

Taxation of investment bonds – Quick reference guide 10

Taxation of investment bonds – bonds held by trustees

This guide provides an overview of the tax which applies to bond owned by trustees. See our chargeable event hub for more detail on the calculation of gain and income tax liability [Quilter.com/CEHUB](https://www.quilter.com/CEHUB).

The structure of bonds makes them a popular choice for trusts

Onshore Investment bonds are a single premium, unit linked, life assurance policy - usually structured as individual policy segments, for example, at Quilter each Bond has 1000 individual policy segments. Whilst the bond holder chooses the investment funds which the bond is linked to, they do not actually own them. The investments are instead owned by the product provider.

The provider of an onshore bond pays UK corporation tax on interest and gains on the underlying funds in which the bond is linked. This is recouped within the charging structure of the bond by the provider and is therefore not reported or directly paid by the trustees. This provides simplicity in the tax obligations imposed on trustees, particularly for discretionary trusts.

To recognise the corporation tax paid by the provider, any gain assessable on the bond holder is deemed to have tax treated as paid equivalent to the basic rate for savings income, currently 20% (moving to 22% from 6 April 2027).

Further information on the corporation tax paid by Quilter Life & Pensions and how we price our bond to account for this can be found here - <https://www.quilter.com/49dd04/siteassets/documents/platform/support/7910-taxation-for-quilter-life-funds.pdf>

Bond holders are taxed under the ‘chargeable event regime’

Bonds are subject to a special tax regime with Income Tax. When a chargeable event occurs, there is a calculation to see if there is a chargeable gain. Chargeable gains are taxed as savings income. Chargeable events include;

- Bond anniversary where part withdrawals exceed the 5% tax deferred allowance – **covered in guide 2**
- Full surrender of one or more individual policy segments – **covered in guide 3**
- Full surrender of the bond – **covered in guide 4**
- Maturity - usually the death of the last life assured – calculated as described in guide 4 using the value on maturity or date of death respectively
- Assignment in exchange for money or money's worth.

The person(s) liable for income tax on any gain depends on the type of trust

Absolute / Bare trust

An absolute trust is referred to as transparent as the beneficiary is taxable at their marginal rate of tax i.e. the trust structure is ‘looked through’. If more than one beneficiary is named, then the gain is divided between them relevant to their share in the trust.



Watch out for the parental settlement rule

Where a beneficiary is the unmarried minor child of the settlor (the person who created the trust) then the parental settlement rule applies. If the trust income exceeds £100, all income is taxed on the settlor.

Interest in possession (IIP) and Discretionary Trusts

The settlor is taxable at their marginal rate of tax if the gain arises either, during their lifetime or, during the tax year of their death.

If the settlor cannot be taxed, then the trust is taxable at the Rate Applicable to Trusts (RAT) - see below.

If there is more than one settlor, divide the gain between them according to their contribution to the trust, this is often simply 50/50. Where one settlor has already died, this can result in a split treatment for trusts i.e. a portion on the settlor, a portion on the trustees.

Contingent interests

Commonly found within a Will. The trust defines one or more beneficiaries, but states that their absolute entitlement is on the attainment of a certain age (e.g. often 21 or 25) or an event (e.g. on event of marriage). There's usually a clause which states who will benefit instead if the beneficiary dies or the event does not occur.

Whilst the contingency is yet to be fulfilled, then the beneficiary does not yet have an absolute interest. Bond gains will be taxed at the RAT. On meeting the contingency, the tax treatment can change. If the beneficiary now has an absolute interest in the trust fund, then they will be taxed at their marginal rate.

The Rate Applicable to Trusts (RAT).

Savings Income (includes bond gains)	45%
Dividends	39.35%
Tax free band	Up to £500

The tax-free band

The tax-free band for trustees of up to £500 applies only where the trust's total income from all sources is below £500 in a tax year. If the income exceeds this, then all income is subject to the RAT. The £500 tax free band is reduced if the settlor has created more than one trust. The £500 is divided between them, but with a minimum of £100. So if 2 trusts £250 per trust - if 10 trusts each one gets £100.

If there is more than one settlor, then it is the settlor who has created the most trusts which is used to determine the tax-free band available should this have an example?.

Trustees report and pay tax to HMRC using the SA900 form.

Reliefs and tax planning

Top slicing relief is not applicable where the trustees are taxable. However, it can be used where the settlor or the beneficiaries are personally liable for tax on the gain in the scenarios outlined above.

Settlor is taxable

The starting position for a flexible trust, where the settlor is alive and UK resident, is that chargeable event gains are assessable on the settlor. Where this applies the settlor can potentially benefit from top slicing relief. If the settlor pays any income tax they have a statutory right to reclaim this tax from the trustees.

Beneficiary is taxable

Trustees can choose to assign ownership of the bond or individual policy segments to adult beneficiaries. The beneficiary is then free to keep those segments or encash them at their marginal rate. This can be useful where;

- the settlor's rate of tax is higher than the beneficiary,
- the settlor is deceased and the RAT applies to any gain,
- the beneficiary wishes to keep the bond or encash it over a prolonged period.

Where the intended beneficiary is below age 18, it is not possible to assign policies within a bond to them. However, it is still possible to apply their marginal rate through an 'appointment'. This is an irrevocable declaration by the trustees that the bond, or individual policy segments within it, will be held specifically for a particular person.

This changes the nature of the beneficial interest giving the beneficiary an absolute entitlement. As described above, where there is an absolute interest, the beneficiary is taxable at their own marginal rate of tax.

This can be useful where;

- the beneficiary is too young for assignment
- the beneficiary would have difficulties in managing the assignment and withdrawal process.

Care should be taken where the beneficiary is the minor unmarried child of the settlor, as the parental settlement rule (described above) applies.

The information provided in this article is not intended to offer advice.

It is based on Quilter's interpretation of the relevant law and is correct at the date shown. While we believe this interpretation to be correct, we cannot guarantee it. Quilter cannot accept any responsibility for any action taken or refrained from being taken as a result of the information contained in this article.

www.quilter.com

Please be aware that calls and electronic communications may be recorded for monitoring, regulatory and training purposes and records are available for at least five years.

Quilter is the trading name of Quilter Investment Platform Limited which provides an Individual Savings Account (ISA), Junior ISA (JISA) and Collective Investment Account (CIA) and Quilter Life & Pensions Limited which provides a Collective Retirement Account (CRA) and Collective Investment Bond (CIB).

Quilter Investment Platform Limited and Quilter Life & Pensions Limited are registered in England and Wales under numbers 1680071 and 4163431 respectively.

Registered Office at Senator House, 85 Queen Victoria Street, London, EC4V 4AB, United Kingdom. Quilter Investment Platform Limited is authorised and regulated by the Financial Conduct Authority. Quilter Life & Pensions Limited is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Their Financial Services register numbers are 165359 and 207977 respectively. VAT number 386 1301 59.

Approver: Quilter February

QIP23902/165/13492