AF1 Taxation of Investments 2022/23
Part 3a: Insurance Policies

This and the next part will cover the taxation of insurance policies in the hands of the investor.

The milestones are to understand:

- The principles of insurance policy taxation
- The main types of qualifying policies.
- How annuities are taxed

Key Principles

The underlying assets in a unit trust or OEIC are deemed to be held on behalf of individual investors who are liable for tax on any income and gains.

With an insurance policy, the company owns the assets and is subject to **Corporation tax** on the income and gains from these. Indexation was allowed to reduce any chargeable gains but cannot be used after January 1 2018.

Whether the investor has any further liability will depend on whether the policy is **qualifying or non-qualifying**.

- If the policy is qualifying the original policyholder will not be subject to **personal tax** on the proceeds. It is not tax free as the company has paid tax on the assets.
- If the policy is non-qualifying the policyholder may be subject to additional **income tax** on the gain. A credit of 20% is given to reflect the tax the company has paid.

Non qualifying policies will be dealt with in the next part.

Qualifying Life Policies

A qualifying policy means that the proceeds are free of any **individual tax liability**. It cannot be described as tax free since the investment fund will have been taxed.

Rules for a qualifying policy:

- It must be paid at least annually (e.g monthly, quarterly, six monthly or annually)
- The term must be at least 10 years
- The premiums in one year cannot be more than double that in any other year
- The premiums in any year must be at least 1/8th of the total premiums payable
- For an endowment policy, the life cover must at least be 75% of the premiums payable. If the age of the life assured is over 55, the 75% figure is reduced by 2% for each year over 55. For a whole of life policy. For a whole of life policy it is 75% of premiums paid to 75.

- Annual premium must be less than £3,600

- A qualifying policy can become non-qualifying. The main reason that it is cancelled within the lesser of 10 years or ¾ of the term

The main type of qualifying policy is an **endowment policy**. This policy runs for a specific period (minimum 10 years) and pays out a sum at the end of the term or on earlier death. They can either be **unit linked** or **with profits**

Unit Linked

- There is a guaranteed death benefit
- Premiums buy units one fund or range of funds
- At any time the value of the policy is the number of units multiplied by the unit price
- There are usually quite high charges with this type of plan and it may be some years until the value of the plan is greater than the premiums paid
- They are sometimes marketed as **Maximum Investment Plans.** This simply means the life cover is set at the minimum to be classed as a qualifying policy.

With profits

- The plan starts with a guaranteed sum assured
- This will be paid out at maturity or on earlier death
- An annual bonus may be added each year
- This increase the promised payment on death or maturity and once paid it cannot be withdrawn
- When the plan matures there may be a terminal bonus

All the benefits in a with profits policy are expressed as a promise to pay. They do not give an indication of the plan's current value. If the plan is surrendered the amount payable will be determined by the life company.

An alternative is to sell the with profits policy on the second-hand market. The attraction to the buyer is that they know that they are certain to get the sum assured plus declared bonuses if they maintain the policy to the end of the term.

The new owner will be subject to **Capital Gains Tax** on the final gain. This is the maturity value less price paid and premiums paid by the new owner

Annuities

The main products are:

- Purchase life annuities
- Compulsory Purchase (Pension annuities)
- Immediate Needs annuities

Purchase life annuities

- Part of the income is deemed to be return of capital and no tax is chargeable on this.
- The remainder is treated as savings income with 20% deducted at source. This can be reclaimed by non-tax payers. Higher rate tax payers pay a further 20%, additional rate tax payers 25%
- As it is savings income the PSA can be used.

Compulsory Purchase annuities

- These are annuities bought with the proceeds of a money purchase pension
- All the income is taxable as non-savings income

Immediate Needs annuities

- These are annuities bought to pay for long term care.
- There is no income tax on the annuitant provided the income is paid directly to the care provider

That concludes this part so you should now understand:

- The principles of insurance policy taxation
- The difference between qualifying and non-qualifying.
- The taxation of insurance/investment bonds
- How annuities are taxed