Collective Investment Bond: taxation of the life fund

Quilter

For financial advisers only

This document outlines how Quilter Life & Pensions Limited ('Quilter') pays Corporation Tax on income and gains within the Collective Investment Bond. It also explains how Quilter recoups this through a 'Life Fund Tax Charge' deducted as part of the bond charges payable by the policyholder.

Key Takeaways:

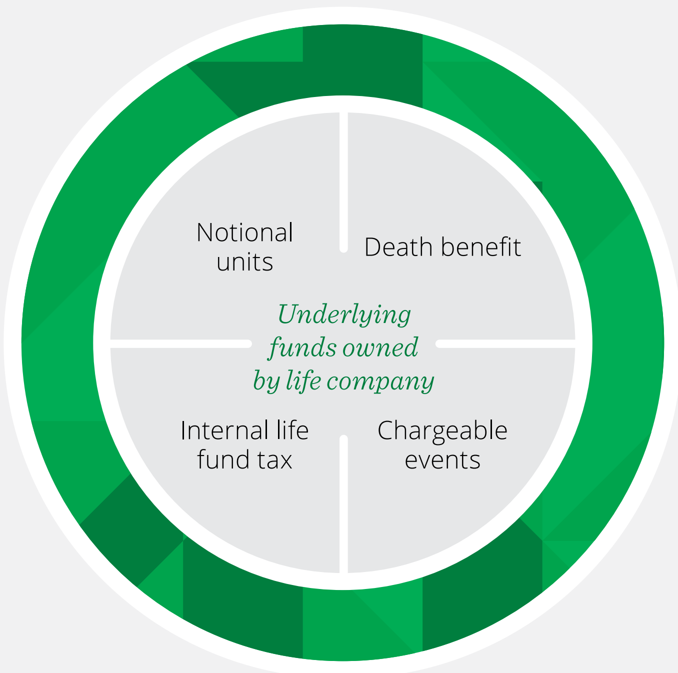
- All UK life companies who offer an onshore single premium insurance bond will be subject to Corporation Tax on income and gains on 'policyholder funds'. These are funds held solely for the purposes of backing the value (liability) of the insurance policies they have written
- Income and gains on policyholder funds are not taxed at the normal rates of Corporation Tax but at a 'policyholder rate' linked to the basic rate of income tax – 20%
- All UK life companies recoup the tax they are subject to from policyholders. This traditionally is done through the price set per unit in the life company's internal life funds
- As Quilter does not offer internal life funds, the Collective Investment Bond is linked directly to the underlying fund. This means the price is consistent across all products on the platform
- The way the corporation tax is recouped on the Collective Investment Bond is through the Life Fund Tax Charge, an explicit charge taken from the investment bond ('the bond')
- The amount of the Life Fund Tax Charge will vary dependent on the investments to which the policyholder links the value of their Collective Investment Bond
- The amount of the Life Fund Tax Charge will be equal to or less than 20% of any income or gains
- The policyholder will receive a 20% tax credit, which can be used against any income tax liability as a consequence of a 'chargeable event gain' on the bond.

Structure of an investment bond

In order to understand how bonds are taxed it is important to highlight the unique structure of an investment bond (see diagram).

- A bond is a unit-linked life insurance policy usually offering a death benefit. Most will be written as a number of identical policy segments. The Collective Investment Bond offers 100.1% (101% prior to 25 November 2024) (of the surrender value) death benefit and 1,000 policy segments
- The policyholder owns the bond, which has 'notional units', which are valued by reference to the rise and fall of the underlying funds
- The underlying funds are legally and beneficially owned by the life company
- Any income and gains made on the underlying funds are taxable on the life company
- If no policy withdrawals are made, then any income or gains within the insurance bond do not create a liability to personal tax or any associated personal reporting obligations
- A personal liability to Income Tax will only arise when one or more chargeable events occur in a tax year. These events include (but are not limited to) full surrender of one or more (including all) policy segments, exceeding the 5% tax deferred allowance and/or the death of the last life assured.

Investment Bond



How the underlying funds are taxed on the life company and how this tax provides a tax credit for the policyholder

Quilter-tax position

Income:

Where the underlying funds generate income, Quilter will be assessed for Corporation Tax as follows:

- UK dividends – exempt*
- Overseas dividends – exempt*
- Interest – 20%
- Rent – 20%
- Fund rebates – 20%

** Dividend payments are made by unit trusts where 40%+ is in equity investments. An element of the dividend distribution may be a non-exempt payment. This element is subject to 20% tax. Overseas dividends may be subject to withholding tax.*

Realised capital gains:

Capital gains may be realised on switches and surrenders of funds. Realised gains suffer tax at 20% (subject to use of losses).

Annual 'rebasing' (deemed disposal):

In addition to actual disposals, underlying funds are subject to a 'deemed disposal' and reacquisition at their open market value at the end of the life office's financial year. The financial year for Quilter is 1 January to 31 December.

The tax on the 'deemed disposal' is paid over a seven-year period, except for the tax on underlying funds primarily invested in interest-bearing securities (eg gilt funds).

The effective tax rates applied to the 'deemed disposal' gains are determined by actuarial calculations that take account of the timing delay between the tax deduction being made from the life funds and the tax being paid to HM Revenue & Customs by the life company.

Use of losses

Losses can be utilised as follows:

Losses on equity funds (40%+ equity investments) - can be offset against gains on other equity funds. Where there are losses in excess of equity gains, then the loss is carried forward against future gains on equity funds only.

Losses on non-equity funds - can be offset against gains on other non-equity funds. Where there are losses in excess of non-equity gains, then the loss can be used against equity gains. Where there remains a loss, this is carried forward against future gains.

Policyholder – tax credit

Regardless of the tax paid by the life company, the policyholder will receive a tax credit that is equivalent to the basic rate of tax. This means for a basic rate tax payer (who remains so after the gain) no further income tax liability will apply on a chargeable event.

How do life companies recoup the Corporation Tax they are charged?

There are different methods of doing this. Some life companies will reflect the liability and subsequent payment of the Corporation Tax charge in the price of the notional units held by a policyholder. The price reflected is therefore the net price after charges (including Corporation Tax).

Quilter recoups the Corporation Tax liability by way of a 'Life Fund Tax Charge'. This allows a policyholder to see the amount of tax that has been paid in relation to the income and gains on the funds that their bond is linked to.

How the Life Fund Tax Charge is applied to the bond

Product charges including the Life Fund Tax Charge (the charge which reflects the Corporation Tax liabilities met by Quilter) are deducted from the Collective Investment Bond firstly out of the 'Transactional Cash' – if there is insufficient money within the transactional cash account, Quilter will encash units proportionally from the bond.

See 'When is the Life Fund Tax Charge taken?' in the frequently asked questions section for details on when a charge might be deducted.

When a policy valuation is given, the unit prices quoted are those of the underlying unit trust or OEIC – ie the price you would see widely quoted. The Life Fund Tax Charge deduction (or charge due) is then shown as a separate item within valuations produced for the bond and will be a monetary amount. An example is shown below:

Asset / Portfolio name	Number of units	Unit price (£)	Asset value (£)
Jupiter Monthly Alternative Income Acc	2,167.8000	1.2923	2,801.45
Man GLG Continental European Growth Acc	620.8380	6.6420	4,123.61
Premier Miton Multi-Asset Distribution Acc	1,807.8630	3.8040	6,877.11
Quilter Investors Cirilium Balanced Portfolio Acc	11,225.9010	0.9836	11,041.80
Quilter Investors Creation Balanced Portfolio Acc	1.1580	0.7778	0.90
Quilter Investors Creation Moderate Portfolio Acc	0.6620	0.8452	0.56
abrdn Global Smaller Companies Acc	1,730.5790	1.6410	2,839.88
		Total assets value	27,685.30
		Transitional cash value	48.23
		Total account value	27,733.53
		Accrued Adviser Servicing Fee	19.24
		Pending Life Fund Tax Charge	18.04
		Total accrued fees and charges	37.28
		Total withdrawal value	27,696.25

Where there is a loss or deemed loss on a fund, these losses are carried forward and are available to reduce the liability on future gains subject to the rules explained under 'Use of losses'. Unused losses on funds within the bond are lost on full surrender.

The overall Life Fund Tax Charge will differ according to how investment returns are achieved. The maximum Life Fund Tax Charge is 20% of the income and growth; however, it is likely to be lower than this. See frequently asked questions for more information.

Policyholder's tax liability

The Life Fund Tax Charge deducted from the bond is a reflection of the Corporation Tax suffered by Quilter. It is not a personal tax liability for the policyholder; it does not need be reported in the policyholder's tax return.

UK policyholders* are subject to tax on 'gains' resulting from the occurrence of particular events (such as, but not limited to, surrender or death of the last life assured). Because of the taxation of the life company described above, the policyholder is treated as having already paid the basic rate of income tax (20%) on any chargeable gain.

For basic rate taxpayers no further tax is payable. A further 20% is payable on the gain for higher rate taxpayers and 25% for additional rate taxpayers. For non and starting rate taxpayers, the tax suffered by the life office is not reclaimable.

Following a chargeable event, we will send a chargeable event certificate to the person we have on record as the owner of the policy. The certificate has information that can be used to help complete a tax return, if necessary.

Example of information provided on a chargeable event certificate:

Chargeable Event and Income details

Type of Event:	**Full Policy Surrender**
Date of Event:	**23 December 2024**
Number of years:	**9**
Amount of gain rounded down:	**£69,879**

Income Tax

Treated as paid:	**Yes**
Amount of tax treated as paid rounded up:	**£13,976**

**With the exception of corporate policyholders. See our brochure on the taxation of corporate investments.*

Summary

Quilter like all UK life companies suffers UK Corporation Tax on income and gains from underlying funds. Quilter offers a clear and transparent reflection of the liability relating to each bond through the Life Fund Tax Charge. As a result of the Corporation Tax paid by the life company, the policyholder receives a credit equivalent to 20% of any gain made on the bond.

Frequently asked questions

Q. When is the Life Fund Tax Charge taken?

The charge is taken at numerous points through the year and you will see these within your quarterly statements:

Income distributions – where a cash distribution is allocated to the bond (from income units) the charge (where applicable) is deducted from the cash received. You'll see the gross receipt with a deduction straight away. The same applies to fund manager rebates. Where no cash is received (accumulation units) a charge is deducted on the next bond charge date (monthly anniversary as described in the terms and conditions).

Realised gains – where units are sold, for example following a switch, and there is a capital gain, then a charge is deducted on the next bond charge date.

Full surrender / closure of the bond – once the units have been sold, the charge is deducted from the proceeds prior to making payment to the nominated bank account.

Deemed disposal - The financial year for Quilter is 1 January to 31 December. We therefore deduct any charge for the year-end deemed disposal in the first few working days of the new calendar year.

Q. What rate of Life Fund Tax Charge will I pay?

The rate of the charge will depend on the underlying funds to which the bond is linked. Different types of investment return will lead to a different Life Fund Tax Charge as described above. The maximum charge is 20% of the investment 'growth'. Where a gain has been made on some units but a loss on others, the overall charge may appear to be more than 20% of the net gain. This is due to the restriction on how losses can be offset - see 'Use of losses' earlier in the document.

Some illustrative examples are provided below showing indicative charge rates for a 6% investment return made up of different types of returns:

	Returns achieved - 6%					
Capital	3%	2%	3%	2%	2%	1%
Interest	2%	3%	1%	2%	1%	2%
Dividend	1%	1%	2%	2%	3%	3%
Indicative Life Fund Tax Charge	16.67%	16.67%	13.33%	13.33%	10%	10%

Q. Is it better for the Corporation Tax paid by the life company to be recouped via a reduction to unit prices, or as a stand-alone charge?

If you compare the Life Fund Tax Charge taken on the Collective Investment Bond with the more traditional approach of incorporating the charge within the price of a life fund (often referred to as mirror funds) you will broadly get a similar result.

Both approaches look to recoup the Corporation Tax suffered by the life company. To illustrate this at high level, a fund that achieves the same 6% shown above through a mixture of Capital 3%, Interest 1% and dividends 2%, would suffer a charge of 13.33%. On an investment of £100,000 a 6% return would be £6,000 and the charge £800.

The Life Fund Tax Charge in this example would therefore show £800 (likely over a number of transactions) whereas, under the pricing model, the price of the funds would be reduced to recoup, as shown below:

> *Fund priced at £1 at the start of the year would be £1.052 at the end of the year, ie 6% increase less 13.33% charge.*

This is a simplified comparison to illustrate the different approaches to recovering the tax suffered by the life company. No consideration has been given to any other factors, for example the difference in management charges within the fund or timing of the charge deduction.

Q. Can I reclaim the tax suffered by the life company?

The tax credit can be used to offset against a personal (or trustee) Income Tax liability. If the Income Tax Liability is less than the credit, for example a non or starting rate taxpayer, the tax suffered by the life office is not reclaimable.

Q. The bond has made a loss, but the bond has still been charged, why is this?

As described within the document, a Life Fund Tax Charge can be deducted at the following times:

- When income is earned on the underlying funds
- Receipt of a Fund Manager Rebate
- Gain on disposal of units (for example a switch or withdrawal)
- Gain on unrealised gains / deemed disposal

The Life Fund Tax Charge for income and rebates is not directly linked to whether the bond has achieved capital growth or not. It will therefore be incurred regardless of the overall gain / loss position of the bond.

The timing of the Life Fund Tax Charge associated with capital gains could lead to a Collective Investment Bond suffering a Life Fund Tax Charge even though there is currently a lower surrender value when compared to the original investment amount.

For example, a Life Fund Tax Charge could be taken at the end of year 1 when the bond is in a gain position; however, a subsequent loss in the following year below the original premium does not retrospectively alter the year 1 charge. In such a scenario no charge would be incurred in year 2.

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