experts' point of view

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The split beneficiary clause, a succession planning tool

The splitting of a beneficiary clause consists of the splitting of the ownership of the capital paid to the beneficiaries. In order to optimise taxation and protect one's spouse in particular, the use of a dismembered beneficiary clause may be wise. Indeed, combining the beneficiary clause with splitting techniques makes it a formidable tool for the transmission of assets.

Why a split beneficiary clause?

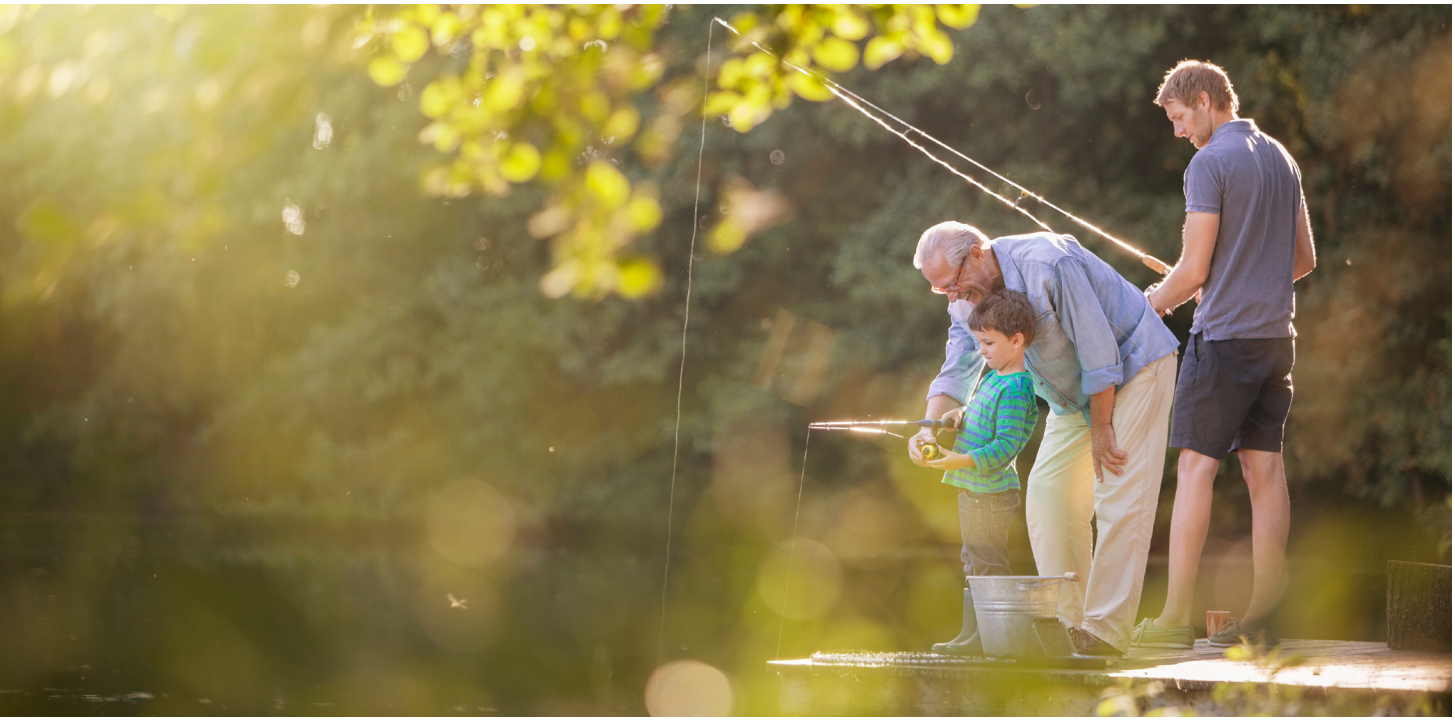
Although the spouse is exempt from taxation on death benefits transmitted through life insurance (whether the premiums were paid before or after the insured person's 70th birthday), the clause providing for the benefit split between the surviving spouse of the insured (usufructuary) and the common children (bare owners) can be very profitable. Indeed, the capital thus paid at the time of the termination of the life insurance contract will not be subject to inheritance tax at the time of consolidation of the property in the hands of the bare owners (on the death of the usufructuary).

The split beneficiary clause of the life insurance contract is therefore the perfect solution to protect the spouse while ensuring the preservation of assets within the family circle.

During his lifetime, the usufructuary spouse will be able to fully dispose of the split capital resulting from the life insurance contract. Nevertheless, upon his death, the bare owners will receive the capital free of inheritance tax.

A second split scheme at the exit has many advantages while meeting different expectations. This is the transgenerational split beneficiary clause.

This scheme is mainly aimed at policyholders wishing to protect their descendants while preparing the transmission to the second generation. The policyholder designates his child as usufructuary and the grandchildren as bare owners. This way, the preservation of assets in the family circle is ensured over at least two generations.



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Principles and mechanisms for splitting the beneficiary clause:

On the death of the insured, under the tax rules for life insurance, the capital is paid to the usufructuary (generally the spouse) who, under a quasi-usufruct*, can freely dispose of it and for example subscribe a capitalisation contract, which is a perfect vehicle for these funds.

The bare owner(s) who receive(s) no funds do(es) however retain a claim for the return of an amount equivalent to that of the capital paid out. On the death of the quasi-usufructuary, the bare owner(s) can exercise this claim against the quasi-usufructuary's estate in the amount of the death benefit paid (assuming the claim is not indexed). This claim, recorded as a liability of the estate, will then diminish the net assets of the estate subject to transfer duties on donations (gift tax). Moreover its reimbursement to the child(ren) is not subject to transfer duties on donations (gift tax).

However, it is possible to include in the beneficiary clause an obligation to reinvest the capital in order to perpetuate the rights of the bare owners.

The attractive tax treatment of the split beneficiary clause of a life insurance policy, in particular for premiums paid before the insured has reached 70 years of age

The settlement of the life insurance policy and the splitting of the capital between the usufructuary spouse and the children as bare owners takes place in a highly advantageous tax framework. In effect, the inheritance tax payable on the policyholder's death is significantly reduced thanks to the advantages linked to the combination of life insurance and split.

More specifically, the taxation of the usufructuary and the bare owner is defined by a proportion of the value of the full ownership in accordance with the scale provided for in Article 669 of the CGI (see table below).

Age of the usufructuary	Value of the usufruct	Value of the bare ownership
Less than:		
21 years	90 %	10 %
31 years	80 %	20 %
41 years	70 %	30 %
51 years	60 %	40 %
61 years	50 %	50 %
71 years	40 %	60 %
81 years	30 %	70 %
91 years	20 %	80 %
Over 91 years	10 %	90 %

Thus, taxation can be considerably reduced (or even almost non-existent) with a usufructuary spouse who would be at least 31 years old for example, since the share of the usufruct value will represent 80% of the full ownership. Considering that the usufructuary spouse is exempt from taxation, the death benefits transmitted will therefore only be taxed up to 20% of their value.

Moreover, the allowance of €152,500 as provided for in Article 990i of the CGI is divided between usufructuary and bare owner(s), in the same proportions. And it is necessary to apply as many allowances as there are duos «usufructuaries / bare owners».

It should be pointed out that the usufructuary can only benefit in total from a maximum allowance of €152,500 on all death benefits received on the basis of life insurance contracts due to the death of the same insured. In addition, when one of the beneficiaries mentioned in the contract is exempt (e.g. surviving spouse or partner linked to the deceased by a civil partnership), the fraction of allowance not used by the exempt beneficiary does not benefit the other beneficiaries of the contract.

N.B. : In the event that the premiums were paid after the insured person's 70th birthday, the death benefits are subject to inheritance tax pursuant to Article 757B of the CGI. This same article provides for a one-off allowance of €30,500. It will be distributed globally between the usufructuary and all bare owner.

* As the usufruct refers to a sum of money, the surviving spouse benefits from a quasi-usufruct on the death capital which is paid in full. The surviving spouse has free disposal of the inherited capital, except for a clause requiring the reinvestment of the funds and/or the payment of a deposit.

Example

Mr. and Mrs. X are married under the regime of legal community and have two children together. Mr. X is 69 years old and Mrs X is 71 years old.

Mr. X has subscribed a life insurance policy for €500,000 following the sale of the family business.

The beneficiary clause provides for the split of ownership of the death benefits between the usufruct for his wife and the bare ownership for his two children (in equal shares).

Upon the husband death, the capital of the contract is transmitted in **split of property between his spouse and his two children**.

- Capital of the contract : €500 000.
- Age of usufructuary spouse: 71 years.
- Value of the usufruct according to the application of article 669 CGI: 40%, or €200,000.
- Value of the bare ownership according to the application of article 669 CGI: 60%, or €300,000.
- Proportion due to the usufructuary spouse: €200,000
- Proportion for each child: €150,000

Premiums paid before the insured had reached the age of 70 years

There are as many allowances of €152,500 as there are duos of usufruct and bare ownership.
In this case, two allowances of €152,500 will be applied:

Duo 1:
Spouse with child 1.

Duo 2:
Spouse with child 2.

Each duo will be able to claim an allowance of €152,500 shared as followed

- 152.500 x 40% = **€61.000** of abatement for the **usufructuary** (spouse).
- 152.500 x 60% = **€91.500** of abatement for each **bare owner** (the children).

The spouse being as such exempt from tax, **only the children will be taxed, at the rate of 20%*,** on the amount exceeding their abatement, i.e.
€150.000 – €91.500 = €58.500 giving **€11.700 in tax to be paid.**

* Note that up to € 700,000 the tax rate provided for in Article 990i of the CGI is 20%. Beyond that, the rate rises to 31.25%.

Contractual arrangements to provide for

The main drawback attaching to the quasi-usufruct is the risk that the holder of this right might squander the funds, since (s) he is free to consume the entire capital. The risk is then that the assets of the estate are insufficient to allow the bare owners to recover their claims.

Besides, in the absence of contractual arrangement, the quasi-usufruct (usufruct of a fungible asset) does not take account of the effects of inflation: the same sum has to be returned to the bare owners, regardless of the time elapsed.

Therefore contractual arrangements must be made with the main effect of protecting the bare owner beneficiary or beneficiaries :

- **Obligation to re-invest**
It is possible to insert within the beneficiary clause an obligation to reuse death benefits within capitalization contracts in split. It will be necessary to open as many contracts as there are usufructuary / bare owner duos in order to avoid any indivision potentially generating conflicts. Thus, the usufructuary will be able to receive the products of the contract and the bare owners will be protected from the risk of squandering capital.

- **Deed of receipt**
The bare owner(s) must be able to obtain proof of their claim by a deed of receipt, whereby the quasi-usufructuary acknowledges having received the funds from the insurance company and being liable for their reimbursement to the bare owner(s) on his or her death.

It may also be wise to have the existence and amount of the reimbursement liability of the usufructuary's estate formally recorded by duly registered notarised or private deed.

In fact any means of ensuring settlement of the capital can be envisaged: obligation to post a bond, etc.

The policyholder thus has several possibilities: by personalising the beneficiary clause of the policy, (s)he can leave the usufructuary entirely free, or on the contrary restrict the usufructuary's freedom in order to provide more protection to the bare owners.

Conclusion

The split beneficiary clause is an excellent way to optimize its wealth transfer through life insurance in that it ensures an optimised transmission over several generations while benefiting from an advantageous tax framework. This type of clause requires tailor-made drafting so that it is best adapted to the expectations of subscribers as well as their patrimonial situation. Indeed, well thought out and carefully drafted, the dismembered beneficiary clause can prove to be the key to an optimized patrimonial transmission over several generations. This is why it is strongly recommended that you contact a specialist in wealth engineering in order to entrust the drafting of it.

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