A guide to tax on your UK investment bond

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

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 above 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 gain 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. If you are in any doubt or require further information you should contact your Financial Adviser.

The value of an investment can go down as well as up and is not guaranteed. You could get back less than you have paid in.

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 individual circumstances.
How is my investment taxed

Prudential pays tax on income and capital gains accrued within its funds. HM Revenue & Customs (HMRC) regards payment of this tax as equivalent to you having paid Capital Gains Tax and Basic Rate Income Tax, so you have no personal liability to Capital Gains Tax or Basic Rate Income Tax on the gain from your Bond. However, the tax paid by Prudential is not reclaimable.

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 your death, or
› on certain assignments (transfer of legal ownership of all or part of your Bond) for money or money’s worth. This can include an assignment as part of a divorce settlement. If this were to ever apply, please refer to a Solicitor for further information, 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 the life/lives assured, dies), or
› on full and final cashing in of your Bond or policy within the Bond; or
› if you withdraw more than 5% (please see below for information for Corporate Investors) 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.

Personal allowances and Tax credits may also be reduced if a chargeable event occurs and a chargeable event gain or “profit”, arises.

For more information on Chargeable Events please speak to your Financial Adviser. You may be charged for any advice provided.

Tax rules for corporate investors

› UK corporate investors cannot benefit from the 5% annual tax-deferred allowance, as investments of this type made by UK companies are held within the ‘loan relationship’ legislation. For more information, please speak to your Financial Adviser.

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 maximum 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.

Tax liability on death and terminal illness

A chargeable event will occur 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 or “profit” is calculated on the cashing in value 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 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.

Please note that where a policy is assigned (including assignments by way of gift), any tax liability arising from withdrawals will usually be assessed against the policyholder at the time of the withdrawals that have given rise to the Chargeable Event.

For bonds sold after 1 January 2013 the adviser charges, such as Ongoing Charge and Ad hoc Charge, are treated as withdrawals.

Large partial withdrawals

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

Say an investor invested £20,000 into a bond. Towards the end of the second bond year there is an unexpected need to make a withdrawal of £10,000. Let’s say that at the time the money was needed, the investor’s bond value was only £17,000.

The investor instructs Prudential to pay £10,000 as a partial withdrawal.

On the second anniversary, Prudential are required to issue a “Chargeable Event Certificate” (CEC) to the policyholder showing that the £10,000 was withdrawn, but 2 years of 5% were available (2X5% of £20,000 = £2,000) so the “chargeable event gain” (the gain) shown on the CEC would be £10,000 – £2,000 = £8,000.

If the investor was already a “Higher Rate Taxpayer” before taking account of “the gain”, tax would be due for the tax-year within which the 2nd anniversary date of the bond occurred. This would be calculated as (currently) 20% of £8,000 = £1,600.

If the investor was already an “Additional Rate Taxpayer” then tax at 25% of £8,000 = £2,000 will be due.

So, even though the overall value of the bond had fallen by £3,000 (−15%), tax on the “excess” withdrawals of £8,000 would have to be paid.

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.

How an artificially high tax liability may be avoided

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

Deficiency relief

On full and final cashing in of the Bond (or individual policies within the Bond), where there has been a previous chargeable event gain(s) and subject to certain conditions, ‘Deficiency relief’ (limited to a maximum of the total chargeable event gains previously notified) may be available, which could reduce liability to income tax above the basic rate. For further information, please speak to your financial adviser.
Tax liability on final cashing in

Any tax liability on final cashing in or death 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.

Top Slicing relief

“Top slicing relief” may reduce the tax liability on any chargeable event gain:

- To work out the profit slice the gain amount is divided by what HMRC refer to as ‘Relevant Years’ which is:
  - on final cashing in – the number of complete policy years that the Bond has been held,
  - on withdrawals – the number of complete policy years that the Bond has been held, or
  - since the last reported chargeable event gain if less.

The amount of the profit slice is then added to your taxable income. Any part of the profit slice that falls into the Higher Rate (and the Additional Rate, where applicable) tax bracket is taxable at the difference between Higher/Additional Rate of Income Tax and the Basic Rate of Income Tax.

The total tax due is calculated by multiplying this amount of tax on the profit slice by the number of Relevant Years.

- Top slicing can reduce your tax liability if none of your taxable income, before the profit slice, would have been subject to tax above the basic rate, or where the excess gain takes your income into the Additional rate tax bracket.

Entitlement to Basic Personal Allowances, Working Tax Credit and Child Tax Credit

You should also be aware that entitlement to personal allowances 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 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.