canada life™

Chargeable gain information for customers holding an onshore policy

Introduction

Gains made under life insurance policies are chargeable to income tax rather than capital gains tax.

However, you will only pay income tax if:

- a chargeable event occurs, and
- a gain arises from that event; and
- When the gain is added to your taxable income, for the tax year,the total falls into the higher or additional rate tax band.

A chargeable event may arise on:

- the death of the last surviving life assured
- the full surrender of the whole bond or a segment within the bond
- partial surrender/regular withdrawals
- all or part of the bond is assigned to another individual for money or money's worth
- maturity.

Please note a chargeable event does not arise on all types of policies; please contact your provider if you are unsure whether your policy is affected.

How is the gain calculated

Maturity or full surrender of a policy

The chargeable gain is worked out as follows:

Maturity/Final Surrender value
+ Value of all withdrawals previously taken
– Amount invested
– Previous chargeable gains
= Chargeable gain

Example

A policyholder took out a bond for £10,000 in January 2012. It is now June 2022 and they wish to fully surrender the bond. The bond is worth £11,000 and over the years they took the following withdrawals

Feb 2014 a single withdrawal of £250

Jan 2016 – Dec 2016 £250 each month (gain of £750 reported)

Jan 2017 – May 2017 £250 each month (gain of £750 reported).

	Surrender value	£11,000
+	Value of all withdrawals previously taken (£250 + (12 x £250) + (5 x £250)	£4,500
–	Amount invested	£10,000
–	Previous chargeable gains	£1,500
=	Chargeable gain	£4,000

Withdrawals

When you withdraw money from the bond a calculation is carried out at the end of that policy year to check whether a chargeable event has happened. If the amount withdrawn exceeds a certain limit then a chargeable gain results regardless of whether the value of the bond has increased.

Each year you can receive 5% of the premium paid into the policy without an immediate liability to income tax. This is known as the 'cumulative annual allowance'. Any allowance not used can be carried forward to future years.

As well as the 5% allowance there is an overall maximum limit. Once 100% of the cumulative allowance has been used any further withdrawals, regardless of the amount, are considered a chargeable event. Therefore, you can take 5% each year for 20 years without any immediate tax liability.

To calculate the gain:

- add together all the withdrawals/part surrenders for that policy year
- calculate the 5% cumulative allowance ('allowable aggregate amount')
- subtract the cumulative allowance from the total withdrawals/part surrenders

Example

The policyholder of a £10,000 bond took a withdrawal of £5,000 in year 4. There have been no previous withdrawals/part surrenders. The amount of the gain is the excess, that is, £3,000 as the cumulative 5% allowance totals £2,000 (4 x 5% x £10,000).

Tax on the chargeable gain

Tax at the basic rate (currently 20%) is regarded as paid automatically on the chargeable gain (due to the way in which the life funds are taxed). The amount of a chargeable gain is added to the policyholder's income to see what tax band this falls into and therefore how much tax is due, although this could still be within the basic rate tax band and therefore not liable for additional income tax.

Examples

1. Sarah has taxable income of £15,000 for the tax year 2022/23. In June 2022 she fully surrenders her bond, which results in a £10,000 chargeable gain. When the chargeable gain is added to her taxable income as the total is still within the basic rate tax band (£37,700 2022/23) no further tax is due.

2. Sarah has taxable income of £50,000 for the tax year 2022/23. In June 2022 she fully surrenders her bond, which results in a £10,000 chargeable gain. Her taxable income already makes her a higher rate taxpayer and when the chargeable gain is added she remains within the higher rate tax band. As the basic rate tax liability has already been covered by the tax paid within the life funds, the higher rate tax liability on the chargeable gain is only 20% (that is 40% - 20%). So, Sarah's tax liability in respect of the chargeable gain is therefore £10,000 x 20% = £2,000.

3. Sarah has taxable income of £33,200 for the tax year 2022/23. In June 2022 she fully surrenders her bond, which results in a £10,000 chargeable gain. When the chargeable gain is added to her taxable income £5,500 is within the higher rate tax band (£43,200 - £37,700). Sarah's tax liability in respect of the chargeable gain is therefore £5,500 x 20% = £1,100.

Top slicing

Where the amount of the chargeable gain falls partly in one tax band and partly in another, as shown in example 3, you could benefit from the top slicing rules. The effect of top slicing relief is to reduce the rate of tax charged on the gain by applying a spreading mechanism. The chargeable gain is allowed to be divided by the number of complete policy years over which it has been accrued (or since any previous chargeable gain) so that only part of the chargeable gain, if any, then falls into the higher or additional rate tax bands.

Let us assume that the policy in example 3 has been running for 10 complete years and there have been no previous chargeable gains. This means that Sarah can divide the £10,000 chargeable gain by 10, which equates to £1,000. This top sliced gain is then added to Sarah's taxable income to determine how much of the chargeable gain, if any, falls within the higher rate tax band. As the total is still within the basic rate tax band (£37,700 2022/23) no further tax is due.

Alternatively, let us assume that the policy in example 3 has only been running for 2 complete years. This means that the top sliced gain would be £5,000 and when this is added to Sarah's taxable income it falls within the higher rate tax band by £500. Sarah's tax liability in respect of the chargeable gain is therefore £500 x 2 years x 20% = £200.

Please note that top slicing relief cannot assist taxpayers already liable to tax at either the higher or additional rate before the chargeable event is added to their income. Also there is no top slicing when calculating entitlement to age related allowances or child or working tax credits. The full amount of the gain is included.

This document is based on Canada Life's understanding of applicable legislation, law and current HM Revenue & Customs practice as at February 2023. The information regarding taxation is based on our understanding of current legislation, which may be altered and depends upon the individual circumstances of the investor. We recommend that investors seek their own professional advice.

Canada Life Limited, registered in England no. 973271. Registered office: Canada Life Place, Potters Bar, Hertfordshire EN6 5BA.
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