INVESTMENT WRAPPERS EXPLAINED

This note is designed to emphasise our reasons for placing specific types of funds into the different tax wrappers. If you want to know the full tax treatment of any wrapper please let us know.

HEADING **PAGE NUMBER**

In your overall portfolio you have both taxed and non-taxed funds. With the advent of the wholesale investment platform we can match the fund to the wrapper, rather than (as was the case in the past) choose the wrapper to get close to the fund we wanted.

1. PENSIONS (TAX EFFICIENT)

These offer tax free capital gains and Income.

1.1 Tax Benefits On Investment

For those earning less than £210,000 tax relief is available at your highest rates of earned income subject to an annual allowance.

1.2 How Are Investments Taxed Whilst In The Investment?

Interest From Cash Deposits	Rental Income	UK Dividends	Capital Gains
0%	0%	0%	0%

1.3 How Are Investments Taxed When Encashed From The Investment?

25% of your funds are available tax free (with numerous exceptions), and the remainder has to be taken as income which is then taxed as earned income.

2. LIFETIME INDIVIDUAL SAVINGS ACCOUNTS (LISA) (TAX EFFICIENT)

These offer tax free capital gains and income plus a bonus if held beyond age 60.

2.1 Tax Benefits On Investment

For those below the age of 50 (who started the plan before the age of 40) there is a 25% uplift in investments provided by HMRC.

2.2 How Are Investments Taxed Whilst In The Investment?

Interest From Cash Deposits	Rental Income	UK Dividends	Capital Gains
0%	0%	0%	0%

2.3 How Are Investments Taxed When Encashed From The Investment?

No tax to pay on encashment however early encashment is subject to a 25% penalty based on the total value of the sum matured.

3. INDIVIDUAL SAVINGS ACCOUNTS (ISA) (TAX EFFICIENT)

These offer tax free capital gains and income.

3.1 How Are Investments Taxed Whilst In The Investment?

Interest From Cash Deposits	Rental Income	UK Dividends	Capital Gains
0%	0%	0%	0%

3.2 How Are Investments Taxed When Encashed From The Investment?

No tax to pay on encashment.

4. INSURANCE COMPANY ONSHORE INVESTMENT BOND (BASIC RATE TAX PAID)

These pay tax at basic rates within them and offer the opportunity to defer higher rates of tax, but all growth and income is ultimately taxed as income.

4.1 How Are Investments Taxed Whilst In The Investment?

Interest From Cash Deposits	Rental Income	UK Dividends	Capital Gains
20%	20%	0%	Taxed each year at 19%

Most of the bond investments we do are on Transact, where the overall composite rate of tax on growth works out at 18%. This can vary between insurers.

4.2 How Are Investments Taxed When Encashed From The Investment?

Bonds are taxed by taking the total gain (ie the value at maturity plus withdrawals) then dividing this by the age of the investment (whole years). For example, if £100,000 was invested and then in 10 years time the plan was encashed for £150,000 (there having been no withdrawals) then the notional income to be taxed is £5,000 (£50,000 increase in value divided by 10 years).

When you add this income to your other income, if you remain in the 20% basic rate tax rate there is no further tax to pay. If this takes your income into higher rate tax the position is:

Plan total gain is:	£50,000
Tax already credited	£10,000

Tax rate	Extra Tax Due
20.00%	-
40.00%	£10,000
45.00%	£12,500
60.00%	£20,000

The 60% tax is due to the loss of personal allowances. We are often able to assign bonds from higher paying trusts and individuals to lower tax paying spouses or beneficiaries to mitigate higher rates of tax. This makes a bond wrapper very attractive for several types of long-term trust investment.

5. ENDOWMENT SAVINGS AND THE TRANSACT QUALIFYING SAVINGS PLAN

Since Transact launched its qualifying savings plan (QSP) in 2009 we have used this wrapper as a means to transfer significant higher rate taxed assets to lower rate taxed assets. The maximum that can now be invested into a QSP is £3,600 pa, which has effectively killed the investment for new plans.

5.1 Tax Treatment During Growth

The tax treatment is the same as for the onshore bond namely

Interest From Cash Deposits	Rental Income	UK Dividends	Capital Gains
20%	20%	0%	Taxed each year at 19%

Transact currently have a composite rate of tax of approximately 18%.

5.2 Tax Treatment On Encashment Before 7½ Years

Again, taxed the same as onshore bonds see 4.2 above.

5.3 Tax Treatment Of Proceeds After 7½ Years

The proceeds should be free from tax as long as over 7½ years premiums have been paid.

5.4 Tax Treatment Of Plan After 10 years

Encashment of all or some of the individual policies should not give rise to any tax liabilities as they are the proceeds of a qualifying life policy. Please note there will no longer be an opportunity to extend the life of 2009-2012 QSP plans where the premium is greater than £3,600 pa.

6. INSURANCE COMPANY OFFSHORE INVESTMENT BOND (TAX DEFERRED)

These do not pay tax (but remember withholding tax is often unavoidable) and defer all taxes until the plan is encashed, at which time tax will be paid at income tax rates on growth and income.

6.1 How Are Investments Taxed Whilst In The Investment?

Interest From Cash Deposits	Rental Income	UK Dividends	Capital Gains
Usually 0% but can have BRT deducted at source	Usually 0% but can have BRT deducted at source	0%	0%

6.2 How Are Investments Taxed When Encashed From The Investment?

They are taxed as income in the same way as the onshore bond (4.2), except there has not been any tax already paid.

Plan total gain is:	£50,000
Tax already credited	-

Tax rate	Extra Tax Due
20.00%	£10,000
40.00%	£20,000
45.00%	£22,500
60.00%	£30,000

We are often able to assign bonds from higher paying trusts and individuals to lower tax paying spouses or beneficiaries in order to avoid higher rates of tax.

7. GENERAL INVESTMENT ACCOUNT (GIA) (CGT AND INCOME TAX LIABLE)

With direct investments within the GIA, we are hoping to keep higher rate income tax receipts to a minimum and to generate gains to use your annual allowances which in this tax year (2021/22) are:

Interest (Personal Savings Allowance Basic Rate Taxpayer)	£ 1,000
Interest (Personal Savings Allowance Higher Rate Taxpayer)	£ 500
Capital Gains Tax	£12,300
Dividend Income	£ 2,000

7.1 How Are Investments Taxed Whilst In The Investment?

Interest From Cash Deposits	Rental Income	UK Dividends	Capital Gains
Paid at owners rate of tax	Paid at owners rate of tax	Paid at owners rate of tax	0%

We will often hold assets in a lower paying spouses name to benefit from lower income tax rates then transfer assets to the other spouse to make use of annual CGT allowances.

8. WHICH INVESTMENT FOR WHICH WRAPPER?

If a client has a mix of wrappers we would try and invest as follows:

Wrapper Type	Investments with Higher Yields	Investments with Lower Yields
General Investments Higher rate taxpayer	Unlikely	Yes
General Investments Lower rate taxpayer	Unlikely	Yes
Pensions	Yes	Possibly
ISAs	Yes	Unlikely
Bonds	Yes	Possibly

9. IS A BOND BETTER THAN SIMPLY USING THE GIA?

If you take it that an ISA is the best investment wrapper for general savings the next consideration is whether a bond (offshore or onshore) is better than a GIA for long term tax treatment.

This will depend on the sums involved, what you have invested elsewhere and what you earn during and at the end of the investment period. Overall, it is unlikely that an insurance company bond will pay less tax than a general investment portfolio where dividend, personal savings allowance (PSA) and capital gain tax (CGT) allowances are available to you.

Having said this, nowadays bonds are not as tax efficient as a general investment but they are still popular:

- Where investors want a simple income solution (bonds can pay out a tax deferred withdrawal of 5% pa for 20 years without any immediate tax liability).
- Where investors wish to protect assets from future local authority care home assessments.
- Where investors want a uniquely insurance company investment such as a with profit bond.
- Where investors which to defer higher rate income tax.

10. WHAT HAPPENS ON DEATH?

10.1 General Investments

If you die holding an investment which is subject to CGT then the value of the fund is uplifted to the value at the date of death without any further taxation considerations.

10.2 Onshore Bonds

If you are a basic rate taxpayer in the tax year when you die, then the onshore bond has no further tax to pay.

10.3 Offshore Bonds

The offshore bond will pay tax at the rate of tax you are paying in year of death.

10.4 ISAs

You can pass your ISA tax free to a surviving spouse who can continue to benefit from the tax free income and growth it generates.

10.5 Pensions

Broadly speaking, if you die before age 75 proceeds can be gifted tax free to your dependants. After 75 the fund passes free from tax, but the recipient pays tax at their highest rates on the income subsequently drawn out.

11. OTHER ISSUES

11.1 Assignments

Where you have a husband and wife you can assign a bond from a higher rate taxpayer to a basic rate taxpayer and hence mitigate higher rate tax. The same situation applies where you wish to encash a bond out of a discretionary trust which is subject to 45% and give the benefit to a beneficiary who is only a basic rate taxpayer. You assign whole segments of the bond to the beneficiary before you encash.

11.2 Emigration

If you plan to move abroad for a period of time and wish to avoid UK taxation, then in order to mitigate CGT you must be non-resident for 5 years. If you have an offshore bond, the proceeds are considered as income. You will, therefore, only need to be non-resident in the year of encashment (ie for about one year so you may be able to avoid all UK tax relatively simply).

11.3 CGT On Switching Funds

If you switch in a collective and have used your annual allowance you may get taxed at between 10% and 20%. Onshore bonds pay their CGT at a rate of 19% on a yearly basis regardless, and offshore bonds pay no CGT as they are taxed as income.

11.4 Top Slicing Relief

You may be able to control your income in the year of encashment of the bond. For example, for a husband and wife, one spouse's income could be significantly reduced in a tax year and then encash substantial bonds, thus avoiding any further taxation. In simple terms (and this is far from simple!) if you have a gain of £10,000 over 10 whole years, then you only need to ensure that the addition of £1,000 to your income will not put you into higher rate tax. If it does not then you can take the whole gain without any further liability to tax.

11.5 Trusts

For trusts where there are no trust income pool considerations, onshore bonds remain a reasonable investment. This is particularly the case when they can be assigned to beneficiaries rather than encashed within the trust.

If significant income is paid out to non tax paying beneficiaries then the GIA approach may well be a better choice.

11.6 Nursing Home Fees

Under the Charging for Residential Accommodation Guide (published in October 2003), known as CRAG, local authorities are not supposed to consider a "policy of life assurance" as "assessable capital" assets for the purpose of the means-test when assessing how much an individual must pay towards their long term care. This means that bonds and endowments should escape any local authority means testing.

As mentioned above, life offices do get tax relief on their expenses and the losses from investments so certain high yielding investments such as property, gilts and bonds may be very attractive within a bond environment. Income can be taken tax deferred and when the bond is encashed further tax liabilities may be avoided.

12. SUMMARY

The efficient investment of a portfolio is not just the accurate assessment of the suitability of asset classes to match a client's risk profile. Great improvements in performance can be created by matching the right underlying investment to the best wrapper as well.

The use of an investment platform enables us to match the investment to the best tax wrapper whenever practical. Good financial planning can also save substantial sums by choosing the right wrapper for each personal circumstance.

Investments are subject to market risk, including the possible loss of the money you invest. Bond funds are subject to the risk that an issuer will fail to make payments on time, and that bond prices will decline because of rising interest rates or negative perceptions of an issuer's ability to make payments. Diversification does not ensure a profit or protect against a loss in a declining market. Performance data shown represent past performance, which is not a guarantee of future results. Note that hypothetical illustrations are not exact representations of any particular investment, as you cannot invest directly in an index or fund-group average.

E.&.O.E.