

information about taxation

offshore single premium investment bonds for individuals for financial advisers only

The aim of this document is to explain how income tax will be assessed and charged where an individual holds an offshore single premium investment bond or a capital redemption bond offered by Royal Skandia Life Assurance Limited (Royal Skandia).

In these notes, references to the current UK tax rates mean rates in the tax year ending 5 April 2009 (tax year 2008/2009).

Royal Skandia is not liable to any form of tax in respect of the fund to which your client's contract can be linked. However, any taxation deducted at source on certain investment income cannot be recovered.

Where funds invest in unit trusts or other collective investment schemes, the valuations are based on the daily dealing prices of the unit trusts (as negotiated by Royal Skandia), usually using the purchase price.

Normally, there is a valuation of each fund on each working day.

rules for UK residents

'Residence' and 'Domicile'

Your client should bear in mind the distinction between 'domicile' and 'residence' for tax purposes. In simple terms, they are 'resident' in the country in which they are living. Their country of origin, usually the country where they were born, is normally where they are 'domiciled' even if they are resident in another country for many years. More information on domicility can be found in the document [UK domicile – questions and answers](#) which is available from Royal Skandia upon request.

UK Capital Gains Tax (CGT)

There is currently no personal charge to CGT in connection with your client's contract provided they are the original owner, regardless of where they are domiciled or resident.

Under current Isle of Man legislation Royal Skandia enjoys tax exemption in respect of policyholders' funds. Disposal of assets in the fund(s) to which your client's contract is linked will not therefore incur any liability to Royal Skandia for CGT in the Isle of Man.

Withholding taxes on fund income

Royal Skandia is not currently liable to income tax in the Isle of Man or the UK. However, certain investment income accruing to a fund may be subject to a tax deduction at source which is withheld in the country where the investment is situated. The income credited to a fund will therefore be net of any such withholding tax.

Highly Personalised Bonds – if UK resident

Your client should be aware that this type of bond is subject to tax under the Personal Portfolio Bond (Tax) Regulations 1999. This has now been consolidated into the Income Tax, Trading and Other Income Act (ITTOIA) 2005, and is taxed each year on a deemed gain equal to 15% of the premium compounded. This tax may be in addition to say, the charge on a 'chargeable event'.

More information can be found in the document [personal portfolio bond tax planning for the international investor](#).

Policy gains if your client is UK resident throughout

Basic points to note

If your client is UK resident throughout the period their contract is in force they will be liable to UK income tax in respect of any policy gains arising under the policies comprising their contract.

All gains may be liable to starting rate income tax (where the individual's taxable earned income is less than £2,320) and the basic rate of income tax. They will also be liable to higher rate income tax if their total taxable income, taking into account their policy gains after any 'slice relief' (see [Higher rate income tax overleaf](#)) exceeds the higher rate income tax threshold.

Currently, UK starting rate income tax which only applies to savings income is 10%. There is just one basic rate of income tax of 20% for taxable income up to £34,800. There is also only one higher rate of income tax of 40% where policy gains, when added to an individual's earned and other taxable savings income, are in excess of £34,800.

Royal Skandia does not deduct any UK income tax from payments under your client's contract. The client will be responsible for declaring the payment in their next self-assessment tax return to their local inspector of taxes and personally settling any liability.

Royal Skandia's tax reporting requirements

Under regulations made in 1999, Royal Skandia will report certain payments and events affecting UK resident policyholders. For policies issued before 6 April 2000, we will report events other than those in relation to part surrenders in excess of twice the basic rate threshold. It remains an obligation of the policyholder to report all gains to HM Revenue & Customs irrespective of the amount.

Policy 'gains' are taxed under special income tax rules for life assurance policies, not under the CGT rules which sometimes apply to investments.

a. When do 'gains' arise?

Policy gains may arise in the following situations:

- (i) when withdrawals are taken from your client's contract by partial surrender of the policies in their contract
- (ii) when a withdrawal is taken by full surrender of one or more policies in their contract
- (iii) when loans are made by Royal Skandia (or by arrangement with Royal Skandia) on security of the policies in their contract
- (iv) when their contract is fully encashed, either on full surrender of all the policies or on the death of the relevant life assured
- (v) when their contract is assigned for consideration in 'money or money's worth'
- (vi) where the contract comes to an end due to maturity.

The contract is issued as a group of policies, so that when your client takes withdrawals from their contract they can either partially surrender all the policies or fully surrender individual policies to suit their particular tax position.

b. Partial surrender of policies

Withdrawals by partial surrender of policies will not result in policy gains under the tax rules provided the amounts withdrawn do not exceed the tax deferred withdrawal allowance. Each policy in your client's contract has its own separate allowance. For each premium under the policy concerned, the allowance is 5% of the premium for the policy year in which it is paid and a further 5% allowance accrues at the start of each subsequent policy year for the next 19 years. Any unused allowance can be carried forward to future policy years.

Part surrenders which fall within the withdrawal allowance are tax deferred because they will be taken into consideration on the full surrender of policies.

If your client exceeds the 5% allowance, the whole of the excess will be treated as a policy gain, which will be deemed to arise on the last day of the policy year in which the part surrender occurs. The tax rules for calculating partial surrender gains ignore actual investment performance.

c. Full surrender of individual policies

The policy gain calculation on full surrender of a policy takes into account investment performance and any previous sums treated as partial surrender gains under the policy concerned.

The gain is the amount by which the proceeds from the policy, including any previous partial surrender proceeds, exceed the premium(s) and any previous partial surrender gains. If there is no gain there is no charge to tax on full surrender of the policy.

d. Contract loans

Where your client's contract allows this facility, any loans made by Royal Skandia, or by arrangement with Royal Skandia, will be treated as a withdrawal by partial surrender. If the amount exceeds the 5% allowance the whole of the excess will be deemed to be a partial surrender gain. This applies whether the loan is interest-free or a normal commercial loan.

The special loan facilities under some of our existing contracts are designed primarily for policyholders who are not UK resident.

e. Full surrender of the contract

On full surrender the gain arising under the contract as a whole will be the sum of the full surrender gains under each of the policies then comprising the contract. The calculation of the gain for full surrender of individual policies also applies to the calculation of the gain on full surrender of the contract.

Where full surrender occurs on death of the relevant life assured, the extra death benefit in excess of the surrender value is ignored for calculating the gain.

Time apportionment if your client is only UK resident for part of the contract term

The chargeable events will be calculated in the same way as those for individuals who are UK resident throughout, but there is a relief available on these gains.

If your client is a UK resident for only part of the period their contract is in force, the gross amount of any gains will be reduced to a net amount reflecting the number of days they have been resident outside the UK.

The reduced gain will be calculated as follows, looking at the period from the policy start date to the date the gain arises under the policy or policies concerned:

$$\text{Gross gain} \times \frac{\text{Number of days they have been resident in the UK}}{\text{Number of days the policy has been in force}} = \text{the net gain}$$

Time apportionment relief does not apply where the contract policies are or have previously been subject to a trust, where one or more of the trustees was not UK resident.

Starting and basic rate UK income tax

Each gain, as reduced by any time apportionment, will be liable to UK basic rate income tax (currently 20%). It may be liable to starting rate tax of 10% if your client's taxable earned income is less than £2,320. However, if your client's taxable earned income is more than £34,800 (2008/09 tax year) it may also be liable to higher rate tax.

Example

If the gain, without any time apportionment, is £10,000, the basic rate tax liability will be £2,000 assuming that your client has other taxable income of £8,355 (personal allowance of £6,035 (if under 65) plus £2,320 starting rate).

If the policy has been in force for 1,000 days when the gain arises and during that period they have been UK resident for only 400 days the reduced gain will be £4,000 and the basic rate liability will be only £800.

Higher rate income tax (HRT) and top slicing relief

Top slicing is a method of assessing the tax payable on policy gains more fairly for your clients who are not normally higher rate taxpayers, but the policy gain may push them into HRT.

If your clients are higher rate taxpayers before assessing the policy gain, then top slicing relief is not relevant.

a. If your client's other taxable income is liable to HRT

The whole of the policy gains (net of any time apportionment relief) will be liable to HRT. Currently there is just one higher rate (40%) on all taxable income (other than dividends) over £34,800. Thus if your client's other taxable income exceeds £34,800 their net policy gains under their Royal Skandia contract policies will bear income tax at 40%.

b. If your client's other taxable income is not liable to HRT

In these situations, the slice relief provisions may reduce or avoid higher rate income tax in respect of policy gains arising in the tax year.

Each gain arising in the tax year, net of any time apportionment relief, is divided into a 'slice' by reference to the number of complete years from the start of their contract to the date the gain arises, the 'slice relief period'. The resulting slices are then added together into an aggregate slice.

Example

Your client has gains under two policies, each with a slice relief period of five years, and the gain under each policy is £2,000 (total gains of £4,000); the slice for each gain will be £400 (ie £2,000 divided by five) and the aggregate slice for calculating any higher rate income tax will be £800.

The aggregate slice for all the policy gains in the tax year is added to your client's other taxable income. Higher rate income tax only arises if the total exceeds the higher rate income tax threshold. In that situation higher rate income tax on the excess over the threshold is calculated and converted into a tax rate by reference to the aggregate slice. That tax rate is then applied to all the policy gains.

Example

Taxable income is £34,800. Using the previous slice relief example, the aggregate slice is £800. Therefore £300 is in excess of the basic rate threshold. £300/£800 x 20% is 7.5% effective tax rate. This tax rate is then applied to £4,000 policy gains.

This document is based on Royal Skandia's interpretation of the law and UK HM Revenue & Customs practice as at February 2009. While this interpretation is believed to be correct, we cannot guarantee it. Skandia cannot accept any responsibility for any losses or liabilities arising from action taken as a result of the information contained in this document. The value of any tax reliefs will depend on individual financial circumstances. Where a fund holds investments in another currency, there may be additional risks because of exchange rate fluctuations.

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Skandia International is the divisional name for the international companies within the Skandia UK Group.

www.royalskandia.com

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