

## **Annex VI**

### **CHARITIES: LIFE ASSURANCE AND CAPITAL REDEMPTION PRODUCTS**

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### **CHARITIES: LIFE ASSURANCE AND CAPITAL REDEMPTION PRODUCTS**

#### **VI.1 Introduction**

- VI.1.1 This is a technical note and general guide about the tax implications for charities and their donors surrounding the acquisition of and proceeds from life insurance policies and capital redemption policies. For ease of reference, when this note refers to 'insurance policies' it means both these types of policy.
- VI.1.2 The tax implications can be complex for both the charity and its donors. Charity trustees may, therefore, consider it prudent to seek professional advice before entering into an insurance policy or accepting a transfer of an insurance policy from a donor.
- VI.1.3 There are a number of problem areas about the suitability of insurance policies as investments for charities. Our view is that it is for the appropriate regulatory body – generally the Charity Commission for charities in England and Wales– to consider whether charities should apply their funds in this way. We are concerned with the taxation implications of charities doing so. The taxation implications fall into four areas:
  - how the application of funds is to be treated;
  - whether relief under Gift Aid is available for gifts to pay the premiums;
  - whether relief for Gifts of Shares etc. is available for gifts of insurance policies; and
  - the treatment of any income/gains from the policies.

#### **VI.2 Premiums paid**

- VI.2.1 The Inland Revenue cannot accept premiums paid by charities on insurance policies (including policies assigned in favour of charities) as qualifying investments within Paragraph 9(1) Schedule 20 Income and Corporation Taxes Act 1988. Further, we do not accept such payments as qualifying expenditure within the definition in S506 ICTA1988. That is, we regard the payment of premiums by a charity as non-charitable expenditure.
- VI.2.2 While Paragraph 9(1) gives the Board the power to consider investments other than those specified in Schedule 20, such investments should be of the same kind as those specified. We do not consider that premiums paid under an insurance policy have the same character as those specified investments. Such premiums are payment of consideration for entering into a contractual relationship. Further, regular premiums are paid in discharge of obligations under such a contractual relationship. The policyholders acquire or maintain rights under the contract; they do not acquire any entitlement to an interest in the underlying investments. The underlying investments remain the property of the insurer.
- VI.2.3 We do not consider amounts paid as premium under insurance policies to be qualifying expenditure within S506 ICTA 1988, as they are not laid out in furtherance of a charity's charitable objects. [Annex II 'Qualifying Expenditure' of the Guidance notes for charities gives advice on the tax treatment where a charity incurs non-qualifying expenditure.]

### **VI.3 Gift Aid donations to pay premiums**

- VI.3.1 Payments made to a charity by a donor, with the intention that they be used to pay the premiums due under an insurance policy transferred to the charity by that donor would not be disqualified from Gift Aid. However, as indicated above, the application of funds in payment of premiums may negate any advantage to the charity in this respect.

### **VI.4 Relief for Gifts of Shares etc, to Charities**

- VI.4.1 There is no relief available under section 587B ICTA 1988 for the value of insurance policies gifted to a charity. These are not included in the list of investments that are qualifying investments for the purposes of section 587B.

### **VI.5 Chargeable event gains**

- VI.5.1 The tax treatment of a chargeable event gain on an insurance policy differs depending on whether the charity that holds the policy is a company or a trust for tax purposes. A chargeable event gain may arise
- when a policy comes to an end due to surrender or maturity or death of the life assured, or
  - when it is partially surrendered or wholly or partially disposed of or
  - when it is a Personal Portfolio Bond.

#### **Corporate charity**

- VI.5.2 If the charity is a company for the purposes of the Taxes Acts (which includes an unincorporated association), there will be a Case VI charge on

the chargeable event gain made as provided by Section 541 and Section 547(1)(b) Income and Corporation Taxes Act 1988. Moreover no tax is treated as having been paid on such a gain when made by a charitable company.

- VI.5.3 Provided any partial withdrawals in respect of the life assurance bond fall below the 5% threshold set by section 546 ICTA 1988, liability to Case VI tax on the corporate charity in respect of those withdrawals is deferred until the policy comes to an end when they will be taken into account as relevant capital payments.
- VI.5.4 Charities are not exempt from tax in respect of income which is chargeable under Case VI of Schedule D by virtue of Section 547(1)(b) ICTA 1988<sup>1</sup>. So the charity will be liable to corporation tax on any gain.

### **Charitable trusts**

- VI.5.5 The treatment of a chargeable event gain that happened before 9 April 2003 was less clear where the holder of the insurance policy is a charitable trust.

### **VI.6 Insurance Policy assigned to charitable trust or taken out by the trust using a donation from an identifiable donor to pay premium – Chargeable event before 9 April 2003**

- VI.6.1 Any gain resulting from a chargeable event is usually chargeable on the assignor or donor if living and resident in the UK.
- VI.6.2 **But** if the policy was taken out on or after 17 March 1998, or taken out before 17 March 1998 and 'enhanced' after that date, the gain may be chargeable to income tax on the charitable trust if it is not possible to tax the assignor or donor because he or she
- died before the date of the event and on or after 17 March 1998 **or**
  - was resident outside the UK when the event occurred

A policy is treated as 'enhanced' if it is changed so as to increase the benefits secured or to extend its term.

### **VI.7 Policy taken out by charitable trust NOT using a donation from an identifiable donor to pay premium – Chargeable event before 9 April 2003**

- VI.7.1 If the insurance policy was taken out before 17 March 1998 and has not been enhanced since that date, the charity is probably not taxable on any gain arising. Strictly, anybody who has ever made a donation to the charity and is still alive and resident in the UK is taxable on a fraction of the gain proportionate to the amount that they donated. Any donor liable to tax at higher rate is entitled to reclaim any tax they pay from the trustees of the charity. There are obvious practical difficulties for donors who will not know that there is a gain that they need to self assess.
- VI.7.2 If the policy was taken out on or after 17 March 1998, or was taken out before 17 March 1998 but has been enhanced since that date, strictly, anybody who has ever made a donation to the charity and is still alive and resident in the UK, is taxable on a fraction of the gain proportionate to the

amount that they donated. Any donor liable to tax at higher rate is entitled to reclaim any tax they pay from the trustees of the charity. Any share of the gain attributable to donors, who have died or are not resident in the UK, is taxable as income of the trustees of the charity. There are obvious practical difficulties for donors and trustees to ascertain how much of the gain they should self assess.

### **Insurance policy assigned to charitable trust or taken out by the trust – Chargeable event on or after 9 April 2003**

- VI.7.3 All gains treated as arising on life insurance policies, which are owned by a charitable trust, are treated as forming part of the income of the trustees for the year of assessment in which the gain arose. This is the case whether or not the policy or premium has an identifiable donor.

## **VI.8 Tax payable on gains by charitable trusts**

### **Tax payable on gains by charitable trusts when gain is treated as forming part of the income of the trustees**

- VI.8.1 Tax on partial withdrawals that fall below the 5% threshold set by section 546 ICTA 1988 is deferred until the policy comes to an end when the withdrawals will be taken into account as relevant capital payments.

### **Chargeable events before 9 April 2003**

- VI.8.2 Charitable trustees are exceptionally liable to tax on the gains they make from insurance policies at the rate applicable to trusts (34% for the 2002/2003 and 2003/2004 tax years). If the gain arises from a:

- UK policy, the gain is deemed to have suffered tax<sup>2</sup> at the basic rate and so the trustees will have tax to pay equal to 12% of the gain;
- overseas policy, the charity will be liable to pay tax on the gain at the rate applicable to trusts.

### **Chargeable events between 9 April 2003 and 5 April 2004<sup>3</sup>**

- VI.8.3 Charitable trustees are liable to tax on the gains they make from insurance policies at the basic rate of 22% in 2003/2004. If the gain arises from a:

- UK policy, the gain is deemed to have suffered tax<sup>2</sup> at the basic rate and so the trustees will have no tax to pay on the gain;
- overseas policy, the charity will be liable to pay tax on the gain at the basic rate of tax.

### **Chargeable events on or after 6 April 2004<sup>4</sup>**

- VI.8.4 Charitable trustees are liable to tax on the gains they make from insurance policies at the lower rate. If the gain arises from a:

- UK policy, the gain is deemed to have suffered tax<sup>2</sup> at the lower rate and so the trustees will have no tax to pay on the gain;

- overseas policy, the charity will be liable to pay tax on the gain at the lower rate of tax.

### **Notes**

1. Gains treated as Case VI income of companies under Section 547(1)(b) are specifically excluded by Section 46(2)(b) Finance Act 2000 from the general Case VI of Schedule D exemption available under Section 46 FA 2000.
2. This tax treated as having been paid is not available for repayment.
3. Section 547(9A)(a) ICTA 1988 and Section 171(3) FA 2003
4. Sections 547(9) and (9)(a) ICTA 1988 and paragraph 2(3) Schedule 35 FA 2003