

- Gains on UK life insurance policies

This Help Sheet will help you fill in the boxes on your Tax Return dealing with gains on UK life insurance policies, life annuities or capital redemption policies (boxes 12.4 to 12.8).

## INTRODUCTION

These notes are not a comprehensive guide to all the detailed rules for taxing gains from insurance policies.

A reference in this Help Sheet to a 'policy' means a 'life insurance policy'. This Help Sheet is about taxing gains arising on such a policy.

Gains also arise in connection with two other types of insurance. The first type is known as a 'life annuity'. The second type is known as a 'capital redemption policy'. These types of insurance are described in more detail at the end of this Help Sheet. The rules for taxing gains on them are broadly similar to those for taxing gains arising on policies of life insurance. Gains on 'life annuities' and 'capital redemption policies' are fairly rare. No additional explanations of the rules applying to them are included in this Help Sheet.

Many insurance packages are made up of a number of policies often referred to as a 'cluster'. All of these policies may be identical. A reference in this Help Sheet to a policy means one policy. The calculation of any gain should be done policy by policy even if you have twenty identical policies and have received an identical lump sum from each one. The Tax Return Guide tells you to add up gains from a cluster of policies and enter the totals in boxes 12.4 to 12.8. (See also 'Tax Return entries' on page 5 of this Help Sheet).

## MORE HELP NEEDED?

If you need more help in finding an answer to a question in this Help Sheet, or in any case of doubt, you may wish to consult your insurer, your financial adviser, your own Tax Office, or, if necessary, you can write to the Insurance Group at the address on page 6 of this Help Sheet. Please bear in mind that your insurer will know about your policy in detail but may know nothing about your personal tax circumstances. Unless you have told them, your Tax Office will have no detailed knowledge of your policy but will know about your tax circumstances in previous years. The Insurance Group will have no detailed knowledge of your policy or your tax circumstances.

## WHAT IS A GAIN?

A gain arises on a chargeable event and is the profit, from a policy, which you made as a result of the chargeable event. The way the profit is worked out depends upon the nature of the event, as explained on pages 3 and 4. A gain is treated as taxable income but in many cases there will be no tax liability unless you are taxable at the higher rate of tax or qualify for the age-related allowances.

## WHOSE GAIN IS IT?

If you are the 'beneficial' owner of the rights under the policy, a gain will be treated as part of your income. You are likely to be the beneficial owner if you paid the premium(s) and you (or your estate after your death) are entitled to any benefits under the policy. You may be regarded as the beneficial owner in other circumstances, usually because you are entitled to benefit from a policy. For example, you may be the beneficiary of what is known as a 'bare' trust or a 'resulting' trust.

If the rights under a policy are held on trusts which you created, a gain on a policy will be treated as part of your income, whether or not you are entitled to benefit under the terms of the trust (unless the gain is treated as income of a beneficiary of a 'bare trust' or a 'resulting trust'). You are entitled to recover (from the trustees) tax that you pay on the gain. The terms of the trust will determine whether a gain is treated as income of a beneficiary or income of the person who created the trusts.

If the rights under the policy are held as security for a debt of yours, such as a mortgage, a gain will be treated as part of your income.

If a gain is to be treated as part of your income, the guidance in the following pages should help you to calculate it.

(Note for Executors and Personal Representatives: a gain may arise because a policy pays a benefit as a result of the death of the person to whom the Tax Return relates. If so, the gain is treated as arising immediately before death and is treated as income of the deceased up to the date of death.)

If you own a policy jointly with someone else, or you created trusts jointly with someone else, or a policy is held as security for a joint debt (or, as the case may be, with a number of people), any gain will be divided between you. The division is made according to your share in the policy at the time the gain arises unless the rights are held in trust. If they are, you may need more help.

## IN WHAT CIRCUMSTANCES MIGHT A GAIN ON A POLICY ARISE?

A gain may arise when **money (or something of value) is obtained from or in connection with a policy; when ownership of a policy changes hands; or when a policy comes to an end.**

In most cases, money is paid out as a benefit under a policy:

- on surrender of all or part of a policy
- when a policy matures
- as a result of death.

The benefit may be paid out as a single sum or as a series of sums.

Your insurance company will often have required you to 'claim' the benefit. (A benefit paid as a result of death will usually be claimed by the deceased's representatives.)

**If a gain has arisen, your insurance company may have sent you a copy of a 'chargeable event certificate'.**

There will be no gain if you have received a lump sum as a result of a claim to a 'critical illness benefit' or a 'disability benefit' due under the policy. Lump sum critical illness or disability benefits are always left out of account in the reckoning of any other gain; for example, if another benefit is paid under the same policy later on. If you are unsure whether your benefit is a critical illness or disability benefit, ask your insurer.

A gain may arise:

- if the insurance company makes you a loan, or makes a loan on your behalf to someone else, **or**
- if you sell a policy (or part of a policy).

If you transfer beneficial **ownership** of a policy by 'gifting' it to someone else, a gain will not arise. But if you transfer beneficial **ownership** of only part of a policy by 'gifting' a part to someone else, special rules apply and a gain may arise. Beneficial ownership may not have been transferred if you retain some right to, or control over, what happens to the policy or the policy benefits.

A gain may arise whenever a **policy comes to an end** even if all (or some) of the proceeds are kept by the insurance company and used to pay a first premium under a new 'replacement' policy or some other type of insurance.

Some policies contain an option on maturity allowing the policy holder to take out a new policy. If such a maturity option is exercised and all the proceeds of the old policy are applied as premium under the new policy, a gain will not usually arise when the first policy comes to an end. Your insurance company may have told you that this applies to you. If not, and you think it does, ask them.

You may have difficulty in recognising that **one policy has come to an end** and that a new 'replacement' policy (or some other insurance contract such as an annuity) has taken its place. You may not have received a new policy document. Your insurance company may have noted the change in some other way, such as endorsing the existing policy document. The circumstances in which a policy comes to an end include:

- the exercise of an option to take out a new policy (but see the reference to maturity options above)

- if the life (or one of the lives) insured under a policy is changed. For example, if on marriage the life of the new spouse is added or on divorce the life of the ex-spouse is removed from the policy (but a gain may not always arise in these circumstances - see page 3)
- the rewriting of a policy under the Married Woman's Property Act of 1882 (or the equivalent statutes in Scotland and Northern Ireland)
- the exercise of other options or making changes to a policy by agreement. Changes which bring a policy to an end include some which alter the nature of the insured risk. It is not possible to list all changes.

Your insurance company may have told you about the effect of any change you have made to your policy but if they have not, ask them.

### **I HAVE RECEIVED MONEY FROM A POLICY - IS THERE A GAIN?**

If you have a '**qualifying**' policy and have received a benefit or one of the other events described above has occurred, a gain will **not usually** arise.

Policies made before 20 March 1968 (and not changed thereafter) will not give rise to gains. (If your policy was made before but was changed after this date it may be treated as made after that date. If you are unsure, ask your insurance company about the effect of any change or write to the address on page 6.)

There may be no gain. Certain temporary insurances (which only pay a benefit if death occurs during the term of the policy) have no surrender value, or a surrender value no greater than the premiums paid. The only time this type of policy can give rise to a gain is if it is sold. A sale may occur because the life assured is suffering from a terminal illness. See below for working out whether a gain arises from any other type of policy.

Some second-hand policies made before 26 June 1982 do not give rise to gains (but may give rise to a Capital Gains Tax charge as explained on page 5).

Certain policies used to provide pension benefits for some sponsored superannuation schemes which existed before 5 April 1980 will not give rise to gains if an Extra-Statutory Concession applies to them. The concession is number A32, a copy of which can be obtained from the Orderline.

**WHAT IS A 'QUALIFYING' POLICY?**

It is important to know whether a policy is a qualifying one because if it is, it will mean, in most cases, that no gains will arise. The exceptions to this general rule are described below.

The rules for 'qualifying' policies are extremely complex. Your insurer will know the details of your policy and is best placed to answer the question. Ignoring the type of temporary insurance which does not usually give rise to a gain, the rules include:

- the policy must have had a minimum term of 10 years from the date it was made to the date it was due to end, or be a 'whole of life' policy (that is a policy that pays out only on death)
- premiums of fairly even amounts must have been payable at regular intervals, weekly, monthly or annually, in every year at least for 10 (or the first 10) years.

If your policy did not meet these conditions it is not a qualifying policy. If it did you **may** have a qualifying policy but there are other tests to be satisfied.

A policy which starts out as a qualifying policy (this may be indicated in the policy documentation) may become a non-qualifying policy because of changes made to it or because the premiums have ceased to be paid.

Two Extra-Statutory Concessions (numbers A41 and B42) may apply in deciding what is a qualifying policy. Minor infringements of the rules may not affect the qualifying status if A41 applies to them. Free gifts costing your insurer no more than £30 will not affect the qualifying status if B42 applies to them. Copies of the concessions are available from the Orderline.

**WILL A GAIN EVER ARISE FROM A QUALIFYING POLICY?**

A gain may arise if, within 10 years from the date it was made:

- you surrender or sell the whole or any part of your policy, **or**
- you give away part of your policy, **or**
- your policy comes to an end in any of the circumstances described in pages 1 and 2 (apart from death within 10 years).

A gain may also arise if you stopped paying premiums early and the policy became 'paid-up' within 10 years from the date it was made and later on (within, or outside, the first 10 years) you receive money or any of the other circumstances described on pages 1 and 2 occurred.

If you have at some point changed the policy and increased the premiums you paid, the 10 years restart from the date of that change unless the change came about because you exercised an option in the policy. Ask your insurer if you made a change and are unsure what you did.

The 10-year minimum rule is reduced in some cases to three-quarters of the intended term; for example, for a policy with an intended 10 year term, no gain will arise if it is surrendered or sold after 7½ years. Or if, for example, a policy is due to run for 12 years after a change (not by way of an option) which leads to an increase in the premiums, no gain will arise if it is surrendered after 9 years.

There are special rules about qualifying policies and interest-bearing loans made to you or on your behalf to someone else (and for loans made to employees of insurance companies or insurance associations, provided Extra-Statutory Concession A47 applies). Your insurance company may have told you whether or not a gain arises in connection with such a loan. If not, ask them.

**WHAT PREVENTS A GAIN ARISING?**

A gain will arise in the circumstances described on pages 1 and 2 unless:

- the policy is a qualifying policy and none of the circumstances described in the previous column apply, **or**
- the policy was made before 20 March 1968 and not changed thereafter (page 2), **or**
- the particular transaction of concern is the transfer of beneficial ownership of a policy to a spouse with whom you are living, or as security for a debt of yours, **or**
- the particular transaction of concern is the ending of a qualifying policy which ended as a result of a change of life (or lives) insured (page 2) **and** all the proceeds are applied as premiums under the new 'replacement' policy **and** nobody was paid or received anything of value in connection with the change. For example (unless one of the other exemptions applies), a gain will arise if your insurance company charged a fee for making the change or paid what is known as 'initial commission' to your financial adviser as a result of the change or you paid or gave something of value to someone else, perhaps as part of arrangements made on divorce, **or**
- the calculations show that there is no gain.

**HOW IS A GAIN CALCULATED?**

There are different rules for calculating a gain on:

- a full surrender (including when a policy comes to an end) or maturity
- death
- a sale
- a part surrender or on your insurer making a loan or on the sale or gift of part of a policy.

Your copy of a 'chargeable event certificate', if you have one, should contain all the information you need to calculate your gain. (Remember, there are different rules applicable to life annuities and capital redemption policies. If you need to know about these rules, ask your Tax Office)

**Calculating a gain on maturity or full surrender**

A gain on maturity or complete surrender (including when a policy comes to an end) is calculated as follows:

Gain equals (amount X plus amount Y minus amount Z minus amount A), where:

**Amount X** is single lump sum benefit receivable now (if the benefits are transferred to a new policy, amount X equals the value transferred to the new policy. If a series of sums is to be paid (including if you opt to receive an annuity), X equals the value of those sums at the time the right to them arises. Your insurer may have told you what the value is - see for example your chargeable event certificate. If not, ask them.)

**Amount Y** is all benefits (money or anything of value) received at any time previously under this or any 'related policy' except critical illness benefits or disability benefits - see page 2.

Free gifts costing your insurer no more than £30 are left out of account if Extra-Statutory Concession B42 applies to them.

A copy of the concession is available from the Orderline. (A 'related policy' is any policy which ended previously - see page 2 - and which was replaced by the policy on which a gain is being calculated. (An earlier policy in a chain of policies is also a 'related policy'.) This applies whether or not the new policy arose as a result of the exercise of a maturity option and whether or not all the benefits under the old policy were transferred to the new policy.)

**Amount Z** is all premiums paid under this or any related policy

**Amount A** is all gains which arose on part surrenders in previous years or on your insurer making a loan or on sale or gift of part of a policy.

**Calculating a gain on death**

A gain on death is calculated in much the same way except that amount X in this case is the surrender value of the policy immediately before death rather than the lump sum benefit receivable as a result of death.

**Calculating a gain on sale**

A gain on sale of all of a policy is calculated in much the same way except that, in this case, Amount X is the sale price of the policy (or the value of any other consideration if the policy is not transferred for cash) unless the person to whom you sold the policy is your wife or husband (but note that no gain arises if you transfer ownership to a spouse with whom you are living - see page 3), a brother, sister, child or another 'connected person'. If you think this rule might apply to you, ask your Tax Office. In such a case amount X is taken to be equal to the market value of the policy. If you do not know the market value you should write giving full details and documentation to the address on page 6.

**Calculating a gain on part surrender etc.**

A gain on a part surrender or on your 'insurer' making a loan or on sale or gift of part of a policy is calculated for a year at a time. The year in this case is the 12 months ending on the day before the anniversary of the day the insurance was first made. The gain for a year is calculated as follows.

Gain equals (amount B plus amount C minus amount D minus amount E minus amount F), where:

**Amount B** is the value of all parts surrendered plus value of all parts that have been gifted or sold plus the amount of all loans in the year

**Amount C** is the value of all parts surrendered and value of all parts gifted or sold and the amounts of all loans in previous years, unless those amounts have already been taken into account in calculating a gain in a previous year

**Amount D** is 1/20th (5%) of premiums paid in the year

**Amount E** is 1/20th (5%) of premiums paid in any previous years

**Amount F** is 1/20th (5%) of each premium paid in any previous year for each year since the premium was paid, unless those amounts have already been set off in calculating a gain in a previous year.

(The maximum deduction is 100% of the premium paid, which is 20 years at 5%.)

Some examples including figures are on page 6.

## THE RESULT OF THE CALCULATION IS ZERO OR A NEGATIVE AMOUNT - WHAT SHOULD I DO?

This may mean that you have made a loss on the policy. If the result is zero or the result of a part surrender type of calculation (see above) is negative, there is no gain and nothing to include in the Tax Return. If the result of one of the other types of calculation is negative and you have included an amount for 'gains which arose on part surrenders in previous years or on your insurer making a loan or on sales or gift of part of a policy (which is Amount A)', a so-called 'corresponding deficiency' arises and this must be included in box 12.9 of the Tax Return. This amount may reduce your liability to tax at the higher rate. The amount to be entered in box 12.9 is the lower of (Amount Z *plus* Amount A *minus* Amount X *minus* Amount Y) and Amount A.

If the result of one of the first three types of calculation mentioned above is negative and A is zero, this means you have made a loss on the policy. There is no relief for that loss. **It should not be entered anywhere on the Tax Return. A loss on one policy cannot be set off against a gain on another policy.**

## IN WHICH YEAR DOES A GAIN ARISE?

A gain is treated as income of the tax year in which a full surrender (including when a policy comes to an end) or maturity, or death or sale occurs.

When a gain resulting from a part surrender or your insurer making a loan or a sale or gift of part of a policy is treated as income, the tax year in which the gain occurred depends upon when the insurance was first made. If, for example, you made your insurance on 25 May 1990, any gain as a result of part surrenders, etc. in the year 25 May 1995 to 24 May 1996 is treated as income arising on 24 May 1996. That is, the gain is treated as income arising on the day before the next anniversary of the day on which the insurance was made.

## OTHER TAX CHARGES

If any other charge to Income Tax arises on money obtained from or in connection with a policy or a change of ownership or a policy coming to an end - see page 2 - that charge will take priority over any charge on a gain. For example, a benefit under a policy may be a receipt of your trade or profession. If you think this applies to you and you need more help, ask your Tax Office or tax adviser.

If you dispose of a policy or a part of a policy which you acquired from its original owner for money or something else of value (including a part of a policy acquired for value from an ex-spouse on divorcing), a capital gain (or a loss) may arise which you should include in the Capital Gains Pages of your Tax Return.

**Lloyd's Underwriters:** Life assurance policies, life annuities and capital redemption policies may be held as part of funds at Lloyd's. The tax treatment of any gain on these policies or contracts depends on how they are used to back your underwriting. If the

insurance company has provided a guarantee to Lloyd's secured on your policy or contract, the gains should be entered in boxes 12.4 to 12.8 on page 4 of the Tax Return, as appropriate, following the guidance in this Help Sheet. If however the Trust Deed governing your Lloyd's deposit includes the policy or contract itself, any chargeable event gain is part of Lloyd's trading income and should be included in box 3L.58 of the Lloyd's Pages of the Tax Return (see page LUN5 of the Notes on Lloyd's Underwriters). In these circumstances, the gain is treated as **not** having been taxed at the basic rate and the total sum received should be entered with no allowance for notional basic rate tax.

## LIFE ANNUITIES AND CAPITAL REDEMPTION POLICIES

A 'life annuity' means an annuity contract for a period ending on death or at some other time related to the end of life. Annuity payments may commence immediately or be deferred. (These contracts are sometimes known as 'purchased life annuities'.) Not all annuities within this description will give rise to tax charges. In particular, pension annuities and any annuity where relief has been given for any part of the cost (or premium) will not give rise to tax charges. Your insurance company should be able to tell you if you have a life annuity or not. If you need further help, ask your Tax Office or tax adviser.

A 'capital redemption policy' is an unusual type of contract from an insurer. On payment of a sum of money the insurer guarantees that a larger sum will be payable on a specified future date. There is no 'life assured' and therefore no amount becomes payable because of a death. Examples include an 'annuity certain' which is an annuity payable for a fixed period not dependent on a life; a 'leasehold redemption policy' which builds up a fund to be used in some way on expiration of a lease; and a 'sinking fund policy' that accumulates a fund, for example, to pay for replacement of an asset.

## TAX RETURN ENTRIES

The following guidance supplements the notes in the Tax Return Guide. You should read those notes as well.

Decide whether your gain is treated as having suffered basic rate tax or not.

Gains which are not treated as having suffered basic rate tax include those arising on:

- a friendly society policy written as part of tax-exempt business
- certain life annuity contracts.

Any gain which is not treated as having suffered basic rate tax is entered in box 12.5 on page 4 of your Tax Return. Any gain which is treated as having suffered basic rate tax is to be entered in box 12.8.

You also need to enter either the number of complete years for which your policy has run, or the number of complete years since the last gain on a part surrender, loan, or sale or gift of part of a

policy. A gain on a part surrender, etc. is treated as arising on the day before the next anniversary of the day on which the insurance was made. For example, for an insurance made on 19 February 1988 a part surrender gain may arise on 18 February 1997. If there were no previous gains of this sort, the number of years to enter is '9'. If there is a further part surrender in the next year, the gain will be treated as arising on 18 February 1998 and the number of years to enter is '1'. If the policy is then fully surrendered on 1 January 1999, the number of years to enter is '10'. The number of complete years is used in calculating the amount of any tax which may be due on a gain. There is a special 'top-slicing relief' to which you may be entitled which is worked out using this figure. Broadly speaking, top-slicing relief treats the gain as spread equally over the years in order to calculate the rate of tax that would apply in the current year.

If you want to calculate your tax bill, you will need either the special 'Tax Calculation Guide (Lump Sums etc.)', or, if you also have Capital Gains, the special 'Tax Calculation Guide (including Capital Gains and Lump Sums etc.)'. These Guides are available from the Orderline.

Both Guides include more information about top-slicing relief.

## OUR ADDRESS

For further help or information contact your insurer, tax adviser or Tax Office. If you need to write to the author of this Help Sheet send your letters to:

Insurance Help Sheet  
Insurance Group  
Financial Institutions Division 1  
Room 530  
22 Kingsway  
London WC2B 6NR.

## EXAMPLES OF CALCULATIONS - SEE PAGE 3

### Example of a calculation (X + Y - Z - A).

1. On **Maturity** a benefit of £10,000 arises (X).

The premiums paid total £4,000 (Z). [Y and A = 0].

The gain is (10,000 - 4,000) = £6,000.

2. As a result of the **Death** of the person to whom the Tax Return relates a benefit of £10,000 arises and the surrender value immediately before death is £8,000 (X) = £8,000.

The premiums paid total £4,000 (Z). [Y and A = 0].

The gain is (8,000-4,000) = £4,000 and the gain is treated as income of the deceased for the year of death.

3. On **Surrender** a benefit of £10,000 arises (X).

On **Maturity** of a related policy a benefit of £5,000 arose (Y).

The premiums paid on the first policy totalled £2,000 and on the second policy were equal to the maturity value transferred to the replacement policy £5,000 (Z) = £7,000.

[(A) = 0].

The gain is (10,000 + 5,000 - 7,000) = £8,000.

### Example of a calculation (B + C - D - E - F).

4. Three part surrenders are made in the year to 24.5.96 of £300, £900 and £800. (B) = £2,000. There were no part surrenders etc, in previous years.

The only premium was £10,000 paid on 25.5.90.

[(D) = 0. (E) = £500. (F) = [£500 x 5 years = £2,500].

[(C) = 0]

The gain is (2,000 - 500 - 2,500) = minus £1,000 so there is no gain - see page 4.

5. This example follows on from example 4, therefore

(C) = £2,000.

In the year to 24.5.97 half of the policy is gifted to your spouse (who is living apart from you) and the value of that half is £8,000 = (B).

A further premium is paid of £4,000 so (D) = £200,

(E) = £500, (F) = [£500 x 6 years = £3,000].

The gain is (8,000 + 2,000 - 200 - 500 - 3,000) = £6,300. The policy is jointly owned at 24.5.97 so only £3,150 is treated as your income for 1997-98. The balance of £3,150 is treated as income of your spouse for 1997-98.

6. This example follows on from example 5 above.

In the year to 24.5.98 a part surrender of £4,000 is made so (B) = £4,000.

(C) = 0 as all the amounts were taken into account in the previous year.

(D) = 0, (E) = £700, (F) = 0 as all amounts were set off in the previous year.

The gain is (4,000 - 700) = £3,300. The policy is jointly owned at 24.5.98 so only £1,650 is treated as your income for 1998-99. The balance of £1,650 is treated as income of your spouse for 1998-99.

### Example of a calculation (X + Y - Z - A).

7. This example follows on from example 6. above. On 7.4.99 the policy is surrendered for £15,000 = (X).

(Y) = £2,000 [see 4] + £4,000 [see 6] = £6,000. Note the value of the part gifted is not included.

(Z) = £10,000 [see 4] + £4,000 [see 5] = £14,000.

(A) = £6,300 [see 5] + £3,300 [see 6] = £9,600.

The gain is (15,000 + 6,000 - 14,000 - 9,600) = minus £2,600.

There is a corresponding deficiency - see page 4 - which is the lower of £2,600 and (A) [£9,600], so £2,600. The policy is jointly owned on 7.4.99 so you each have a corresponding deficiency of £1,300 for 1999-2000.

*These notes are for guidance only, and reflect the position at the time of writing. They do not affect any rights of appeal.*