description of Estate Duty as it affects Life Assurance policies and to show how con-:cessions allowed by the existing legislation although reasonable in them-:selves can give rise to avoidance of tax and Estate Duty on a large scale. The danger is, of course, that any legislation which may be introduced to stop these loopholes may be more widespread and have a harmful effect on Life Assurance business as a whole. Life Offices are, of course, aware of this and keep the position under constant review and co-operate with the Authorities as far as possible to control the worst of the abuses.

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Conclusion (contd.)

We will perhaps have some of the above questions answered by the Chancellor of the Exchequer by the time this paper is presented and I hope that any solution adopted will not be too drastic.

All views and opinions expressed in this paper are my own and do not necessarily reflect the views and practice of the Office with which I am associated.

APPENDIX A.

FINANCE ACT 1894.

Estate Duty.

1. In the case of every person dying after the commencement of this Part of this Act, there shall, save as hereinafter expressly provided, be levied and paid, upon the principal value ascertained as hereinafter provided of all property, real or personal, settled or not settled, which passes on the death of such person a duty, called "Estate Duty", at the graduated rates hereinafter mentioned, and the existing duties mentioned in the First Schedule to this Act shall not be levied in respect of property chargeable with such Estate Duty.

2. (1) Property passing on the death of the deceased shall be deemed to include the property following, that is to say:-

(a) Property of which the deceased was at the time of his death competent to dispose;

(b) Property in which the deceased or any other person had an interest ceasing on the death of the deceased, to the extent to which a benefit accrues or arises, by the cesser of such interest; but exclusive of property the interest in which of the deceased or other person was only an interest as holder of an office, or recipient of the benefits of a charity, or as a corporation sole;

(c) Property which would be required on the death of the deceased to be included in an account under section thirty-eight of the Customs and Inland Revenue Act 1881, as amended by section eleven of the Customs and inland Revenue Act 1889, if those sections were herein enacted and extended to real property as well as personal property, and the words "voluntary" and "voluntarily" and a reference to a "volunteer" were omitted therefrom; and

(d) Any annuity or other interest purchased or provided by the deceased, either by himself alone or in concert or by arrangement with any other person, to the extent of the beneficial interest accruing or arising by survivorship or otherwise on the death of the deceased.

4. For determining the rate of Estate Duty to be paid on any property passing on the death of the deceased, all property so passing in respect of which Estate Duty is leviable shall be aggregated so as to form one estate, and the duty shall be levied at the proper graduated rate on the principal value thereof.

Provided that any property so passing, in which the deceased never had an interest shall not be aggregated with any other property but shall be an estate by itself, and the Estate Duty shall be levied at the proper graduated rate on the principal value thereof.

A P P E N D I X B.

MARRIED WOMEN'S PROPERTY ACT, 1882.

A married woman may effect a policy upon her own life or the life of her husband for her own benefit; and the same and all benefit thereof shall enure accordingly.

A policy of assurance effected by any man on his own life, and expressed to be for the benefit of his wife, or of his children, or of his wife and children, or any of them, or by any woman on her own life, and expressed to be for the benefit of her husband, or of her children, or of her husband and children, or any of them, shall create a trust in favour of the objects therein named, and the moneys payable under any such policy shall not, so long as any object of the trust remains unperformed, form part of the estate of the insured, or be subject to his or her debts: Provided, that if it shall be proved that the policy was effected and the premiums paid with intent to defraud the creditors of the insured, they shall be entitled to receive, out of the moneys payable under the policy, a sum equal to the premiums so paid. The insured may by the policy, or by any memorandum under his or her hand, appoint a trustee or trustees of the moneys payable under the policy, and from time to time appoint a new trustee or new trustees thereof, and may make provision for the appoint-:ment of a new trustee or new trustees thereof, and for the investment of the moneys payable under any such policy. In default of any such appointment of a trustee, such policy, immediately on its being effected, shall vest in the insured and his or her legal personal representatives, in trust for the purposes aforesaid. If, at the time of the death of the insured, or at any time afterwards, there shall be no trustee, or it shall be expedient to appoint a new trustee or new trustees, a trustee or trustees or a new trustee or new trustees may be appointed by any court having jurisdiction under the provisions of the Trustee Act, 1850, or the Acts amending and extending the same. The receipt of a trustee or trustees duly appointed, or, in default of any such appointment, or in default of notice to the insurance office, the receipt of the legal personal representative of the insured shall be a discharge to the office for the sum secured by the policy, or for the value thereof, in whole or in part.

APPENDIX C.

MARRIED WOMEN'S POLICIES OF ASSURANCE (SCOTLAND) ACT, 1880.

1. A married woman may effect a policy of assurance, on her own life or on the life of her husband, for her separate use; and the same and all benefit thereof, if expressed to be for her separate use, shall, immediately on being so effected, vest in her, and shall be payable to her, and her heirs, executors and, assignees, excluding the jus mariti and right of administration of her husband, and shall be assignable by her either inter vivos or mortis causa without consent of her husband; and the contract in such policy shall be as valid and effectual as if made with an unmarried woman.

2. A policy of assurance effected by any married man on his own life, and expressed upon the face of it to be for the benefit of his wife, or of his children, or of his wife and children, shall, together with all benefit thereof, be deemed a trust for the benefit of his wife for her separate use, or for the benefit of his children, or for the benefit of his wife and children; and such policy, immediately on its being so effected, shall vest in him and his legal representatives in trust for the purpose or purposes so expressed, or in any trustee nominated in the policy, or appointed by separate writing duly intimated to the assurance office, but in trust always as aforesaid, and shall not otherwise be subject to his control, or form part of his estate, or be liable to the diligence of his creditors, or be revocable as a donation, or reducible on any ground of excess or insolvency: And the receipt of such trustee for the sums secured by the policy, or for the value thereof, in whole or in part, shall be a sufficient and effectual discharge to the assurance office: Provided always, that if it shall be proved that the policy was effected and premiums thereon paid with intent to defraud creditors, or if the person upon whose life the policy is effected shall be made bankrupt within two years from the date of such policy, it shall be competent to the creditors to claim repayment of the premiums so paid from the trustee of the policy out of the proceeds thereof.

3. This Act shall apply only to Scotland and may be cited as the Married Women's Policies of Assurance (Scotland) Act, 1880.