

- Gains on Foreign Life Insurance Policies

This Help Sheet will help you fill in boxes 6.6 to 6.8 on the Foreign Pages of your Tax Return.

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INTRODUCTION

This Help Sheet supplements the information on gains on foreign life insurance policies, life annuities and capital redemption policies in the Notes on Foreign Pages. Where it is necessary, the two should be read together to help you decide if you need to complete boxes 6.6 to 6.8 and, if so, how to do it. This Help Sheet applies specifically to the law as it applies for the year to 5 April 2002 and should be used only in connection with your Tax Return for that year. It covers the most common circumstances that you are likely to come across in connection with the taxation of gains on life insurance contracts. The Notes on Foreign tell you if you need this Help Sheet and where to look in it for the information you need. As in the Tax Return Guide and the Notes on Foreign, 'gains' in the Help Sheet means chargeable event gains which are taxable as income.

If, when you have read the notes below, you are sure that you have made no gain on the payment or other benefit received in connection with a foreign policy and that you do not have a foreign Personal Portfolio Bond, you may leave boxes 6.6 to 6.8 blank. If you think you may have made a gain go to Part 5, beginning on page 10, to work out what, if any, figures to include in those boxes or in box 12.9 on page 4 of the Return.

The Help Sheet cannot cover every possible circumstance. Where appropriate, it suggests who to contact for more information; see the 'More help needed?' section on page 10.

The Help Sheet is divided into 5 parts:

- PART 1** explains about the different types of policy that there are and about when they might give rise to a gain.
- PART 2** sets out who is liable to tax on any gain that has arisen.
- PART 3** shows how to calculate the gain in different circumstances and what to enter in boxes 6.6 to 6.8 of the Foreign Pages and box 12.9 on page 4 of the Return.
- PART 4** contains general information about special circumstances and other types of insurance contracts.
- PART 5** explains how to work out the gain on your policy and includes a number of worked examples.

These notes are generally applicable to individuals, trustees and personal representatives of a deceased person unless they say otherwise.

A reference in this Help Sheet to a 'policy' means a 'life insurance policy'. Gains also arise in connection with two other types of insurance. The first type is a 'life annuity' including a 'purchased life annuity'. The second type is known as a 'capital redemption policy or bond'. The rules for taxing gains on them are broadly the same as those for taxing the gains on life insurance policies. Read the section on 'Life annuities and capital redemption policies' on page 9 in Part 4 **first** if you think you have either of these.

PART 1

If you read pages FN12 to FN14 in the Notes on Foreign you should be able to decide:

- whether you have an insurance policy, life annuity or capital redemption policy (if not, these notes do not apply to you),
- whether it is a UK or foreign policy (if a UK policy, see the Tax Return Guide and *Help Sheet IR320: Gains on UK life insurance policies*), **and**
- whether you may have made a gain on your policy.

Pages TFN9 to TFN11 of the Notes on the Trust and Estate Foreign provide similar guidance for trustees and personal representatives.

If, when you have read the relevant Notes, you are still unsure of the position, Part 1 will help you decide whether the payment or other benefit that you have received may have given rise to a gain. This will depend first on the type of policy and then on the type and amount of the payment.

WHAT SORT OF POLICY DO YOU HAVE?

For tax purposes, the most important distinction is between 'qualifying' and 'non-qualifying' policies. Qualifying policies are much less likely to give rise to a gain. Non-qualifying policies will normally give rise to a gain though whether tax is payable on it depends on a number of factors. Most foreign policies are **not** qualifying policies. If you think your foreign policy may be a qualifying policy, please read the 'Qualifying policies' section aside. Non-qualifying and qualifying policies are dealt with separately.

Policies that normally give rise to a gain

— Non-qualifying policies – 'single premium' policies

A single premium life insurance policy is one where you pay an amount to the insurance company (a premium) at the beginning of the policy and they pay over a lump sum on its maturity or if you (or another life assured) should die. You may also withdraw sums, or a loan may be made by the insurer or by arrangement with it, while the policy is in force, or you may sell or assign the

policy or surrender it completely before it is due to mature. You may also be able to pay additional amounts at irregular intervals during the life of the policy. This type of policy can never be a qualifying policy and is most likely to give rise to a taxable gain.

When will a gain not arise on a non-qualifying policy?

You will not have made a gain if:

- the event is the transfer of beneficial ownership of a policy, in whole or in part, to a spouse with whom you are living at some time in the tax year in which the transfer took place, **or**
- the beneficial ownership was transferred as security for a debt, **or**
- the calculations show that there is no gain (see 'Calculating the amount of the gain' on page 6 in Part 3).

If you have received a benefit or one of the other events described in 'In what circumstances may a gain on a policy arise?' on page 4 has occurred, and you do not fall into one of the categories above, you have probably made a gain. If so, see 'Calculating the amount of the gain' on page 6.

Policies that do not normally give rise to a gain — Qualifying policies

Apart from the exceptions described in 'Will a gain ever arise on qualifying policies?' on page 3 the benefits paid out on qualifying policies do not give rise to gains. So it is important to know whether a policy is a qualifying one.

Most foreign policies are **not** qualifying policies. A policy which is part of the Overseas Life Assurance Business of a UK insurer (see the Notes on Foreign) and was taken out after 16 March 1998 will **not** be a qualifying policy. In addition, any Overseas Life Assurance Business policy taken out on or before 16 March 1998 that is changed since that date to increase the benefits secured or to extend the term will **not** be a qualifying policy. When this Help Sheet refers to a 'UK insurer' it includes a UK branch of an overseas insurer.

Any other foreign policy will **not** be a qualifying policy if it was taken out on or after 18 November 1983 or if it was taken out before 18 November 1983 but has been enhanced since that date. A policy is 'enhanced' if it is changed so as to increase the benefits secured or to extend its term.

The exceptions to the general rule, when a foreign policy **may** be a qualifying policy, are set out below.

If you took out your policy before 15 March 1984 and you received Life Assurance Premium Relief throughout its term, you can be sure that your policy was a qualifying policy and that no gain arose.

For other policies, pointers to whether it was a qualifying policy are:

- 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 unless it is surrendered early), **and**
- premiums of fairly even amounts were payable at regular intervals, weekly, monthly or annually, in every year for at least 10 (or the first 10) years so it was a regular premium policy.

In addition, if the policy is part of the 'Overseas Life Assurance Business' of a UK insurer, it may be a qualifying policy if it was taken out on or before 16 March 1998 unless it has been 'enhanced' since then - see above.

Other foreign policies will not be qualifying policies unless:

- the policy was taken out before 18 November 1983 and it was not enhanced since that date (see above), **and**
- where the policy was taken out after 31 March 1976, it must have been stamped by the Inland Revenue as a qualifying policy. If it has been changed in any way since it was taken out it must have been re-stamped by us as a qualifying policy.

If you have a policy which was taken out after 31 March 1976 and your policy has not been stamped (or re-stamped), but it meets the conditions in all other respects you should send it for stamping before it comes to an end, together with any supporting documentation, including any marketing literature, to the address on page 10 of this Help Sheet.

If you have a policy which was taken out before 1 April 1976, it may be a qualifying policy but there are other tests to be satisfied. Your insurer will know the details of your policy and is best placed to tell you if it is a qualifying policy because the rules are extremely complex. If more guidance is needed, write to the address on page 10 of this Help Sheet, with full details of the circumstances. Such a policy may have started out as a qualifying policy (the policy documents may give an indication of this) but become a non-qualifying policy because payment of premiums has stopped, or is not regular, or the premiums have increased or other changes have been made to the policy. If you are unsure, ask your insurer whether any of these apply.

If the policy comes to an end and is substituted with a new policy (see 'In what circumstances may a gain on a policy arise?' on page 4) the date the substitute policy was taken out is the date of the substitution.

Free gifts costing your insurer no more than £30 and minor infringements of the rules will not affect the qualifying status of a policy if Extra-Statutory Concessions A41 and B42 apply. Copies of the concessions are available from the Orderline.

There are special rules about qualifying policies and interest-bearing loans made to you or on your behalf to someone else. If you know of such a loan ask your insurance company whether or not a gain arises in connection with it if you have not already been told. If the policy is a qualifying policy and interest at a commercial rate is payable on the sum lent, the making of the loan is not a chargeable event. This might apply, for example, where the loan was secured by way of a mortgage granted in connection with house-purchase. If you need more help, write to the address on page 10, with full details of the circumstances.

If you are not the original owner of a qualifying policy, see the section on 'Policies purchased from a third party' on page 9 about a possible charge to Capital Gains Tax if you have received any money in connection with such a policy, given it away or exchanged it for another asset.

WILL A GAIN EVER ARISE ON A QUALIFYING POLICY?

A gain may have arisen on your policy if you surrendered or sold the whole or any part of it, or received benefits or a loan was made, other than at a commercial rate of interest, less than 10 years from the date the policy was made.

A gain may also arise if you or a previous owner stopped paying premiums so that the policy became 'paid-up' less than 10 years from the date that it was made and, at any time later, you received money in connection with the policy. Examples of this are if money is received when the policy matured or is paid out on death or when you surrendered or sold the whole or any part of it.

If you have, or a previous owner has, at some time changed the policy so as to increase the premiums paid, the 10 year period restarts from the date of that change unless the increase was made under an option in the policy. Any change to a policy less than 10 years before it is due to mature may mean that the policy is no longer a qualifying policy even if the change did not affect the premium. If any such change was made to a policy taken out before 1 April 1976 and you are unsure what effect it had, ask your insurer or write to the address on page 10. If the policy was taken out on or after 1 April 1976, it will not have stayed a qualifying policy after the change unless we have re-stamped it as a qualifying policy before it came to an end.

A qualifying policy may come to an end as a result of a change of the life (or lives) assured. (See 'In what circumstances may a gain on a policy arise?' on page 4). If the policy came to an end for this reason less than 10 years after it was either made or changed so as to increase the premium (not by way of an option), the ending may give rise to a gain **unless**:

- the whole value of the policy immediately before the change of life assured was applied as premium under the post-change of life policy, **and**
- nobody was paid or received anything of value in connection with the change of the life assured.

Examples of such payments or receipts of value include your insurance company charging a fee for, or paying commission to your financial adviser as a result of, making the change of life assured. Paying or giving something of value to someone else, perhaps as part of arrangements made in a pre-nuptial contract or on divorce or separation, are further examples.

The 10-year minimum period mentioned above is reduced to three-quarters of the intended term if that gives a lower number than 10. For example, no gain will arise from a policy with an intended 10 year term if it is surrendered or sold after 7½ years. Similarly, where a policy is due to run for 12 years after a change that increases the premium (not by way of an option) no gain will arise if it is surrendered 9 years or more after the change.

Other circumstances where there is no gain

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. Benefits of this kind are always left out of account in the reckoning of any gain; for example, if another benefit is paid under the same policy later on. If you are unsure whether a benefit is a critical illness or disability benefit, ask your insurer.

Policies **made before 20 March 1968** (and not changed thereafter) will not give rise to gains. (If your policy was made before that date but was changed after it, the policy 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 10.)

There may be no gain on certain other policies. **Term assurance** and other similar policies (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, for example, because the life assured is suffering from a terminal illness.

Some **policies made and assigned before 26 June 1982** do not give rise to gains. However, these may give rise to an annual gain if they are a personal portfolio bond - see below - or to a Capital Gains Tax charge as explained in 'Policies purchased from a third party' on page 9 in Part 4.

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 Extra-Statutory

Concession A32 applies to them. A copy of the concession is available from the Orderline.

If you have given all of a policy to someone else and have not received anything in return, you will not have made a gain. For this to apply you must have transferred the beneficial ownership of **all** the rights under the policy. This may not be the case if you retain some right to, or control over, what happens to the policy or the policy benefits. Transferring a policy as part of arrangements made on divorce or separation must be treated as a transfer for value and will not therefore fall within this category of exception.

IN WHAT CIRCUMSTANCES MAY 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, **or**
- ownership of a policy or part of a policy changes hands, **or**
- a policy comes to an end, **or**
- the policy is a personal portfolio bond - see page 5.

In most cases, the insurer pays out money as a benefit under a policy:

- on surrender of all or part of a policy, including on payment of a cash bonus or what some insurers call a regular withdrawal or even an 'income payment', **or**
- when a policy matures, **or**
- as a result of the death of the life assured.

A surrender means giving up the right to receive a future benefit in exchange for something, usually cash, now. A surrender may be of the 'whole' of the rights, in which case the policy will come to an end, or 'part' of the rights which means that the policy continues but the benefits paid out at the end are reduced.

The benefit may be paid out as a single sum or as a series of sums. You may have had to claim the benefit from the insurer. (A benefit paid as a result of death will usually be claimed by the deceased's personal representatives.)

Other circumstances in which you may make a taxable gain include:

- if you sell or assign all or part of a policy,
- when 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, **or**
- if the insurance company makes you a loan, or makes a loan on your behalf to someone else or makes an arrangement for some other person to make such a loan.

Some policies contain an option on maturity allowing the policy holder to take out a new policy. If you exercise such an option and all the proceeds payable under the old policy, including any income arising on maturity, are applied as premium under the new policy, a gain will not usually arise when the old policy comes to an end. If you think this applies to you and your insurer has not told you, ask your insurer or write to the address in 'More help needed?' on page 10.

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. The insurer may not have sent you a new policy document. Ask your insurer. It 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:

- exercising an option to take out a new policy (but see the reference to maturity options above)
- changing the life or lives assured, for example, if on marriage the life of a spouse is added or on divorce the life of a former spouse is removed from the policy
- in certain circumstances exercising 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 or otherwise fundamentally change the contract. It is not possible to list all changes that have this legal result.

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. If your insurer is unable to help, write to the address on page 10.

Personal portfolio bonds (PPB)

An annual charge arises in respect of this type of bond in addition to the other charges that arise on a gain. In general terms, a personal portfolio bond (PPB) is a life insurance policy where the benefits payable are determined by the value of property chosen directly or indirectly by the policyholder. The charge will arise if the policy is a PPB at the end of the policy year, that is at the end of the day before the anniversary of when the PPB was made - see the date on the policy documents. You are treated as having made a gain of an amount equal to 15% of premiums paid, with the premiums paid being treated as increased annually by 15%, on a compound basis. There is however no annual charge in the year the policy comes to an end.

A policy or bond will not be a PPB for the purposes of the annual charge if the property that can be chosen to determine the value of the benefits is limited to certain kinds of collective investments, such as unit trusts or investment trusts, or to indices like the retail prices index or the FTSE-100 share index. In certain circumstances,

there are special rules which extend the range of investments that may be used to determine the value of benefits. These only apply for a bond taken out before 17 March 1998 and not subsequently enhanced. If these rules are met the bond will not be subject to the annual charge. A policy that was both made and assigned before 26 June 1982, if a PPB, is also subject to the charge even though it does not give rise to any other gains.

Your insurer should know if you have a PPB subject to this annual charge.

Ask your adviser, insurance company or Inland Revenue office for more details or ask the Orderline for leaflet *Personal Portfolio Bonds - Guidance Notes for Insurers and Practitioners* (also on our website www.inlandrevenue.gov.uk). There are special rules for non-resident holders of a PPB who become resident. See the *Guidance Notes* mentioned above and Extra Statutory Concession B53.

How is a life policy taxed?

The way the gain is worked out depends upon the nature of the event - see the section called 'Calculating the amount of the gain' and Part 5. A gain is treated as taxable income and added to other income.

PART 2 - WHOSE GAIN IS IT?

Individuals

A gain will be treated as part of your income if you are:

- the 'beneficial' owner of the rights under the policy. 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 absolutely entitled to benefit from a policy. For example, you may be the adult beneficiary of what is known as a 'bare trust' or a 'resulting trust'
- the owner of rights under a policy which is held as security for a debt of yours, such as a mortgage
- the person who either created or added property to a trust that holds the policy. The gain is treated as your income whether or not you are entitled to benefit under the terms of the trust (unless the trust is a 'bare trust' or a 'resulting trust' - see above). You are entitled to recover from the trustees any tax that you pay on the gain, **or**
- the UK beneficiary of an overseas trust or entity. A gain may be treated as 'unexpended income' of the trust or entity and the benefit you received may be treated as your income. (See the notes for boxes 6.5 and 6.5A on pages FN11 and FN12 of the Notes on Foreign.) An overseas entity is a company or other institution resident or domiciled outside the UK.

UK resident trustees

A gain will be treated as your income if:

- the trust was created by an individual who, when the event that gives rise to the gain occurs, is not resident in the UK or is dead,
- the trust was created by a company or some other entity that is not resident in the UK or that has been dissolved, wound up or has otherwise come to an end, **or**
- the rights under a policy are held as security for a debt owed by the trustees.

There is further guidance for trustees in the Trust and Estate Tax Return Guide.

Personal representatives

A gain may be treated as your income where a gain arises on a foreign policy that is not treated as income of a deceased individual and is not treated as having been taxed at the basic rate. See the Notes on Trust and Estate Foreign Pages and below.

In certain circumstances a gain may be treated as income of the personal representatives. It should be included in box 4.8 of the Trust and Estate Foreign Pages. Some of the circumstances in which a gain is treated as the income of the personal representatives are when on or after the next 6 April following the date of death:

- a policy of life insurance owned by the deceased but taken out on the life of somebody else is surrendered by the personal representatives, **or**
- such a policy matures while it is still an asset of the estate, **or**
- a life annuity owned by and on the life of the deceased has a guaranteed period during which annuity payments are made that extends beyond the date of death and the personal representatives commute the annuity payments in favour of a lump sum, **or**
- a capital redemption policy owned by the deceased is surrendered by the personal representatives, **or**
- such a policy matures while it is still an asset of the estate.

Co-ownership etc.

A policy is in co-ownership if:

- more than one individual is beneficially entitled to the benefits payable under the policy, **or**
- the rights under the policy are held on trusts created by more than one person (including where property was added to an existing trust), **or**
- the rights under the policy are held as security for a debt owed by more than one person, **or**
- the rights under the policy are held in more than one capacity (for example, part of the rights are held as owner and part as trustee).

In each case, any gain has to be divided among the co-owners in accordance with special rules. See 'Dividing a gain where there are joint or multiple owners or interests' on page 7.

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

PART 3

This Part tells you how to work out whether you have made a gain from your policy, the amount of that gain and how to complete your Tax Return.

Calculating the amount of the gain

Part 5 gives details of how to calculate the gain for various events. Use it if you:

- have sold your policy, **or**
- have received a copy of a chargeable event certificate which does not show the amount of the gain that you have made, **or**
- think that you may have made a gain but have not received a certificate.

If the result given by the calculation is zero or a negative amount go to the section 'The result of the calculation is not a positive amount' on page 8.

Multiple policies

Many insurance packages are made up of a number of policies often referred to as a 'cluster'. All of these policies may be identical and have identical numbers apart from a sub-designation (for example, 10 policies number AB1234567/1-10). There may be only one policy document for all the clustered contracts. 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 Notes on Foreign tell you to add up gains from a cluster of policies and enter the totals in the appropriate boxes.

In which year is a gain taxable?

If the event is a death or the maturity, sale or surrender of the whole of a policy, the gain is treated as income of the tax year in which the particular event occurs.

If the event is the sale or surrender of part of a policy, including the making of a loan, it is the date on which the policy was taken out that determines the tax year in which any gain is taxed. The gain is taxed in the tax year in which the end of what is known as the **policy year** falls. A policy year begins on the day on which the policy was taken out and on that same date in subsequent years. It ends on the day before the anniversary of that date in each subsequent year. For example, if you took out your policy on 25 May 1990, the end of the policy year is on 24 May

in each subsequent year so long as the policy remains in force. So even if the event itself took place in the tax year 2000-01, if the sale or surrender of part of the policy occurred during the policy year 25 May 2000 to 24 May 2001 any gain is treated as income arising on 24 May 2001. This means that it should be included in your Tax Return for the year ended 5 April 2002.

— Dividing a gain where there are joint or multiple owners or interests

If you have a share in the rights under a policy, your share of any gain that arises is the same as your share of the rights. Joint owners are treated as all having equal shares. If the rights under a policy are held on a trust or trusts that you created, or if you added property to an existing trust, your share of the overall gain is the same as the share of the property held in trusts that originates from you at the time the gain arises. (For example, say you settled £2,500 on a trust and this was used to buy assets that have become worth £3,000 by the time the gain on a life policy in the trust arose. If the total assets of the trust were worth £4,500 at that time then you would be taxable on 3000/4500 or 2/3 of the gain. The person who donated the other property held in the trust would be taxable on the other 1/3 of the gain.)

If the rights under a policy are held as security for a debt owed by you and others, your share of any gain that arises is the same as your share of the debt.

Similar rules apply in more complex situations such as in apportioning gains to trustees, personal representatives and as 'unexpended income' of an overseas trust or entity. If you need more help, write to the address on page 10, with full details of the gains and the circumstances.

COMPLETING BOXES 6.6 TO 6.8 ON THE FOREIGN PAGES OF YOUR TAX RETURN

Section A

— Introduction

If you have or had:

- a life policy that is part of a UK insurer's Overseas Life Assurance Business (see Notes on Foreign) that was taken out on or before 16 March 1998 and not enhanced (see 'Qualifying policies' on page 2, for the meaning of enhanced) since then, **or**
- a foreign policy issued by a foreign insurer that was taken out before 18 November 1983 and not enhanced since then, **or**
- a foreign life annuity or capital redemption policy that was taken out on or before 22 February 1984 and not enhanced since then

read this section about how to complete your Return. If your policy or contract does not fall into one of these categories, please complete the Return following the guidance in Section B on page 8.

— No Apportionment of Gain

Always enter the full amount of the gain in box 6.8. There is **no** apportionment of the gain on these policies and contracts for periods in which you (or any previous holder of the policy) were not resident in the UK.

— Top Slicing Relief from higher rate tax

You need to know the number of complete years (see below) to work out whether you are due the relief that is available in connection with a gain when you are not liable to higher rate tax on your other income. This includes where you are taxable on a gain under any of the first three items under the heading 'Whose gain is it?' on page 5. This relief is only available to individuals, and is not available to trustees, beneficiaries of overseas trusts, personal representatives or companies.

If the policy came to an end as a result of the event (surrender, maturity, or death) or is the **first** sale or surrender of a part of the policy or contract, the number of years is the number of complete periods of 12 months since the policy or contract was made. So, if you took out your policy or contract on 1 February 1981 and surrendered it on 30 June 2001, it has run for 20 complete years and that is the number you put in box 6.6.

However, where the gain arises on a second or subsequent sale or surrender of part of a policy or two or more loans have been made, the number of years is the number of complete periods of 12 months since the last preceding gain arose. For this purpose the date on which each gain is treated as arising is the end of the policy year in which the event occurred - see 'In which year is a gain taxable?' on page 6.

Note, enter '1' in box 6.6 of the Foreign Pages if:

- partial withdrawals etc. giving rise to gains are made each year, **or**
- the period from when the policy was made to when it ended is less than a complete year, **or**
- a gain arises each year on a personal portfolio bond.

Do not leave the box blank or enter 'zero'.

— Basic rate tax treated as paid on gain?

Gains on life policies and capital redemption policies of the types included in Section A are treated as if tax at the basic rate has been paid on them. So are some life annuities but only if they were taken out **on or before 26 March 1974**. If appropriate, enter in box 6.7 an amount equal to 22/100 of the gain entered in box 6.8.

Section B

— Introduction

The entries you need to make on the Return may be different if you have or had:

- a life policy that is part of a UK insurer's Overseas Life Assurance Business (see Notes on Foreign) that was taken out **after** 16 March 1998 or if taken out before then, enhanced since, **or**
- a foreign policy issued by a foreign insurer that was taken out **after** 17 November 1983 or, if before then, enhanced since, **or**
- a foreign life annuity or capital redemption policy that was taken **after** 22 February 1984 or, if before then, enhanced since.

If you made a gain on one of these types of policy or contract, this section tells you about how to complete your Return. If your policy or contract does not fall into one of these categories, please follow the guidance in Section A on page 7.

'Enhanced' means changed so as to increase the benefits secured by the policy or contract or to extend its term.

— Apportionment of gain for periods of non-residence

The amount of the gain you enter in box 6.8 is reduced if you (or any previous holder of the policy) were not resident in the UK for any part of the period since the policy was taken out. However, no reduction is due if the rights under the policy were ever held on trusts, any of the trustees were at any time not resident in the UK, and the policy was taken out after 19 March 1985 or taken out on or before then and enhanced since.

No reduction is due if a non-resident company or other entity was at any time the policy holder, or one of the policy holders if there were more than one, and the policy was taken out after 16 March 1998, or taken out on or before then and enhanced since. The gain is reduced to the fraction: A / B

of the gain where 'A' is the number of days the policy holder was resident in the UK in the total period 'B', where 'B' is the number of days between when the policy was made and the date when the gain is treated as arising (see 'In which year is a gain taxable?' on page 6 and Example 1 in Part 5). If you are entitled to relief for a 'corresponding deficiency' (see 'The result of the calculation is not a positive amount' aside) the relief is restricted by the same fraction as a gain would have been.

— Top-slicing relief from higher rate tax

You need to know the number of complete years (see aside) to work out whether you are due the relief that is available in connection with a gain when you are not liable to higher rate tax on your other income. This includes where you are taxable on a gain under any of the first three items under the heading 'Whose gain is it?' (see page 5). This relief is only available to individuals, and not to trustees, beneficiaries of overseas trusts, personal representatives or companies.

The number of years to be entered in box 6.6 or in the 'Additional information' box, box 23.5 on page 9 of your Tax Return, is the number of complete periods of 12 months since the policy or life annuity was made. However, if you have reduced the gain for periods of non-residence, the number of years you enter in box 6.6 should be reduced by the number of complete periods of 12 months since the policy or annuity was made during which you (or any previous holder of the policy) were not resident in the UK - see Example 1 in Part 5.

— Basic rate tax treated as paid?

You will **not** usually be entitled to relief for tax treated as paid on gains from these types of policy and contract. However, it may be possible for you to claim that the gain should be treated as if basic rate tax has been paid on it for some policies from insurers resident in other European States if the insurer has been taxed on the investments underlying the policy. There are other conditions and it is likely that they will only be met if the insurer is resident in Denmark, Ireland (other than in the International Financial Services Centre) or Sweden. If you think you may be entitled to make a claim write, giving full information, to the address on page 10.

The result of the calculation is not a positive amount

This may mean that you have made a loss on the policy. There may well be no relief for this loss.

There is no gain and no relief is due if:

- the result is zero, **or**
- the calculation on an assignment gives a negative result, **or**
- the result of a part surrender type of calculation (see Examples 4 to 6 in Part 5) is negative.

Do not make any entries on your Tax Return.

If the event is death, full surrender or maturity of the policy and the calculation includes any amount for gains made on earlier events, the result of the calculation of the gain (see Examples 1 to 3 in Part 5) may be a negative amount. If so, you may be entitled to a relief that is known as 'corresponding deficiency' relief. This relief is not available to trustees, personal representatives and beneficiaries of an overseas trust, company or other entity. Individuals who would have been chargeable to tax on the gain if one had been made may claim relief up to a maximum of the gains made on earlier events. There is no reduction in your tax liability if you do not pay tax at the higher rate but if you are taxable at the higher rate in the tax year in which the gain is taxable, it will reduce your liability. See Example 7 in Part 5: enter in box 12.9 the smaller of $[(Z + A) \text{ minus } (X + Y)]$ and A.

If the corresponding deficiency arises from a policy or contract within Section B (see aside) and you (or any other previous holder

of the policy) were resident outside the UK for any period since the policy was taken out, the corresponding deficiency should be reduced to the fraction relevant to the period of residence. This is the fraction which would have been applied to any gain and an example of how to calculate it is given in Example 1 in Part 5.

If the result of a full surrender, death or maturity calculation is negative and you have made no gains on the policy in earlier years, so that the number represented by A in Examples 1 to 3 in Part 5 is zero, you have made a loss on the policy. There is no relief for that loss. **Do not enter it anywhere on your Tax Return.**

A loss on one policy cannot be set off against a gain on another policy.

PART 4

Other Income Tax charges take priority

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 4 - that charge will take priority over the charge described in this Help Sheet. For example, a benefit under a policy may be taxable as a receipt of your trade, profession or employment. If you think this applies to you and you need more help, ask your Inland Revenue office or tax adviser.

— Lloyd's Underwriters

Life insurance 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 life annuities depends on how they are used to underpin or support your underwriting. If the insurance company has provided a guarantee to Lloyd's secured on your policy or life annuity, the gains should be entered in 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 life annuity itself, any chargeable event gain is part of Lloyd's trading income. If you are an individual include it in box 3L.58 of the Lloyd's Underwriters Pages of your Tax Return (see page LUN5 of the Notes on Lloyd's Underwriters). If you are a personal representative include it in box 1L.58 of the Lloyd's Pages of the Trust and Estate Tax Return. In these circumstances, the gain is treated as **not** having been taxed at the basic rate so enter the total sum received, with no allowance for basic rate tax treated as paid.

— Policies purchased from a third party

If you dispose of a policy which you did not take out yourself but acquired for money or something else of value, a capital gain (or a loss) may arise. As well as a sale or other transaction that results in beneficial ownership of a policy passing to someone else, the maturity or surrender of a policy counts as a disposal for the purposes of Capital Gains Tax.

Policies purchased from a third party are often qualifying policies. This sort of policy is sometimes called a 'Traded Endowment Policy' or 'TEP'. The maturity or disposal of a 'second hand' qualifying policy does not generally give rise to a gain chargeable to Income Tax - see 'Qualifying policies' on page 2. However, if it does not give rise to a gain chargeable to Income Tax, there may be a charge to Capital Gains Tax.

You should enter details of capital gains and losses you make during the tax year on policies purchased from third parties on the Capital Gains Pages of your Tax Return. You will find basic information about how to calculate capital gains in the Notes on Capital Gains.

— Life annuities and capital redemption policies

Capital redemption policies are relatively rare. While purchased life annuities are much more common, it is rare for them to give rise to gains.

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'.) Your insurance company should be able to tell you if you have a life annuity on which a gain has arisen. A life annuity will normally only have given rise to a gain if you have received a lump sum in return for giving up the right to receive some or all of the future annuity payments. If you need further help, ask your Inland Revenue office or tax adviser.

A **'capital redemption policy'** is a particular type of contract that is available from an insurer. It provides that 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. You may make a gain on a capital redemption policy in the same circumstances (apart from death) as with a life insurance policy, that is:

- when money (or something of value) is obtained from, or in connection with, a policy
- if the insurance company makes you a loan, or makes a loan on your behalf to someone else or makes an arrangement for some other person to make such a loan
- when ownership of a policy or part of a policy changes hands
- when a policy comes to an end, **or**
- when the policy is a Personal Portfolio Bond.

There is more detail in 'In what circumstances may a gain on a policy arise?' on page 4.

Examples of capital redemption policies 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: see notes in your Tax Return Guide**

Tax Returns indicate what boxes are appropriate for different types of gains.

This Help Sheet and the Tax Return guidance is updated every year to take account of changes to the law and in response to comments made. If you have any comments, they may be sent to the address below.

MORE HELP NEEDED?

If you need more help in filling in your Tax Return in connection with gains on life policies you may ask your insurer, your financial adviser, or your Inland Revenue office. If you wish, you may also write to the Business Tax (Insurance Group) at the address shown below. 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 Inland Revenue 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, but will be able to advise on general points of principle.

If you need to write to the author of this Help Sheet send your letters to:

Insurance Help Sheet
Revenue Policy, Business Tax (Insurance Group)
5th Floor, 22 Kingsway
London WC2B 6NR
or email to Claire.Ritchie@ir.gsi.gov.uk

Details of calculations and examples follow in Part 5.

PART 5 - HOW IS A GAIN CALCULATED?

There are different rules for calculating a gain on:

- a full maturity or surrender
- death
- a sale or assignment
- a part surrender giving rise to a partial withdrawal of benefits or a payment of a cash bonus or an insurer making a loan or on the sale of part of a policy, **and**
- a part assignment other than by way of gift.

Calculating a gain on maturity or full surrender

A gain on maturity or full surrender is calculated as follows:

Gain = (X + Y) minus (Z + A), where:

'X' is the single lump sum benefit receivable as a result of the maturity or full surrender. (If you do not receive a cash payment on maturity or surrender because the full value of the amount of the benefits payable under the policy are transferred to a new policy, amount X is equal to the value transferred to the new policy.

If instead of a single lump sum you are to receive a series of sums as a result of maturity or full surrender [including if you opt to receive an annuity], X equals the value of the right to receive those sums at the time when the right to them arises. Ask your insurer about the valuation if you do not have a chargeable event certificate or if the certificate does not tell you what the value is.)

'Y' is all benefits (money or anything of value) received at any time previously under this or any 'related policy' (see below) with the exception of critical illness benefits and disability benefits - see page 4. Benefits also include loans made during the life of the policy to you or on your behalf to someone else by your insurance company or under an arrangement made by your insurance company. Free gifts costing your insurer no more than £30 are also left out of account if Extra-Statutory Concession B42, available from the Orderline, applies to them.

'Z' is all amounts paid as premium under this or any related policy.

'A' is all gains which arose on part surrenders or part sales, including gifts, in previous years or on your insurer previously making a loan.

All of the amounts above, apart possibly from A, should be included on the chargeable event certificate the insurer sent to us. If you are unable to work out the amounts of previous gains your insurer may be able to help you.

(A 'related policy' is any policy which ended previously, see page 4, 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. Your insurer should be able to tell you if there were any policies 'related' to the policy giving rise to the gain.)

Calculating a gain on death

Calculate the gain on death using the same formula as above but in this case amount X is the surrender value of the policy immediately before death rather than the lump sum benefit receivable as a result of death. Ask your insurer to tell you the value if it has not already done so.

Calculating a gain on sale

You also calculate a gain on the sale of all of a policy using the same formula except that in this case amount **X** is normally the sale price of the policy (or the value of any other consideration if the policy is not transferred for cash). Note that the transfer of ownership of a policy between a husband and wife who are living together does not give rise to a gain – see 'When will a gain not arise on a non-qualifying policy?' on page 2. Also note that amount **X** is the market value of the rights sold, not the sale price if the person to whom you sold the policy is your wife or husband (with whom you are not living and ceased to live with before 6 April 2001), a brother, sister, child or another 'connected person'. Your Inland Revenue office can tell you if the purchaser is connected with you.

'Y' is the same as on surrender or maturity as set out above **plus** the aggregate value of any previous sales or gifts of part of the policy.

Part surrenders and part assignments (sales)

A gain on a part surrender etc. which results in a receipt of benefits or a payment of a cash bonus 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. As an example, the policy year (see 'In which year is a gain taxable?' on page 6) is the 12 months running from 1 July 2000 to 30 June 2001. The gain is taxable in the tax year in which the policy year ends. So for a gain on a part surrender in October 2000, the policy year ends on 30 June 2001. The gain will therefore be taxable in 2001-02 and should be included in this Return.

Note, there is a special rule if this policy year ended in 2001-02 and the policy ended some time later but still in the same tax year (2001-02) as a result of a full surrender, the maturity of a policy or death giving rise to the payment of benefits. In this case, calculate the gain on the full surrender, maturity or death according to the rules above. Include in Amount Y the benefits from the part surrender. There is no need to also calculate a gain on the part surrender.

Calculating a gain on part surrenders and part assignments (sales)

The gain for a policy year when there has been a part surrender is calculated as follows:

Gain = (B + C) minus (D + E + F), where:

'B' is the value of all parts surrendered **plus** all cash bonuses **plus** the value of all parts that you have gifted or sold plus the amount of all loans in the year

'C' is the value of all parts surrendered and all cash bonuses and the value of 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

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

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

'F' is 1/20th (5%) of each premium paid in any previous year for each year since the premium was paid (excluding the current year), 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 follow.

EXAMPLES OF CALCULATION

— Example of a calculation of the gain on maturity or full surrender using the formula $(X + Y) \text{ minus } (Z + A)$

See page 10 for details of what X, Y, Z and A represent.

Example 1

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

The premiums paid total £4,000 (Z).

[In this example, both Y and A = 0, and as with the other zeros in the following examples, are not shown in the calculations below].

The gain is $(£10,000 \text{ minus } £4,000) = £6,000$.

If the policy is not an Overseas Life Assurance Business policy, was taken out after 17 November 1983, is not held in trust, and the policy holder was resident outside the UK, the gain is reduced.

For example, if the policy matures at the end of a term of 3,000 days and the policy holder was UK resident for 2,200 days the gain entered on the Foreign Pages is reduced to $£6,000 \times 2,200/3,000 = £4,400$. £4,400 is the gain entered in box 6.8.

The number of complete years in box 6.6 is calculated as follows:

Number of complete years to maturity	8
Minus number of complete years not resident in the UK , (3,000 minus 2,200 = 800 days which is 2 complete years)	2
	—
Number of years	6

The gain will not be treated as having been taxed at the basic rate because the policy was taken out after 17 November 1983 unless a claim can be made, as explained on page 8.

Example 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).

The premiums paid total £4,000 (Z).

[Again, both Y and A = 0].

The gain is $(£8,000 \text{ minus } £4,000) = £4,000$ and the gain is treated as income of the deceased for the year of death.

Example 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 (Z) 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 = £7,000. [Here A = 0].

The gain is (£10,000 (X) + £5,000 (Y)) *minus* (£7,000 (Z)) = £8,000.

Exceptionally in these circumstances, tax may have been paid on the gain of £3,000 (£5,000 benefit (Y) above) *minus* £2,000 premium (part Z above) that arose on the earlier related policy. In such a case, the later gain, if taxable, will be reduced by the amount of the earlier taxable gain to ensure that there is no double charge to tax.

— Example of the calculation of a gain on part surrender etc using the formula (B + C) *minus* (D + E + F)

See page 11 for details of what B, C, D, E and F represent.

Example 4

Three part surrenders are made in the year to 24 May 1999 of £300, £900 and £800 = £2,000(B). There were no part surrenders etc. in previous years.

The insurance was made and the only premium of £10,000 was paid on 25 May 1993.

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

[In this case C = 0].

The gain is £2,000 (B) *minus* (£500 (E) + £2,500 (F)) = (-£1,000) so there is no gain - see page 8.

Example 5

This example follows on from Example 4, therefore (C) (the total of part surrenders from previous years ('B' above) = £2,000.

In the year to 24 May 2001, half of the policy is sold to a third party for £8,000 = (B).

A further premium of £4,000 is paid of in the year so (D) = £200, (E) = £500, (F) = [£500 x 7 years = £3,500].

The gain is (£8,000(B) + £2,000 (C)) *minus* (£200 + £500 + £3,500) = £5,800.

The gain on the sale of part of a policy is taxed according to who owned the policy at the end of the policy year (see 'In which year is a gain taxable?' on page 6). You owned half of the policy on 24 May 2001 so half the gain of £5,800 (£2,900) is treated as your income for the year to 5 April 2002. The balance of £2,900 is treated as income of the purchaser of the other half of the policy for the year to 5 April 2002. The number of years to enter is 8. This is because the gain is treated as arising on the last day of the policy year ending on 25 May 2001, 8 years after the insurance was made (see page 6).

Example 6

This example follows on from Example 5.

In the year to 24 May 2002 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, and (F) = 0 as all amounts were set off in the previous year. (E = £700 as it represents 1/20th of premiums paid in previous years, that is the premium of £10,000 on 25 May 1993 plus the £4,000 in the year to 24 May 2001.)

The gain is (£4,000 (B) *minus* £700 (E)) = £3,300.

The policy is jointly owned at 24 May 2002 and there were no sales in the year, only £1,650 is treated as your income for the year to 5 April 2003. The balance of £1,650 is treated as income of the purchaser of the other half of the policy for the year to 5 April 2003. The number of years to enter is 1, because it is one year since the previous gain. Please note that this income would have to be included in next year's Tax Return (assuming no change of law for that year).

— Example of a calculation (X + Y) *minus* (Z + A)

Example 7

This example follows on from Example 6 above. On 7 April 2003 the policy was surrendered for £15,000 = (X).

(Y) = £2,000 [see amount 'B' in Example 4] + £4,000 [see amount 'B' in Example 6 above] = £6,000.

Note that the value of the part sold is not included.

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

(A) = £5,800 [see gain in Example 5] + £3,300 [see gain in Example 6 above] = £9,100.

The gain is:

(£15,000 (X) + £6,000 (Y)) *minus* (£14,000 (Z [the total premiums paid]) + £9,100 (A total of previous gains)) = (-£2,100).

There is a corresponding deficiency - see page 8 - which is the lower of £2,100 and (A) [£9,100], so £2,100. The policy was jointly owned when the policy was surrendered on 7 April 2003 so each have a corresponding deficiency of £1,050 for the year to 5 April 2004. (This assumes, of course, that there is no change in the law for that year.)