

Why Life Insurance Belongs in Wealth Plans

Life Insurance: Understanding the Options and Strategic Uses

When thinking about how to protect your family, preserve your assets, or avoid a forced sale of the things you've worked hard to build, life insurance might not be one of the first tools that comes to mind - but it should be. Whether it's covering known inheritance tax (IHT) liabilities, securing family stability, or ensuring business continuity, the right insurance strategy could make all the difference.

Whole of Life vs Term Insurance

Whole of Life Insurance pays out a lump sum when you die (as long as you keep paying the premiums). Because the payout is guaranteed, it's typically used for permanent needs such as inheritance tax on assets that are unlikely to leave your estate.

Did you know? UK inheritance tax is charged at 40% on estates above the threshold (£325,000, plus £175,000 for a main residence, if applicable). This quickly captures many families for who this can mean a seven-figure bill.

If you own a London townhouse, a boat in the Med and a ski chalet in the Alps, the combined value of those assets alone means your estate is likely to face a significant tax bill. A Whole of Life policy, especially one placed in trust, provides a pool of liquidity to pay those taxes, without forcing your family to sell cherished or illiquid assets.

Term Insurance, in contrast, covers you for a fixed period e.g. 10 or 20 years, and only pays out if you die during that term. It's far more affordable and ideal for temporary liabilities, such as:

- Outstanding mortgages or loans
- Replacing income for dependants
- Covering school or university fees
- Providing short-term IHT cover if your estate is reducing over time

Example: Your estate is worth £5 million now, but you're planning to reduce it to £3 million through gifting and tax planning over the next 10 years. A Term policy can cover the tax on the £2 million gap for a decade, at a fraction of the cost of Whole of Life.

What's the Price of Certainty?

Unsurprisingly, Whole of Life insurance costs more because the payout is guaranteed.

- A healthy 50-year-old non-smoker might pay £7,000/year for £1 million of Whole of Life cover
- The same cover over for 20 years via a Term policy might cost around £1,200/year

Cost varies with age, health and underwriting, but the key difference is this: Term is cheaper, but temporary.

Gift Inter Vivos Policies

Gifting wealth during your lifetime is a common estate planning strategy. In the UK, gifts fall out of your estate after seven years, but if you die within that window, inheritance tax may still apply - especially in the first three years. From year three onward, taper relief gradually reduces the tax liability each year, until it drops to zero after year seven.

A Gift Inter Vivos policy is a specific type of Term insurance designed to cover this risk. The cover decreases over seven years, mirroring the tapering liability.

Example: You gift £1 million to your children. If you pass away within seven years, inheritance tax may still apply - with the full 40% rate potentially due in the first three years. A Gift Inter Vivos policy ensures this liability is covered, without burdening your family or disrupting your plans.

Business Protection: Cross Option Agreements

If you own a business with partners or co-shareholders, life insurance can protect the business (and your family) from unintended consequences.

A Cross Option Agreement supported by Term insurance ensures that, if one partner dies, the others can buy their shares at an agreed price. This keeps ownership in the hands of people who understand the business and avoids leaving your family with illiquid, hard-to-value shares they may not want, or know how to manage.

These arrangements are typically set up with Term policies running to retirement age (e.g. 65), and should reflect each person’s shareholding.

Tailoring to Needs

The art lies in aligning the type of insurance with the nature of the liability:

Insurance Type	Best Used For
Whole of Life	Permanent inheritance tax liabilities and long-term legacy planning
Term Insurance	Temporary needs such as debt cover, education costs or bridging a planned estate reduction
Decreasing Term	When the liability (e.g. tax on a gift or a mortgage) reduces over time

Structuring is Key

To make the most of any policy, structure it properly. Writing a policy in Trust keeps the payout outside your estate (so it doesn’t create an additional IHT bill) and ensures the money can be accessed quickly by trustees - without waiting for probate.

Final Thoughts

Life insurance isn't just about protecting against the unexpected. It’s a powerful, flexible tool for wealthy families looking to preserve wealth, manage risk and protect the next generation.

If you're not sure whether your current plans fully protect your family or business from tax or liquidity pressures, a quick review might be worth millions. These policies are rarely front of mind, but when structured well, they sit quietly in the background until they’re needed most.

Glossary of Key Terms

- Premium: The regular payment you make to keep an insurance policy active.
- In Trust: A legal arrangement keeping assets or payouts outside your taxable estate.
- Whole of Life Insurance: A policy that pays out whenever you die, as long as premiums are paid.
- Term Insurance: A policy that covers you for a specific period only.
- Decreasing Term Insurance: A policy where the payout decreases over time, matching a reducing liability.
- Gift Inter Vivos: A gift made during your lifetime that can still be subject to inheritance tax if you die within seven years.
- Cross Option Agreement: A business agreement where surviving partners can buy out the deceased’s shares using insurance proceeds.
- Guaranteed vs Reviewable Premiums: Fixed (guaranteed) vs potentially rising (reviewable) costs over time.

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29 Queen Anne’s Gate, London SW1H 9BU, England
Tel +44 (0) 20 7222 8081, Fax +44 (0) 20 7227 8440, Email info@bentleyreid.com

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