LONDON & COLONIAL

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Offshore Open Bond Tax Guide

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1 Introduction

This leaflet sets out London & Colonial's understanding of the various taxation issues in relation to the Offshore Open Bond for Bondholders who are resident in the UK for tax purposes. It covers both the taxation of the fund itself as well as the UK taxation implications for the policyholder. It is not intended to be a comprehensive guide so if you are in any doubt as to how the Bond could affect your tax position please speak to your financial adviser. Different taxation rules may apply if you are resident outside the UK.

2 Taxation of the fund

There are no UK or Gibraltar taxes on income or capital gains within the fund. Because of this funds such as ours are commonly referred to as "gross roll up" funds. However, please note that some countries apply a non-recoverable withholding tax on dividends paid by companies based in that country.

3 Taxation of the policyholder

When part of or your entire Bond is cashed in you may have to pay UK tax on the amount received. The following paragraphs provide further information.

4 Withdrawals

Your Offshore Open Bond has been split in to 1000 "mini" policies. Each mini policy is treated separately in order to benefit from the tax advantages available.

You may withdraw up to 5% of your original investment paid into each mini policy each year without an immediate tax charge becoming due. Any unused amount of this allowance in one year can be carried forward indefinitely. Once you have withdrawn 100% of the amount you have paid in then this allowance ceases.

This means that if you wish to cash in some of your Bond you may either cash in an amount spread across all your mini policies or you can cash in one or more mini policies in full. Each method has a different tax treatment and you may use the method which produces the lowest tax liability. Please see the examples at the end of this document.

If you cash in your Bond or take withdrawals in excess of the 5% allowance the amount taken will need to be tested to see whether some of the withdrawal needs to be treated as a "chargeable gain" and thus liable to an income tax charge.

5 Chargeable gains

A chargeable gain is calculated as follows:

1. If individual policies or the whole Bond is fully surrendered then the chargeable gain is the amount surrendered, plus any previous amounts taken, less the amounts paid into the Bond less any previous chargeable gains which have already been taken into account.

2. Where only part of the Bond is surrendered and this amount is in excess of the 5% allowance then the gain is calculated as the amount surrendered less the available 5% allowance.

6 Tax payable

The chargeable gain is added to your other income in the relevant tax year and taxed at the appropriate rate. So for a basic rate taxpayer the tax charge will be 20% and for a higher rate tax payer it will be 40%.

7 Top slicing

If the amount of the chargeable gain, when added to your other income, takes you into the higher rate tax bracket you may use “top-slicing relief” to reduce the amount of the tax charge. Please speak to your financial adviser for further information about this.

8 Tax credits/allowances

When a chargeable gain occurs then the amount of the gain will affect the amount of any age allowance that you currently receive. However, the allowance cannot drop below the basic personal allowance.

Chargeable gains may also affect your entitlement to either working tax credits or child tax credits.

9 Time apportionment

If you have not been resident in the UK for tax purposes while the Bond has been in force chargeable gains due may be proportioned for the period that you have been resident overseas. This means that gains payable are calculated as:

$$\text{Total gain} \times \frac{\text{Period of residence in the UK while the Bond was in force (in days)}}{\text{Total period that the Bond was in force (in days)}}$$

10 Inheritance Tax

If your Bond is not set up under Trust then on your death it will form part of your estate and may increase any liability to inheritance tax.

11 Examples

Example of chargeable gain calculations

A single premium bond was purchased on 1.1.01 for £100,000. The following part surrenders were made:

1.9.02 - £6,000

1.12.03 - £6,000

1.10.04 - £10,000

1.5.06 - £12,000

The policy is fully surrendered on 1.10.08 for £120,000.

Gains are computed as follows:

(i) Part surrenders

Allowance available for each policy year = 5% of £100,000 = £5,000

Policy year	5% allowances	Partial encashments	Gains	Unused allowances carried forward
1.1.01 - 31.12.01	5,000	-	-	5,000
1.1.02 - 31.12.02	5,000 + 5,000 b/f	6,000	-	4,000
1.1.03 - 31.12.03	5,000 + 4,000 b/f	6,000	-	3,000
1.1.04 - 31.12.04	5,000 + 3,000 b/f	10,000	2,000	-
1.1.05 - 31.12.05	5,000	-	-	5,000
1.1.06 - 31.12.06	5,000 + 5,000 b/f	12,000	2,000	-
		34,000	4,000	

(ii) Full surrender

On the full surrender of the Bond the gain arising is as follows:

[Surrender value + previous part surrenders]

Less

[Premiums paid + gains arising on previous part surrenders]

= [120,000 + 34,000] - [100,000 + 4,000]

= £50,000

It should be noted that where a policy is substituted, premiums paid under the old policy are not taken into account in the calculation of the 5% allowances although the value of the old policy applied as the first premium under the new policy can be taken into account for this purpose. The 20 year period runs from the commencement of the substitute policy.

Example of taking withdrawals across all segments vs. cashing in whole segments

Example 1.

Investment of £100,000 split into 10 mini policies i.e. £10,000 each.

1.5 years later the Bond is worth £125,000 i.e. £12,500 for each mini policy.

The Bondholder wishes to surrender £50,000.

As the policy is in its second year the 5% allowance is:

£100,000 × 5% × 2 = £10,000.

If the policyholder cashes in £50,000 across all segments then the taxable gain is:

£50,000 - £10,000 = £40,000.

£40,000 is then added to the policyholder’s income and, assuming they are a higher rate taxpayer, taxed at 40% so there is a tax liability of:

£40,000 × 40% = £16,000.

If the policyholder had surrendered 4 clusters each of which are currently worth £12,500 (£125,000/10 = £12,500) the gain would be:

£50,000 - £40,000 = £10,000.

Hence there would be a tax liability of £10,000 × 40% = £4,000.

A difference of £12,000.

Example 2

Investment of £100,000 with 10 clusters.
In year 3 the policyholder wants to cash in £11,000.

By encashing across clusters the client has no immediate tax liability as £11,000 is within the 5% allowance of £15,000 (£100k × 5% × 3)

If a whole segment had been cashed in the gain would be:

£11,000 - £10,000 = £1,000.

Tax at 40% would mean a tax bill of £400.

In example 1 it is therefore better to cash in whole segments, however, in example 2 it would be better to take the money across all segments.

12 Enquiries

If you have any queries or require any further information please contact us at this address:

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