A guide to tax on your UK investment bond

Investment Bonds offered by Prudential now, or in the past, are normally set up as single premium life assurance policies. This means they have a different tax treatment from other types of investments. Regular premiums may also be paid into certain Investment Bonds.

How is my investment taxed?

Prudential pays tax on income and capital gains made within its funds. The policyholder will only be subjected to tax when a "chargeable gain" arises on certain events. Chargeable gains are subject to income tax* but due to the tax paid within a UK life fund the policyholder receives a "tax credit" equivalent to the basic rate of income tax to offset against their tax liability. While the tax credit can reduce your income tax liability it cannot be reclaimed.

A liability to Income Tax above the basic rate may arise if a chargeable event occurs and a chargeable event gain or "profit", arises;

- in the event of death, or
- on certain assignments (transfer of legal ownership of all or part of your Bond) for money or money's worth, or
- on maturity of your Bond (this does not apply to Bonds written as whole of life policies which remain in force until full and final cashing in or there is a death of a life assured giving rise to benefits, or
- on fully cashing in your Bond or any individual policy/segment within the Bond; or
- if you withdraw more than 5% per policy year of the amount that you have paid into your Bond.

This 5% withdrawal allowance is cumulative, and any unused part can be carried forward to future years, subject to the total cumulative 5% allowance amount not exceeding 100% of the amount you have paid into your Bond.

Note that the basic personal allowance is restricted for those with 'adjusted net income' (ANI) exceeding £100,000. In addition the amount of Personal Savings 'Allowance' (PSA) depends on ANI. The high income child benefit tax charge impacts those with ANI over £50,000.

A chargeable event gain on a bond is included within ANI.

What happens when a chargeable event occurs?

When a chargeable event occurs, you will be sent details of any chargeable event gain arising for you to notify HMRC of the gain. Prudential may also send details of the chargeable event gain direct to HMRC.

As Basic Rate Income Tax is treated as already paid, the rate of Income Tax that may become payable is the difference between the Higher Rate (and the Additional Rate, where applicable) of Income Tax and the Basic Rate of Income Tax.

When a chargeable event arises, it is then necessary to calculate if a gain has arisen. Chargeable event gains on UK bonds are not liable to basic rate tax.

Where a tax liability can arise

On withdrawals

- A part surrender will trigger a chargeable event gain if it exceeds a certain limit. Part surrenders of up to 5% of accumulated premiums can be taken without any immediate tax charge. Withdrawals are tax deferred and not tax free. Where there has been a part surrender, a calculation must be made at the end of the 'insurance year' (the policy anniversary) to see whether a gain has arisen and if so its amount.
- Where regular premiums have been paid, the 5% allowance is applied separately to the premiums (including any single premium) paid in each year.
- For bonds sold after 1 January 2013 the adviser charges, such as Ongoing Charge and Ad hoc Charge, are treated as withdrawals.

On death and terminal illness

A chargeable event will happen on the death of the life assured (second death under a joint life second death Bond; first death under a joint life first death Bond).

In this situation, the tax treatment is the same as if the Bond had been finally cashed in immediately before death. Any gain is calculated on the surrender value immediately before death rather than the total amount that is actually paid on the death claim.

Terminal illness claims (where life expectancy is no more than 12 months) under Prudential Investment Bond or Flexible Investment Plan do not give rise to a chargeable event. Please refer to your policy terms and conditions to confirm that Terminal Illness applies to your Bond.

Tax liability on final cashing in

Any tax liability on final cashing in is based on the gain or "profit" (if any) that the Bond has made. This profit is defined as:

- the amount you receive when you cash in your Bond plus all previous withdrawals;

less

- the total amount you have paid in plus any excesses over the accumulated 5% allowances.

In the case of a payout triggered by death, the calculation will be surrender value immediately before death plus all previous withdrawals less the total amount you have paid in plus any excesses over the accumulated 5% allowances.

Partial withdrawals

Large withdrawals from your Bond can result in an excessive and unnaturally high tax liability. This is because the excess over 5%, the "chargeable event gain", is always used for the tax calculation, irrespective of any profit or loss on the Bond.

Tax liability on part surrenders

Where there has been a part surrender, a calculation must be done at the end of the policy year to see whether a gain has arisen and if so its amount. For example, a policy taken out on 3 June 2017 will have a policy year ending on 2 June 2018. The second policy year will begin on 3 June 2018 and end on 2 June 2019 (and so on).

You should be aware that even in circumstances where the value of your policy or Bond has reduced, if you have taken a part surrender, a tax liability could arise.

Example

At the start, you invest **£20,000**

In year two of the policy, it's worth **£17,000**

you want to take a part surrender of **£10,000**

So how do we work out if there's any gain which may give rise to an income tax liability.

At the end of policy year two we'll send you a Chargeable Event Certificate.

This will show the £10,000 you've taken out.

Part surrenders of up to 5% of premium(s) paid can be taken without any immediate tax charge. Withdrawals are tax deferred and not tax free.

In this example that would be £20,000 x 5% = £1,000. That's £1,000 each policy year. And if you don't take it out in one policy year, you can carry it forward.

At the end of policy year two, the part surrender of £10,000 has exceeded the cumulative 5% allowance of £1,000 x 2 meaning that a chargeable event gain of £8,000 arises. Income tax may be payable on this depending on your circumstances.

This is just an example designed to represent a typical situation and does not relate to any particular individual. You should not consider this as financial advice or a recommendation of a particular course of action. You should consider your own circumstances fully and may wish to consult a financial adviser to help you make a decision.

Here's the example again with just the figures.

£20,000 x 5% = £1,000 – your annual 5% allowance.

£10,000 taken out in the second policy year

2 x £1,000 = £2,000 – the cumulative 5% allowance at the end of the second policy year

£10,000 – £2,000 = £8,000 – the chargeable event gain you might have to pay tax on.

How an unusually high tax liability may be avoided

To help counter such excessive and unusual gains, Prudential issues Single Premium Bonds as a series of identical policies. This allows for the full cashing in of one or more policies, rather than a large partial withdrawal spread across the whole Bond.

What reliefs are available?

Deficiency relief

There's no relief under the chargeable event regime for an investment loss on a bond. Also, a loss on one bond cannot be set against a gain on another.

However, 'deficiency relief' may be available to you when a bond comes to an end. It's given as a tax reduction from your income tax liability for the year, but unless your income is liable at higher rate or dividend upper rate (not additional rate) on some income, there will be no tax reduction and deficiency relief will be of no benefit. Entitlement arises as follows:

- the calculation of the gain on the final chargeable event shows a negative amount
- one or more gains arose on 'excess events' in earlier tax years on which the same individual was liable, and
- the individual is the chargeable person (i.e. would have been liable had the calculation shown a gain)

The amount of deficiency relief will be the lesser of the deficit calculated in the final chargeable event calculation, and the total of gains on previous 'excess events' which formed part of the total income of the same individual who is now benefiting from the relief.

Top Slicing relief

Top slicing relief may reduce the tax payable on a bond gain. It does not reduce the gain. It is most commonly available where you are liable to tax at a lower rate were it not for the inclusion of the chargeable event gain in your income for the year. HMRC have a process for calculating top slicing relief.

Step 1 Calculate the total taxable income for the year and identify how much of the gain falls within the starting rate for savings, personal savings allowance nil rate, basic, higher or additional rate bands as appropriate. Any gift aid payments must be disregarded both in this computation and in the remaining steps below.

Step 2 Calculate the total tax due on the gain across all tax bands. Deduct basic rate tax treated as paid* to find the **individual's liability** for the tax year.

Step 3 Calculate the annual equivalent of the gain. The annual equivalent is calculated by dividing the gain by N (see below).

Step 4 Calculate the individual's liability to tax on the annual equivalent. For gains arising on or after 11 March 2020, the personal allowance is recalculated where appropriate. The starting rate for savings and the amount of PSA is now as follows. For gains arising in 2020/21 and earlier, neither the starting rate nor the PSA are recalculated in the TSR calculation. In contrast, for gains arising in 2021/22 onwards the amount of PSA and the starting rate for savings are recalculated based on total income in the year with only the 'sliced gain' included. Deduct basic rate tax treated as paid* on the annual equivalent, and multiply the result by N. This gives the individual's relieved liability.

Step 5 Deduct the **individual's relieved liability** at step 4 from the **individual's liability** at step 2 to give the amount of top slicing relief due.

*Basic rate tax is also deducted for offshore bonds for the purposes of the top slicing calculation

Calculating 'N'

On full surrender of segments "N" is the number of complete years since the start date of the policy. For "excess gains" on part surrender of the policy "N" is the number of complete years since the later of the start date of the policy or the last excess event*

** unless policyholder has a period of non-residence*

This can be complex and you may wish to discuss with a financial adviser or accountant.

Entitlements – what you should be aware of

Your entitlement to Basic Personal Allowances, Working Tax Credit and Child Tax Credit may be affected whenever you incur a chargeable event gain; for example you cash in some or all of the policies in the Bond or take proceeds in excess of the accumulated 5% allowances.

For those with 'adjusted net income' in excess of £100,000, then it should be noted that total bond gains are included within this figure meaning that entitlement to the personal allowance can be affected. Note also that total bond gains are included when assessing entitlement to the personal savings allowance and whether there is any liability to a child benefit tax charge as again this is based on adjusted net income.

The amount of Child Tax Credit and/or Working Tax Credit to which you are entitled also depends on your income. Any gain from your Bond or withdrawal in excess of the accumulated 5% allowances will be added to your income (without top slicing) for this purpose and could reduce or eliminate any Tax Credit that you would otherwise be entitled to.

Adviser Charges (only applicable to bonds sold after 1 January 2013)

Set-up adviser charges

This charge is taken from the initial payment you make before the contract is set up. The original premium is therefore your payment less the set-up adviser charge. Set-up adviser charges are not seen as withdrawals and do not form part of the 5% p.a. cumulative withdrawal allowance.

Ongoing adviser charges

Ongoing adviser charges facilitated by the provider, come out of the product. They are withdrawals and form part of the 5% withdrawal allowance. Care is needed when withdrawals are taken from the product where ongoing adviser charges are also being paid from that product. The ongoing adviser charges from the product reduce the amount you can take without exceeding the cumulative 5%. If it is exceeded, a chargeable event arises, resulting in a potential income tax liability on the excess.

Taxation of bonds is a particularly complex topic and as such, we would recommend you speak to your financial adviser.

Glossary

Chargeable Event

If a chargeable event arises, it is then necessary to calculate if a gain has arisen on that event. If so, then tax may be due, but remember that chargeable event gains on UK bonds are not liable to basic rate tax. The main chargeable events were explained on page one.

Chargeable Event Certificate

A chargeable event certificate is issued on the occurrence of a chargeable event.

Deficiency Relief

A special relief called 'deficiency relief' may be available to individuals only when a policy or contract comes to an end.

There is no relief under the chargeable event regime in any circumstances for an investment loss sustained on a policy or contract. Neither can a loss on one policy be set against a gain on another.

For more information on entitlement to, and calculation of, deficiency relief, please refer to **HMRC**.

Offshore Bonds

An Offshore Bond is a single premium insurance policy written outside the UK. It also confers certain tax advantages on the assets contained within it.

Single Premium Life Assurance Bonds

Single premium investment bonds are investments packaged as life assurance, primarily designed for investment but with an insurance over-ride (often 101% of the investment value).

Top Slicing Relief

Top slicing relief is generally available where the taxpayer would be liable to tax at a lower rate were it not for the inclusion of the chargeable event gain in their income for the year. When the chargeable event gain does not move a taxpayer into a higher tax rate, there may be still be some top slicing relief available due to the effect of the personal savings allowance nil rate and the starting rate for savings.

Time Apportionment Relief (TAR)

For those UK residents who have not been UK resident throughout the period the policy/Bond has been held, then TAR may apply. Under TAR, the chargeable gain on the policy is reduced for tax purposes if the beneficial owner was not UK resident throughout. For example if the beneficial owner was non-UK resident for the whole period then the chargeable gain would be nil. This is a complex area and professional advice may be necessary

Important information

This leaflet describes the taxation treatment of UK investment bonds. Offshore bonds may be treated differently by HMRC for tax purposes.

Also, the tax treatment described may not apply if your Bond is held in trust, depending on the nature of the trust. We suggest that you consult your legal adviser if you are concerned about this.

A tax return guide (explaining how to use information contained within a chargeable event certificate, in your tax return), and a help sheet about life assurance policy gains, are available from HMRC if required. For self-assessment purposes a chargeable event certificate must be retained for at least six years. For more information on Chargeable Events please speak to your Financial Adviser. You may be charged for any advice provided.

The information in this document is based on our understanding of current taxation, legislation and HM Revenue & Customs practice, all of which are liable to change without notice. The impact of taxation (and any tax reliefs) depends on your circumstances.

INVS0002 08/2023_WEB