UK TAXATION OF AN RL360 POLICY

INTRODUCTION

The aim of this guide is to explain the UK tax treatment of an RL360 policy.

WHAT ARE RL360 POLICIES?

RL360 policies are non-qualifying foreign life insurance 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 POLICIES

RL360 policies are subject to the UK chargeable events regime, which is contained within Part 4, Chapter 9 (Gains from contracts for life insurance etc.) of the UK income tax legislation, the Income Tax (Trading and Other Income) Act (ITTOIA) 2005.

Contrary to most investments for UK tax residents, any gain realised from an RL360 policy is subject to **income tax** and not capital gains tax.

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 the policy
- Surrender in full or of individual policy segments
- Regular withdrawals or one off withdrawals taken from the policy, which are in excess of the 5% cumulative tax deferred allowance in any policy year
- Full assignment of a policy for consideration in 'money or money's worth'
- Part assignment of a policy for consideration in 'money or money's worth' which are in excess of the 5% cumulative tax deferred allowance
- A fundamental reconstruction of the policy (e.g. an addition or a removal of a life assured).

RL360

THE 5% ALLOWANCE AND WITHDRAWALS WHICH EXCEED THE ALLOWANCE

For each premium paid into a policy, an amount equal to 5% of that premium can be withdrawn each policy year for 20 years without an immediate liability to income tax.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 a return of the original capital paid.

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

The total amount withdrawn in any policy year will be compared with the cumulative total of unused 5% allowance at the end of that policy year and any excess will be a chargeable gain.

The total allowance is limited to 100% (5% x 20 years) of each premium. 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.

The following examples are designed to give an understanding of how the calculation for a withdrawal exceeding the 5% allowance works in practice.

EXAMPLE (REGULAR PREMIUM) – EXCEEDING THE 5% ALLOWANCE

- Regular annual premium = £2,000
- Policy Year 1 – 4, no withdrawals
- Policy Year 5, £3,000 is withdrawn from the policy

Policy Year 1: 5% = £100 (£2,000 x 5%)
Policy Year 2: 5% = £300 (£2000 + £2,000 x 5%) + £100
Policy Year 3: 5% = £600 (£2000 + £2,000 + £2,000 x 5%) + £300
Policy Year 4: 5% = £1,000 (£2000 + £2,000 + £2,000 + £2,000 x 5%) + £600
Policy Year 5: 5% = £1,500 (£2000 + £2,000 + £2,000 + £2,000 + £2,000 x 5%) + £1,000

Total cumulative 5% tax deferred allowance = **£1,500**

The **chargeable excess gain** at the end of policy year 5 would be:

£3,000 (total withdrawal in policy year) - £1,500 (total 5% tax deferred allowance) = **£1,500**

The excess gain (£1,500) is what will need to be declared for UK income tax.

NB: The amount withdrawn within the 5% allowance (£1,500) is **not** tax free. It is only tax deferred as it is accounted for when the policy is surrendered.

EXAMPLE (SINGLE PREMIUM) – EXCEEDING THE 5% ALLOWANCE

- £200,000 single premium and no subsequent additional premiums made
- Policy Years 1 – 4, no withdrawals
- Policy Year 5, £55,000 is withdrawn from the policy

Policy Year 1: 5% = £10,000 (£200,000 x 5%)
Policy Year 2: 5% = £20,000 (£200,000 x 5%) + £10,000
Policy Year 3: 5% = £30,000 (£200,000 x 5%) + £20,000
Policy Year 4: 5% = £40,000 (£200,000 x 5%) + £30,000
Policy Year 5: 5% = £50,000 (£200,000 x 5%) + £40,000

Total cumulative 5% tax deferred allowance = **£50,000**

The chargeable excess gain at the end of policy year 5 would be:

£55,000 (total withdrawal in policy year) - £50,000 (total 5% tax deferred allowance) = **£5,000**

The excess gain (£5,000) is what will need to be declared for UK income tax.

NB: The amount withdrawn within the 5% allowance (£50,000) is **not** tax free. It is only tax deferred as it is accounted for when the policy is surrendered.

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

If a policy or individual policy 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.

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 benefits - This is the surrender value of the policy, plus any previous withdrawals.
- **TD** = Total allowable deductions - This is the total amount invested into the policy, for the policy segments which are maturing or being surrendered.
- **PG** = Total amount of previous gains. This is the total amount of previous chargeable excesses created by withdrawals that exceeded the 5% cumulative allowance.

EXAMPLE – FULL SURRENDER

Mrs Williams invested £10,000 per policy year over a 10 year period. The total investment into the policy was £100,000. No withdrawals have been taken from the policy and the policy is 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 = **£100,000**

However, if Mrs Williams had taken withdrawals of £10,000 in total with £2,000 of which exceeded the 5% allowance, the calculation would be:

TB = £200,000 + £10,000 = **£210,000**
TD = £100,000 + PG of £2,000 = **£102,000**

Chargeable gain - £210,000 – £102,000 = **£108,000**

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

Therefore, if there is a gain and policy has increased in value since the date of death, this increase is free of income tax. However, if the policy 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.

EXAMPLE - DEATH

Mr Jones invested £10,000 per policy year over a 10 year period. The total investment into the policy was £100,000. No withdrawals have been taken from the policy. Mr Jones dies on the 01 February 2021, the value of the policy on the 31 January 2021 (date immediately before death) was £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 = **£100,000**

When the death benefits are finally paid out the value of the policy has decreased to £180,000. However, the TB value is still based on £200,000.

WHEN DOES A CHARGEABLE EXCESS GAIN BECOME A CHARGEABLE EVENT?

This depends on the type of chargeable event:

Withdrawal in excess of the 5% allowance: This is tested on the last day of the policy year.

For example, if a withdrawal was taken on 4 March 2019 and the next policy anniversary is 7 July 2019, the chargeable excess event would occur on 6 July 2019.

Full or segment surrender: This is an immediate chargeable event.

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

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

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

PERSONAL PORTFOLIO BONDS (PPB)

In simple terms, a PPB is a single premium life assurance or capital redemption policy, 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 acquired 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.

Where a UK resident policyholder holds highly personilsed property (those outside of the permitted categories above) at the end of the insurance year, the PPB legislation imposes a yearly cumulative tax charge of 15% of the premium.

WHAT RELIEFS ARE AVAILABLE TO A CHARGEABLE GAIN?

Time Apportionment Relief (TAR). This allows the gain to be reduced by the amount of time the policy owner has been resident outside the UK, during the term of the policy.

TAR works as follows:

$$\text{Total Gain} \times \frac{\text{The period of residence of the policyholder outside of the UK whilst the policy is in force in days}}{\text{Total period in days the policy has been in force}} = \textbf{TAR}$$

Different rules apply depending on when the policy was issued and where certain changes have been made. Please refer to our guide on TAR for further information and examples.

Top slicing relief (TSR) allows a gain made on the policy to be annualised. This allows the policy owner to pay tax at a rate equivalent to the rate that would have applied if the gain had been taxable in each year that it was made.

The TSR calculation is complex and will depend on an individual's personal circumstances.

Please refer to our guide on TSR for further information and an example calculation.

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 policy is owned by an individual or is held in a discretionary trust created by that person (the settlor), then he/she is liable to income tax at his/her marginal rate.
2. If the policy is held under a bare trust, the beneficiary is liable to the tax, as the beneficial owner of the policy, 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 policy is held in a discretionary 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.

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

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

This information is to be used by financial advisers only. RL360 accepts no liability for any action taken or not taken by an individual or a firm as a result of the contents of this material. The tax treatments and information contained in this document are based on our understanding of current tax law and HM Revenue and Customs (HMRC) practice and may be subject to change in the future.

RL360 Insurance Company Limited. Registered Office: International House, Cooil Road, Douglas, Isle of Man, IM2 2SP, British Isles. Registered in the Isle of Man number 053002C. RL360 Insurance Company Limited is authorised by the Isle of Man Financial Services Authority.

RL360°