Quilter

Technical insights - Quick reference guide 9

Taxation of Investment Bonds: Death of the bond owner or life assured

This guide is designed to help you identify if the death of an owner or life assured will trigger a chargeable event and, if it does, where the tax liability will fall. It also includes an outline of how tax is applied where the liability falls on the estate. This guide is not suitable for bonds held in trust or by a limited company and assumes that a life assurance bond has been setup on a 'last death' basis.

Will there be a chargeable event?

The table below will help you understand the impact the death will have on the bond. Start by selecting either scenario 1 or 2.

<table>
<tr><th colspan="2">1. The deceased was the last or only life assured</th><th colspan="2">2. There are surviving lives assured, or the policy is a redemption bond</th></tr>
<tr><th>Deceased was the sole bond owner</th><th>Deceased was not the sole owner at the time of death</th><th>Deceased was the sole bond owner</th><th>Deceased was not the sole owner at the time of death</th></tr>
<tr>
<td>– Chargeable event triggered on date of death.
– Legal Personal Representatives report the gain as income of the deceased for tax year of death.
– Any tax due is paid from the estate.
Any income tax due can be offset against the estate value for the calculation of Inheritance tax (IHT).</td>
<td>– Chargeable event triggered on date of death.
– The gain is divided between the bond owners, including the deceased.
– Surviving bond owners are taxed at their marginal rate.
– LPRs report the share of the gain as income of the deceased for tax year of death.
– Any tax payable on that part is taken from the deceased's estate.
Any tax due on the deceased's share can be offset against the estate value for the calculation of Inheritance Tax (IHT).</td>
<td>– No chargeable event triggered by the death.
– The bond is an asset of the deceased's estate.
– The LPRs can instruct either to:
1. Assign the bond to the beneficiaries of the estate. They can continue with the bond or encash at their own marginal rate, or;
2. Surrender the bond and distribute the proceeds to the beneficiaries of the estate.</td>
<td>– No chargeable event triggered by the death.
– The bond transfers automatically to the surviving bond owner.
– The value of the deceased's share of the bond forms part of their estate for the Inheritance tax (IHT) calculation.
– If the surviving bond owner is the spouse or civil partner of the deceased and long-term UK resident, then there will be no IHT liability. Otherwise, there may be IHT to pay.</td>
</tr>
<tr>
<td colspan="2">For further help
– Guide 4 - Calculating gain on Full Surrender and gain calculator.
– Guide 5 - Top slicing relief and income tax calculator.</td>
<td colspan="2">See below for further details on how income tax applies when the bond is encashed by the LPRs.</td>
</tr>
</table>

For financial advisers only

Who are the Legal Personal Representatives (LPRs)?

Legal Personal Representative (LPR) refers to the persons appointed to manage the estate of the deceased. Often referred to as executors or administrators of the estate. Their role is to manage the distribution of the deceased's estate. Any tax arising during the administration of the estate is paid from the estate's assets.

Where the deceased was the owner of an investment bond which continues after death (see above table), then the LPRs have the option to assign it to the estate's beneficiaries or encash it then distribute the proceeds.

Taxation of bonds when encashed by the LPRs

If the LPRs choose to encash the bond, then there are two parts to consider, the tax paid by the estate and the income tax liability of the beneficiary when the proceeds are distributed.

Tax paid by the estate

Full surrender of the bond is a chargeable event. Once the chargeable gain has been calculated (see our gain calculator and quick reference guides) the LPRs will need to report the gain to HM Revenue and Customs (HMRC) using the SA900 Trusts and Estates Return form.

The income tax rate for estates is equivalent to the basic rate, 8.75% (dividends) and 20% (all other income). There are no allowances available. Therefore, the estate will pay 20% on all bond gains. Onshore investment bond gains have an income tax credit of 20%, which covers the liability.

Tax paid by the estate's beneficiary

When the proceeds of the surrender are distributed between the beneficiaries of the estate, each recipient is deemed to have taken a proportionate amount of gain.

Example: Onshore Bond, surrender proceeds of £200,000 with a chargeable gain of £50,000. The proceeds are divided under the terms of the Will equally between two beneficiaries. Each receives £100,000 proceeds which comes with £25,000 of the gain.

The beneficiary is required to report the gain in their personal tax return as 'estate income' rather than a gain from a life policy. Estate income will be taxed at the beneficiary's marginal rate.

As this is now classed as estate income and not income from a life policy this will not benefit from top slicing relief. The LPRs must provide the beneficiary with an R185 form which declares the amount of tax paid (or deemed paid within an onshore bond) by the estate. This gives the beneficiary a tax credit to use against their personal liability.

Example continued

John is one of the beneficiaries of the estate. He has earnings of £45,000 in the tax year and is deemed to have received £25,000 estate income with a tax credit of £5,000 (20%).

Earned income	Personal Allowance	£12,570	0%	£0
	Basic rate band	£32,430	20%	£6,486
Estate Income	Basic rate band	£5,270	20%	£1,054
	Higher rate band	£19,730	40%	£7,892
	Tax on estate income			**£8,946**
	Tax credit			**£5,000**
	Tax due on estate income			**£3,946**

John has paid **£3,946 tax on the estate income**, after the credit

Consider assigning the bond to the beneficiaries

The executors are not required to surrender the bond. The beneficiary's share of the estate can instead be satisfied by assigning the bond to them. Bonds are ideally suited for this as the assignment itself does not trigger a chargeable event. Many bonds are also 'segmented' into a number of identical policies which can individually be assigned across multiple beneficiaries and surrendered independently.

Once assigned to a beneficiary, any chargeable gains will be taxed at their marginal rate of income tax. The key difference is that the resulting gain will be reported in their tax return as 'gains from insurance policies' rather than estate income. This means top slicing relief will be available. Top slicing relief recognises that the gain was made over a number of relevant years. The gain is divided over this number of years to give the 'sliced gain'. An income tax relief is then calculated using this slice and can reduce the amount of higher or additional rate income tax payable on the gain.

See the difference for yourself

Take this opportunity to try out our income tax calculator by visiting ***quilter.com/cehub***

Enter John's earned income (£45,000) and an onshore chargeable gain of £25,000. For the purpose of this example, let's assume 10 relevant years.

The value of your client's investments may fall as well as rise and they may not get back what they put in.

This document is based on Quilter's interpretation of the law and HM Revenue and Customs practice as at May 2025. We believe this interpretation is correct, but cannot guarantee it. Tax relief and the tax treatment of investment funds may change.

The value of any tax relief will depend on the investor's individual circumstances.

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