UK TAXATION
SINGLE PAYMENT OFFSHORE PLANS

INTRODUCTION

The aim of this guide is to explain the UK tax treatment of single payment offshore plans issued by RL360.

WHAT ARE OFFSHORE PLANS?

Offshore plans are non-qualifying policies that are issued as either life insurance or capital redemption versions for UK tax purposes and are referred to as such by HM Revenue & Customs (HMRC).

PERSONAL TAXATION OF PLANS

Contrary to most investments for UK tax residents, any capital gain realised from an offshore plan is subject to income tax, not capital gains tax.

Plans are subject to the UK chargeable events regime, which is contained within Part 4, Chapter 9 of the UK income tax legislation, the Income Tax (Trading and Other Income) Act (ITTOIA) 2005.

CHARGEABLE EVENTS

Where certain transactions happen, they are treated as chargeable events and a chargeable gain calculation is then required to establish any tax that may be due.

A list of chargeable events that can occur is as follows:

- Death of a life assured that gives rise to the death benefit becoming payable.
- Maturity of a plan.
- Surrender in full or of individual plan segments.
- Regular withdrawals or one off withdrawals taken from the plan, which are in excess of the 5% cumulative tax deferred allowance.
- Full assignment of a plan for consideration in 'money or money's worth'.
- Part assignment of a plan for consideration in 'money or money's worth' which are in excess of the 5% cumulative tax deferred allowance.
- A fundamental reconstruction of the plan (e.g. an addition or a removal of a life assured).

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THE 5% ALLOWANCE AND WITHDRAWALS WHICH EXCEED THE ALLOWANCE

For each payment into a plan, an amount equal to 5% of that payment can be withdrawn each plan year for 20 years without an immediate liability to income tax. This is due to the fact that for tax purposes, withdrawals taken within the 5% allowance are treated as returns of the original capital paid.

If the 5% annual allowance is not fully used in any plan year, the unused allowance will be carried forward to the next plan year and so on, on a cumulative basis.

Where a withdrawal is made, the total amount withdrawn in that plan year will be compared with the cumulative total of unused 5% allowances at the end of that plan year and any excess will be a chargeable gain.

The total allowance is limited to 100% (5% x 20 years) of each payment. Therefore, where the regular withdrawals cease and the total allowance has been used in full, any further withdrawals taken are treated as chargeable excess gains.

Example – exceeding the 5% allowance

- £200,000 single payment and no subsequent additional single payments made.
- Plan years 1 – 4, no monies withdrawn.
- Plan year 5, £55,000 is withdrawn from the plan.

The cumulative allowance in plan year 5 is:

£200,000 x 5% = £10,000 x 5 plan years = £50,000

Total cumulative allowance = £50,000.

Therefore, **the chargeable excess gain** at the end of plan year 5, is:

£55,000 - £50,000 = **£5,000** – which will need to be declared for UK income tax.

WHEN DOES A CHARGEABLE EXCESS GAIN BECOME A CHARGEABLE EVENT?

It should be noted that where a withdrawal is taken which creates a chargeable excess gain, **the event does not occur for tax purposes until the last day of that plan year**.

For example, if a withdrawal was taken on 4 March 2019 and the next plan anniversary is 7 July 2019, the chargeable excess event would occur on 6 July 2019, i.e. in the 2019-20 tax year and not in the 2018-19 tax year.

In addition, where there is a chargeable excess event and the plan is then surrendered, the last life assured dies or the plan matures in the **same tax year**, then the previous chargeable excess event is ignored (i.e. is wiped out as though it never happened), it is only the final calculation on the exit value that is taken into account.

This is known and referred to by HMRC as 'extending the final insurance year'.

For example, where a plan has a plan anniversary of 1 August and is fully surrendered on 1 December, as both are in the same tax year, the final plan year will run for 16 months, August to December of the following calendar year.

SURRENDER IN FULL OR OF INDIVIDUAL PLAN SEGMENTS, MATURITY OR DEATH

If a plan or individual plan segments end by surrender, maturity or death, any profit may give rise to a tax liability.

If a loss occurs, then no tax liability should apply.

Please note that contrary to a full surrender or maturity, the chargeable gain calculation on the event of the death of the sole or last life assured **is based on the surrender value of the plan immediately before death and not the death benefit that is paid**.

Needless to say, if there is a gain and the plan has increased in value since the date of death, this increase is free of income tax.

However, if the plan decreases in value in this period (i.e. results in a reduction in the death benefit payable), then it is still the value immediately prior to death that applies for chargeable event calculation purposes. There is no relief available if this happens.

As per S.491 of the Income Tax (Trading and Other Income) Act 2005, the method to calculate a chargeable gain is as follows: **TB – (TD + PG)**, which is defined as:

- **TB** = Total Value

  This is the early exit value of the plan, plus any previous part withdrawals.
- **TD** = Total allowable deductions

  This is the total amount of the monies invested into the plan, for the plan segments which are maturing or being surrendered.

- **PG** = Total Amount of gains treated as arising on calculation events occurring before the surrender or maturity.

  This is the total amount of previous chargeable excesses created by withdrawals in excess of the 5% cumulative allowance.

Example – full surrender
Mrs Williams invested a single payment of £100,000. No withdrawals have been taken and the plan is then surrendered with a value of £200,000.

The calculation would be:

TB = £200,000 + £0 = £200,000
TD = £100,000 + PG of £0 = £100,000

Chargeable gain = £200,000 – (£100,000 + £0) = **£100,000**

However, if Mrs Williams had taken withdrawals of £12,500 in total with £2,500 of which exceeded the 5% allowance, the calculation would be:

TB = £200,000 + £12,500 = £212,500
TD = £100,000 + PG of £2,500 = £102,500

Chargeable gain = £212,500 – (£100,000 + £2,500) = **£110,000**

TIME APPORTIONMENT RELIEF (TAR)

TAR is used to reduce a UK chargeable gain. It allows the gain to be reduced by the amount of time the plan owner has been resident outside the UK, during the term of the plan.

For plans issued on or after 6 April 2013

As a result of the Finance Act 2013, TAR for plans issued on or after 6 April 2013, is now defined as 'a reduction in the chargeable gain on an offshore plan, if the person liable to UK income tax was not UK resident throughout the life of the plan.

Therefore, where there have been previous plan owners (with the exception of gifts between spouses and civil partners who live together), only the residence history of the person liable to the tax can now be claimed.

For plans issued prior to 6 April 2013

The TAR rule which applies to plans issued prior to 6 April 2013 that have not been topped up or been assigned since this date (including security assignments), is 'TAR is available for the plan owner, for any period the plan has been held by a non-UK resident individual since the plan started.'

So, if for example, a plan had been assigned prior to 6 April 2013, from a non-UK resident individual to a UK resident individual, the assignee could benefit from the original owners period of non-UK residence.

When TAR doesn't apply

TAR is only available to individuals and cannot be claimed if the plan has ever been owned by a non-UK resident trustee.

TAR Calculation

$$\frac{\text{Chargeable gain} \times \text{Number of days held as a UK resident}}{\text{Total days plan has been in force}}$$

To illustrate this:

Mr & Mrs Miller invested £200,000 into an offshore plan on 18 May 2010, whilst non-UK resident.

They returned to the UK on 30 May 2017 and then surrendered the plan on 20 February 2018, for a value of £300,000. Therefore creating a gain of £100,000 as no withdrawals were taken.

TAR will reduce the £100,000 gain as follows:
Gain of £100,000 x 266 days/2835 days = **£9,382.72 net gain, i.e. a 90.62% reduction**.

TOP-SLICING RELIEF

Top-slicing relief is currently undergoing a review by HMRC. Therefore the following information is subject to change.

Top-slicing relief allows individuals to potentially mitigate paying higher rate or additional rate income tax, on some or even possibly all of a chargeable gain.

Top-slicing relief is available for UK resident individuals who 'do not pay higher or additional rate income tax on other income (excluding the gain) however, when the gain is added to income, the individual becomes subject to higher or the additional rate.'

This is applied to the chargeable gain **for any complete plan years the plan owner was a UK resident**.

The Finance Act 2013 brought the following changes for top-slicing relief on **chargeable excess events only** i.e. where withdrawals have exceeded the 5% allowance:

For plans issued on or after 6 April 2013

The number of top slicing years equals the number of years since the previous excess event.

However, for those UK residents who have not been UK resident throughout, TAR will also apply.

Where TAR applies, the number of years available for top-slicing remains the period back to the start date, subject to the figure being reduced for periods of non-UK residence.

For plans issued prior to 6 April 2013, which not been varied since

The number of top-slicing years available remains the number of years since the plan start date.

For all other chargeable events, such as surrenders, deaths and maturities, the top-slicing relief period has not changed and always goes back to the start date of the plan for any complete plan years the plan owner was a UK resident.

When top-slicing relief doesn't apply

- It's not available to assist taxpayers already liable to tax at the higher rate before the chargeable event gain is added to their income.
- It doesn't reduce income below £100,000 to preserve full entitlement to the personal allowance.
- Top-slicing is only available to individuals, therefore it cannot be claimed by trustees, executors/ personal representatives, or corporate entities.
- This does not apply to annual gains that arise on 'personal portfolio plan events.'

Example:
Mr Smith, who has recently retired is permanently resident in England and has a current total taxable income of £25,000 after allowances.

He invested a single payment of £150,000, which started on the 10 April 2012 and he then surrendered the plan on the 15 April 2017 for £190,000.

No withdrawals were taken.

So, the chargeable gain is £190,000 - £150,000 = £40,000.

No TAR relief will apply, as there has been no period of non UK residence.

Top-sliced gain
£40,000/5 plan years = £8,000 to be added to the plan owner's income.

So, the top-sliced gain of £8,000, plus £25,000 other income is £33,000, which is within the basic rate threshold for England & Wales of £37,500 for the 2019-20 tax year.

Therefore, the income tax payable is £40,000 x **20%** = £8,000

Let's also consider what would happen if Mr Smith had a total taxable income after allowances of £32,500. The income tax payable would be:

Remainder of the basic rate threshold = £37,500 - £32,500 (other income) = £5,000

£5,000 x 5 plan years = **£25,000** x **20%** (Basic Rate Tax) = **£5,000**

£40,000 gain - £25,000 taxed at BRT = **£15,000 x 40%** (Higher Rate Tax) = **£6,000**

Total Tax payable = **£11,000 (£5,000 + £6,000)**

Effective Tax Rate = £11,000/ £40,000 x 100 = **27.5%**

Who does the income tax liability for a chargeable gain fall upon?
The income tax liability for a chargeable gain is payable in the following order:

1. Where a plan is owned by an individual or is held in a flexible trust created by that person, then he/she is liable to income tax at his/her marginal rate.

2. If the plan is held under a bare trust, the beneficiary is liable to the tax, as the beneficial owner of the plan, unless the donor is a parent of the beneficiary and the chargeable event occurs whilst the beneficiary is an unmarried minor.

   In this situation, the donor would be liable to the tax.

3. If the plan is held in a flexible trust and the settlor is non-UK resident or has died in a previous tax year, then the trustees are liable for the tax if they are UK resident.

In this instance the first £1,000 is taxed at the basic rate of income tax and anything over this is taxable at the trustee tax rate, currently 45%. Please note that the trustees are not able to use top slicing relief to reduce the tax payable.

4. If the trustees are all non-UK resident, the beneficiaries of the trust resident in the UK, to the extent that they receive benefit, are liable for the tax.

PERSONAL PORTFOLIO BONDS (PPB)

In simple terms, a PPB is a single payment life assurance or capital redemption plan, which gives investors the freedom to invest in a wide range of assets beyond those described within the PPB legislation, which are as follows:

- Property appropriated by the insurer to an internal linked fund;
- Units in an authorised unit trust;
- Shares in an approved investment trust, or an overseas equivalent;
- Shares in an open-ended investment company (OEIC);
- Cash (but not aquired for speculative purposes);
- Interests in collective investment schemes, which are units in non-UK unit trusts or any other arrangement that creates rights in the nature of co-ownership under the law of a territory outside the UK;
- Shares in a UK Real Estate Investment Trust (REIT) or an overseas equivalent;
- An interest in an authorised contractual scheme.

For instance, where a UK resident plan owner invests into equities through their plan, or a Non-UK resident plan owner subsequently moves to the UK and holds equities, the PPB legislation imposes a yearly cumulative tax charge of 15% of the payment, plus 15% of the previous PPB charges.

Example:
Mrs Robinson, a UK resident invested a single payment of £500,000 into an offshore plan. No surrenders have been taken and she then cancels the plan in year 6 for £670,000 (based upon a 5% annual growth rate, net of fees).

If the plan did not hold any offending assets and was never classed as highly personalised, the gain to be assessed for income tax would be £170,000 (£670,000 - £500,000).

However, if Mrs Robinson's plan held assets that made the plan highly personalised, she would have been assessed for UK income tax each year on the deemed gains basis.

As a result the annual PPB tax charge would be £131,175 by the end of plan year 5.

The total cumulative PPB tax liabilities during the life of the plan are £505,679.

Please see below a table which illustrates the calculation for the above PPB gains.

If Mrs Robinson had lived in another country when the plan commenced and only moved to the UK in plan year 4 and did not sell the offending assets held by the end of plan year 4, the plan would become a PPB at the end of that plan year.

As such Mrs Robinson would be issued with a chargeable event certificate for the deemed gain of £114,066.

However, if the offending assets were sold before the plan anniversary upon returning to the UK, there would be no deemed gains as the plan would not be highly personalised.

Finally, even if the assets were not sold in time, the plan owner would still have until the end of that tax year in order to fully surrender the plan, which would wipe out the PPB gain, as a PPB gain does not occur in the final insurance year.

For example, if upon returning to the UK and the last day in the current plan year was the 26 April 2018, the plan owner would have until the 5 April 2019 to fully cancel the plan.

The full surrender would supercede and effectively wipe out the PPB Gain which occurred on the 26 April 2018.

How is a chargeable gain declared for UK income tax purposes?

Gains on foreign plans should be inserted into the 'Foreign' pages of the UK tax return referenced as the 'SA106'.

HMRC help sheet HS321 (Gains on foreign life insurance plans) provides further information and guidance for completing UK tax returns.

IMPORTANT NOTES

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Calculation

Year (y)	Payments made, years 1 to end year y (A)	Cumulative amount of PPB excesses for years 1 to (y - 1) (B)	Aggregate withdrawal 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 PPB gain applies in the plan year that the plan is cancelled.