TAXATION OF HIGHLY PERSONALISED POLICIES FOR UK RESIDENTS

Investing via an offshore bond can bring a number benefits, not least access to thousands of underlying investments at a discounted cost.

However, for UK resident individuals, settlors and trustees this flexibility if not managed correctly could result in an unexpected and unwelcome tax liability.

Many years ago, Her Majesty's Revenue and Customs (HMRC) introduced restrictions to limit a UK resident policyholder's power to select and hold certain assets. This was done to stop highly personal assets being sheltered in an offshore bond and, as a result, obtaining a tax advantage.

As such, where a policy holds assets which are deemed to be 'offensive' at the end of a policy year, the policy is viewed as personal portfolio bond (PPB) and subject to a 'deemed gain' tax charge, irrespective of whether there has been a gain on the policy or not.

This only applies to such bonds owned by UK residents, which took effect from the 2000/2001 tax year.

What is an offensive asset?

Offensive assets are things which are 'personal' to the policyholder or rather, not freely available to anyone else, however, they can also be structured notes, unauthorised investment trusts and equities. HMRC provides detailed information, on their website, about what is and isn't deemed to be an acceptable asset, more information can be found at the following link:

www.hmrc.gov.uk/manuals/iptm/iptm7745.htm

What is a deemed gain?

Essentially, it is an anti-avoidance tax. The legislation can be found in Income Tax, Trading and other Income Act (ITTOIA) 2005 Sections 515 to 526.

How is the calculation applied?

The tax charge is not based on actual gains within the bond. Instead, it assumes there is a gain of 15% of the premiums paid for each year the offshore bond has been in force. The tax charge is cumulative so you end up paying tax on the tax. That being said, the calculation does take into account any previous excess gains that have occurred on the policy (excess on 5% tax deferred withdrawal allowance).

Example:

Harold, a UK resident, took out a policy with a premium of £500,000. He then surrenders his policy in year 6 for £530,000.

If the policy did not hold any offending assets and was never classed as highly personalised, the gain to be assessed for income tax would be £30,000 (£530,000 – £500,000).

However, if Harold's policy held assets that made the bond highly personalised, he would have been assessed for UK Income Tax each year on the deemed gains basis. As a result, the tax charge would be approximately £131,175 by the end of policy year 5, this is shown in the table on the following page.

If Harold was holding offending assets at the end of each policy year and surrendered his bond with a gain, over the course of the policy he would have been subject to a total income tax liability of £535,679.

Total income tax liabilities during life of policy

Deemed gains - £505,679

Gain on surrender - £30,000

Total = £535,679

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Calculation

Year (y)	Premiums paid, years 1 to end year y (A)	Cumulative amount of PPB excesses for years 1 to (y - 1) (B)	Aggregate part surrender gains for years 1 to (y - 1) (C)	PPB gain for year y = 15% (A+B-C)
1	500,000	Nil	Nil	75,000
2	500,000	75,000	Nil	86,250
3	500,000	161,250	Nil	99,188
4	500,000	260,438	Nil	114,066
5	500,000	374,503	Nil	131,175
6	500,000	505,679	Nil	No Gain
			Total deemed gains:	**£505,679**

No deemed gain applied in policy year that bond is fully surrendered.

If Harold lived in another country when he opened the bond, only moved to the UK in policy year 4 and did not sell the offending assets he held by the end of policy year 4, his bond would become a PPB at the end of that policy year. As such, Harold would be issued with a Chargeable Event Certificate for the deemed gain of £114,066. If the offending assets were sold before the policy anniversary, there would be no deemed gains as the policy would not be highly personalised.

Reliefs available

Whilst top slicing relief is not available, Harold may be able to mitigate some or all of the gain by applying Time Apportionment Relief (TAR), further details on taxation of offshore bonds and the available reliefs can be found in our *Guide to offshore bonds*.

How will this affect my client?

In keeping with our product terms and conditions, we do not permit UK resident policyholders to continue to hold highly personalised policies. This does not mean that the policy needs to be surrendered, but offending assets must be sold as soon as possible. Once resident in the UK, any offending assets must be sold by the end of the current policy year to avoid it becoming a PPB.

For example, the policy commenced on the 12 July 2014 and the client returns to the UK on the 7 January 2018, any offending assets must be sold and the policy endorsed by 11 July 2018.

Important notes

For financial advisers only. Not to be distributed to, nor relied on by retail clients.

Finally, please note that every care has been taken to ensure that the information provided is correct and in accordance with our understanding the UK law and Her Majesty's Revenue and Customs' (HMRC) practice as at 30 October 2015. You should note however, that we cannot take upon the role of an individual taxation adviser and independent confirmation should be obtained before acting or refraining from acting upon the information given. The law and HMRC practice are subject to change.

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