A guide to tax on your UK investment bond

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

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.

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, 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 fully cashing in your Bond or any individual policy within the Bond; or
- if you withdraw more than 5% (please see the next page 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.

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 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. 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.
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.

• 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 tax calculation, irrespective of any profit or loss on the Bond.
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).

**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 unless by the time the deferred charge is triggered, your circumstances have changed so that no tax is payable.

So, 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 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. 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

Deficiency relief (limited to a maximum of the total chargeable event gains previously notified) may be available, to reduce liability to income tax above the basic rate. This may apply on maturity, death or fully cashing in the Bond/individual policies within the Bond, where there has been at least one previous chargeable event gain due to the 5% allowance being exceeded, subject to certain conditions. For further information, please speak to your financial adviser.

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.

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: Work out 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.

Step 2: Work out the total tax due on the gain across all tax bands and then deduct basic rate tax treated as paid, to find your liability for the tax year.

Step 3: Work out the annual equivalent of the gain – calculated by dividing the gain by N (see below).

Step 4: Work out your liability to tax on the annual equivalent. The amount of the savings starting rate and personal savings allowance used in the top slicing relief calculation are set as a result of your adjusted net income for the tax year. They are not adjusted to calculate the notional tax due on the ‘sliced gain’. To work out your relieved liability, deduct your basic rate tax treated as paid on the annual equivalent and multiply the result by N.

Step 5: Deduct your relieved liability at Step 4 from your liability at Step 2 to give the amount of top slicing relief due.

Calculating ‘N’

‘N’ is the number of complete years ending with the date of the chargeable event and starting with the later of either the commencement or last excess event*

* unless policyholder has a period of non-residence in which case TAR (time apportionment reduction) will apply.

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