

INSURANCE BONDS

Insurance Bonds, sometimes known as Single Premium Investment Bonds, are non-qualifying insurance policies. Whilst they do include a small amount of life cover to qualify as an insurance policy this is, essentially, a small amount (up to 1%) above the current fund value at any time. This means the product is more akin to a Unit Trust than a conventional insurance policy with important differences in the tax treatment of profits made.

Profits made within these products are taxed internally at the appropriate life assurance companies corporation tax rates. This is approximately equivalent to the tax on savings income, dividends and other income that would be paid by a basic rate taxpayer. Capital Gains Tax is also paid on all profits made, again at the corporation tax rate.

The investor, therefore, does not have to meet any basic rate Income Tax liability that may arise due to the profits made on investment in such a Bond. However, whilst basic rate tax is deemed to have been paid, this is not reclaimable by individual investors who are paying Income Tax at 10% or not paying tax at all.

All profits made will be taxed to Income Tax and Capital Gains Tax allowances cannot be set against profits made.

The Inland Revenue allow a withdrawal of up to 5% of the initial investment to be made during each policy year without there being an immediate assessment of tax due. This can be useful in providing "income" for the investor but it does represent a withdrawal of capital and will deplete the investment portfolio unless there is sufficient investment profit to make up the amount withdrawn. The impact of charges should not be forgotten and anyone withdrawing 5% from a single premium investment Bond will probably have to see investment returns of 6% to 6.5% per annum to maintain the value of the investment.

Where withdrawals exceed 5% of the initial investment in any one policy year, the excess profits are added to the taxpayer's income for that tax year. The relevant date for this purpose is the policy anniversary rather than the date of withdrawal. If this amount, as the top slice of the taxpayer's income, triggers a higher rate tax charge, this is calculated at the difference between basic rate tax on savings and higher rates of tax which, from April 2004 is 20% (40% minus 20%).

When the policy is finally encashed, the profit calculated by reference to the total proceeds received (including all previous withdrawals not already assessed to tax) less the original investment, will be divided by the number of complete years that have elapsed since purchase. The resultant figure will be added to the taxpayer's income for that particular tax year (based on encashment date rather than policy year) and an appropriate "rate" of tax calculated. If the sliced gain does not push the taxpayer into higher rates of tax, no further charge will arise. If the gain is wholly into the 40% bracket, then an additional 20% tax, calculated on the whole of the gain, will be due. If

the slice straddles the basic rate and higher rate tax bands then the average rate of tax will be calculated on the slice and the amount of tax due will be this percentage of the whole gain.

Top slicing relief will not apply for the purposes of age allowance which may be wholly withdrawn by virtue of profits made in this fashion.

These Bonds offer a number of different funds links varying from Cash, Fixed Interest, Property, Equity, Managed and With Profit. All of these funds can fall in value as well as rise (save the Cash or Deposit Fund) and can be quite volatile. With Profit Funds can suffer from a market value reduction which may be applied at any time by the life assurance company. This can reduce the investment value considerably and erode the initial value of investment.

Early surrender penalties may also apply to many Bonds.

These notes are based on our understanding of current legislation and practice which is subject to change.

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