The UK taxation of investment bonds

This guide gives an outline of the UK taxation of Zurich's investment bonds. We have based it on our understanding of current UK law and HM Revenue & Customs (HMRC) practice as at April 2024.

If you are a Scottish or Welsh Rate taxpayer, these rates of Income Tax don't apply to savings income, therefore the tax rates and bands provided in this guide will apply to you as they are the same for all taxpayers across the UK.

Please consider all the tax implications when taking out, making changes to, and disposing of some or all of your investment. The amount of tax due will depend on individual circumstances. Future changes in law and tax practice, or in individual circumstances, could affect the amount of tax you may have to pay.

Non UK residents, Trustees and organisations should take separate advice, as their tax position can be more complex.

'Investment bond' is the general term for a single premium, non-qualifying whole of life insurance policy. In this guide, the term covers policies issued or administered by Zurich Assurance Ltd.

It also includes Zurich's With Profits Bond, Portfolio Investment Bond, Distribution Bond and Guaranteed Equity Bond.

Investment bonds

What is an investment bond?

An investment bond is:

- a whole of life insurance policy, meaning that it does not have a fixed term or specified end date and provides an element of life cover
- non-qualifying for UK tax purposes, meaning that tax may be due on any withdrawals or surrender (cash-in).

Any gain you make from an investment bond, for example following a withdrawal or surrender, is treated as savings income (income) and taxed at your marginal rate. You will need to include the full amount of the gain in your tax return. The amount of tax you will pay depends upon your personal circumstances. No basic rate income tax is due because an equivalent amount of tax is paid on the income and capital gains produced within the fund(s) the bond is invested in and is reflected in the unit price(s). This tax can't be reclaimed. This means that the maximum amount of tax payable on the gain will be the difference between the higher rate (or additional rate, if applicable) of income tax and the basic rate of income tax.

If you are a basic rate taxpayer, and part of the gain from a withdrawal or surrender takes your income above the higher rate tax threshold in that tax year, you may pay tax on that part of the gain.

If you are already a higher rate (40%) or additional rate (45%) taxpayer, the gain will be liable to income tax and you may have to pay an extra 20% or 25% income tax respectively subject to any reliefs or allowances you may be entitled to.

If you are a Scottish or Welsh Rate taxpayer, these local rates of Income Tax don't apply to savings income, therefore the tax rates and bands provided in this guide will apply to you as they are the same for all taxpayers across the UK.

A chargeable gain may occur whenever there is a chargeable event, as described below.

Chargeable events

Chargeable events that can cause an income tax charge are:

- regular or one-off partial surrenders that exceed the 5% allowance (described in the 'Withdrawals' section)
- the full surrender of the investment bond (or individual policies)
- the death of the last life insured
- the assignment of the investment bond.

These are all explained in more detail in the sections that follow.

If a chargeable event happens, we will send you details of any chargeable gain. We will also inform HMRC where we are required to do so under current tax law.

The examples in this guide don't take into consideration any entitlements, allowances and tax reliefs available. For more information on entitlements, allowances and tax reliefs, see page 5.

Types of chargeable event

Withdrawals

Depending on which Zurich investment bond you are invested in, your investment bond may consist of a single policy or a series of individual policies. For example, it may be a series of 100 separate but identical policies.

Regular withdrawals

Under chargeable event rules, each regular withdrawal is considered to be a partial surrender of the investment bond. As such, for tax purposes, regular withdrawals are treated in the same way as partial surrenders as explained in the 'One-off withdrawals' section below.

One-off withdrawals

One-off withdrawals can be made in two ways:

1. By taking a one-off withdrawal equally from all the individual policies that make up the investment bond – this is known as a partial surrender.

   Each year, by which we mean 12 months from the investment bond start date and each subsequent anniversary, you can take regular withdrawals or one-off partial surrenders of up to 5% of the amount invested without an immediate chargeable event gain. However, if you take out more than the 5% allowance in any year, this will be classed as a chargeable event and any amount over the 5% allowance, the chargeable gain, may be taxable.

   If you don't use the 5% allowance in one year, you can carry it forward to the next. For example, if £100,000 is invested and you don't take any partial surrenders in the first two years, you can withdraw up to £15,000 in the third year without an immediate tax gain.

   If you withdraw your full 5% allowance every year, after 20 years you will have used up all your allowance. So any withdrawals you make after this will be classed as chargeable event gain and may be taxable, depending on your circumstances.

   Taking a large one-off partial surrender, either on its own or when added to regular withdrawals, may result in an artificially high tax liability. This is because the tax liability is calculated on the full value of the partial surrender over the 5% allowance, and takes no account of investment performance.

   Any gain will be calculated in the tax year in which the last day of the investment bond year falls. The investment bond year ends on the day before the next start date anniversary.

2. By fully surrendering one or more whole policies that make up the investment bond. This isn't available on single policy investment bonds.

   If you fully surrender whole policies, your gain will depend on how much the value of each policy has increased, in the same way as a full surrender of the investment bond, as described in the 'Full surrender' section.

   Any gain is treated as income for the tax year in which the surrender happens.

Example 1 – withdrawal taken equally from all policies

You pay £100,000 into an investment bond. In the second year its value has increased to £120,000 and you withdraw £40,000. You have not taken any previous withdrawals. The cumulative (total) 5% allowance is £10,000 (£100,000 x 5% x 2). The gain over the 5% allowance is £30,000 (£40,000 – £10,000).

If you are a higher rate taxpayer*, the maximum tax due is £6,000 (20% of the gain for tax year 2024/25).

If you are an additional rate taxpayer, the maximum tax due is £7,500 (25% of the gain for tax year 2024/25).

Example 2 – surrendering whole policies

Assuming that your investment bond consists of 100 individual policies, each individual policy is worth £1,200 in the second year. This represents a gain of £200 for each policy.

You could surrender 34 policies and receive £40,800, resulting in a gain of £6,800 (£200 x 34).

If you are a higher rate taxpayer*, the maximum tax due is £1,360 (20% of the gain for tax year 2024/25).

If you are an additional rate taxpayer, the maximum tax due is £1,700 (25% of the gain for tax year 2024/25).

*and the gain, doesn't take your income into the additional rate tax band.

Each policy has its own 5% allowance, so when you surrender a whole policy, any accumulated 5% allowances on that policy are lost. This means the 5% allowance will then be based on the remaining policies. For the example above, in future the 5% allowance will be based on the amount you have invested in the 66 remaining policies.

Full surrender

When fully surrendering the investment bond, the chargeable event is treated as having happened on the day it is surrendered. Any tax liability is calculated based on the overall gain made on the investment bond.

The overall gain is calculated by adding the surrender value you receive to the value of all previous withdrawals you have taken, then deducting the total value of payments you have made to the investment bond and any previous gains over the 5% allowance.

For example

You invest £100,000 and later surrender it for £120,000. You have previously taken a withdrawal of £10,000 of which £5,000 was treated as a gain over the 5% allowance.

The chargeable event gain would be calculated as:

£120,000 (surrender value) + £10,000 (previous withdrawal) = £130,000

less

£100,000 (original investment) + £5,000 (previous gain over the 5% allowance) = £105,000

equals a gain of £25,000 (£130,000 – £105,000).

If you are a higher rate taxpayer*, the maximum tax due is £5,000 (20% of the gain for tax year 2024/25).

If you are an additional rate taxpayer, the maximum tax due is £6,250 (25% of the gain for tax year 2024/25).

*and the gain, doesn't take your income into the additional rate tax band.

Important things to consider

The surrender method you choose may result in significantly different chargeable event gains and therefore tax liabilities. We are not permitted to give you tax advice. If you are in any doubt about any tax liabilities that may arise, we recommend that you seek independent advice.

Please note, under HMRC rules, once a full surrender has been completed, it can't be changed or reversed.

Death

The chargeable event is treated as happening on the day immediately before the death of the last life insured.

The chargeable gain is calculated on the surrender value of the investment bond immediately before death.

On death, if the investment bond is not written in trust, depending on the overall value of the investor's estate, inheritance tax may be due on some or all of the proceeds from the investment bond.

If the investment bond is written in trust, depending on the type of trust, an inheritance tax liability may be reduced. However, most trusts can't be changed so you should seek professional advice before writing your investment bond in trust.

Assignment

Assignment means changing the ownership of an investment bond. Assigning your investment bond to someone else may cause a chargeable event and a possible tax liability.

If an investment bond is assigned in return for money or something of equivalent value, a chargeable event will occur and there may be a tax liability. If it is assigned as a gift then it won't create a chargeable event.

If the ownership of an investment bond is transferred to someone else, we need to be informed by an appropriate 'Notice of assignment'. This protects the legal position of the person to whom it is transferred. Notices of assignment must be given in writing and must state the date and purpose of the assignment.

Entitlements, allowances and tax reliefs

Gains are included in your income and therefore may affect your entitlement to the Personal Allowance, Personal Savings Allowance and certain benefits such as Tax Credits. Gains will also be included when assessing whether you have any liability to a child benefit tax charge.

Gains can be used, in some circumstances, against any unused:

- Personal Allowance.
- Personal Savings Allowance.
- Starting rate for savings band of up to £5,000 depending on other income.

These should be used against other income in preference to the gain, any excess however can be used against the gain.

Personal Savings Allowance

Depending on your income (including any gain) you may be able to receive some savings income tax-free, this is known as the Personal Savings Allowance. If you are a basic rate taxpayer (including the gain) you can receive up to £1,000 in savings income tax-free or £500 if you are a higher rate taxpayer. There's no Personal Savings Allowance for additional rate taxpayers.

Depending on the total amount of savings income you receive from all sources and the level of your Personal Savings Allowance, the amount of your gain that is taxable may be reduced.

Starting rate for savings

The starting rate for savings is available if your non savings income is less than your Personal Allowance plus £5,000 (£17,570 for 2024/25). The starting rate for savings is currently 0%.

Time apportionment reduction

If you are only resident in the UK for part of the time your bond is in force and the plan meets certain conditions, it may be possible for gains to be reduced to allow for this. If you believe this may apply to you please speak to your tax adviser.

Top-slicing relief

Top-slicing relief may reduce the tax payable on a gain. It allows chargeable gains to be divided by the number of complete years the bond has been in force to recognise the fact that the chargeable gain has accrued over the whole period for which the bond was in force and not just in the tax year in which the chargeable event gain arose.

It most commonly applies when the addition of the gain to your taxable income would result in you paying a higher level of tax than you would without the gain. However, there may be some top-slicing relief in other circumstances due to the interaction of other allowances. The relief is the amount that your tax liability is reduced by and several steps are involved in the calculation.

1. Identify your total taxable income for the year and how much of the gain falls within the starting rate for savings, the Personal Allowance, Personal Savings Allowance nil rate, basic, higher or additional rate bands as appropriate.
2. Calculate total tax due on the gain across all tax bands and then deduct basic rate tax treated as paid, to find your liability for the tax year. Remember, your Personal Allowance and Personal Savings Allowance may be reduced.
3. Work out the annual equivalent of the gain – calculated by dividing the gain by N (N is the number of years the policy has been held or, in the case of a partial surrender, since the last chargeable event). This may be different if you have not always been a UK resident – if this applies to you please speak to a tax adviser.
4. Work out your liability to tax on the annual equivalent*. Deduct basic rate tax treated as paid on the annual equivalent and multiply the result by N. This gives your relieved liability.
5. Deduct your relieved liability at 4 from your total liability at 2 to give the amount of top-slicing relief due.

**Remember – when calculating your liability to tax on the annual equivalent:*

- *For gains prior to 11th March 2020* where the Personal Allowance has been reduced, it is this reduced figure that forms part of the top-slicing calculation.*
- *If the gain arose after 11th March 2020* your Personal Allowance can be recalculated based upon the annual equivalent for the purposes of the top-slicing relief calculation only.*
- *For gains prior to 6 April 2021, neither the starting rate for savings nor the Personal Savings Allowance are recalculated in the top-slicing relief calculation. In other words, the full gain is added to total income to determine their availability.*

- *If the gain arose from 6 April 2021 onwards, the starting rate for savings and your Personal Savings Allowance can be recalculated based upon the annual equivalent gain. In other words, the top-sliced gain is added to total income to determine their availability.*

**In practice HMRC will allow reduced Personal Allowances to be recalculated, where relevant, for all gains arising in tax years 2018-2019 onwards.*

This can be complex and we are not permitted to give you tax advice. If you are in any doubt we recommend you seek independent advice. HMRC guidance and examples can be found at **gov.uk/hmrc-internal-manuals/insurance-policyholder-taxation-manual/iptm3820**

Deficiency relief

There is no relief available if you lose money on an investment bond. However, deficiency relief may be available when an investment bond ends.

The relief will only benefit you if your taxable income (before any gains or top-slice gains are added) is above the basic rate limit (£37,700 in tax year 2024/25). The relief is not available for basic rate taxpayers. The relief does not extend to the additional rate of tax.

Deficiency relief is available if the chargeable event calculation on death or full surrender shows a negative amount (a loss) and there were gains over the 5% allowance from earlier tax years (because of earlier partial surrenders from the investment bond).

If a loss arises when an investment bond ends, the investor is entitled to a deduction from their taxable income for that tax year, up to the limit of the previous chargeable gains.

For example

As a higher rate taxpayer you invest £200,000 in May 2015.

In the same tax year you take a one-off partial surrender of £50,000 resulting in a gain over the 5% allowance of £40,000.

Three years later the investment bond is fully surrendered for £170,000.

The gain is calculated as:

(£170,000 + £50,000) – (£200,000 + £40,000) = –£20,000.

The deficiency relief is limited to the lower of the previous chargeable gain (£40,000) or the final loss (£20,000).

The relief is given by extending the basic rate band by the amount of the loss. This means that up to £20,000 of taxable income is chargeable at the basic rate instead of the higher rate that would otherwise have applied.

Frequently asked questions

What if I am a joint owner?
Any gain is normally shared equally between owners and each person is then responsible for any tax on their part of the gain.

Is the 5% allowance for each tax year?
No, the allowance is for each period of 12 months starting from the start date of the investment bond. In other words, on the start date and on each anniversary of the start date there is a 5% allowance.

After you have taken withdrawals equal to the amount you have paid in (where 5% is withdrawn each and every year, this will be after 20 years), any further withdrawals may be taxable, depending on your circumstances.

Are withdrawals taxed in the year they are taken?
If the bond holder dies or the investment bond (or any individual policy) is fully surrendered, any gain is treated as income for the tax year in which the death or surrender happens.

If the event is a regular or one-off partial surrender (explained in the 'Withdrawals' section), the start date of the investment bond determines the tax year in which any gain is taxed. The gain is taxed in the tax year in which the end of the investment bond year falls. An investment bond year begins on the day the investment bond was taken out and on that same date in subsequent years. It ends on the day before the anniversary of that date in the following year and each subsequent year.

What happens if there is a partial surrender over the 5% allowance and then the investment bond is fully surrendered during the same year?
If both events are taxable in the same tax year (see 'Are withdrawals taxed in the year they are taken?' above), the gain on the partial surrender is ignored. The calculation of the gain on full surrender includes the partial surrender.

Can I set a loss from one investment bond against a gain from another?
No, each investment bond is treated separately and a gain from one can't be reduced by a loss from another.

What if my investment bond started before 14 March 1975?
You'll get less than 20 years worth of allowances. If your investment bond started within one year before 14 March 1975, you'll get 19 years worth, if it started within 2 years before 14 March 1975, you'll get 18 years worth and so on.

Are transfers between spouses taxable?
No, transfers (often referred to as assignments) between spouses or civil partners living together are ignored.

My investment bond consists of a number of individual policies. How does this affect the gain?
Each of the individual identical policies is treated separately and has its own 5% allowance.

If you'd like to make a one-off withdrawal, you can choose to withdraw equally from all the individual policies or to surrender a number of individual policies (explained in the 'Withdrawals' section).

Who pays the tax if the owner dies?
When someone dies, their final income tax liability is calculated. If the investment bond is written on the owner's life only, any gain on death will form part of the final income tax assessment. This will be handled by the deceased's executors or personal representatives.

Where can I find out more information?
You should discuss your individual circumstances with your adviser(s).

Further information is available on HMRC's website at **hmrc.gov.uk**.

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