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Nucleus Onshore Bond account – tax considerations

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Tax on the bond

The Nucleus Onshore Bond account is a life assurance investment bond. It is provided by Countrywide Assured plc.

The taxation of life assurance bonds can be complex, but basically the life assurance company (i.e. Countrywide Assured plc) must pay corporation tax on the gains and some of the income of the bond's underlying investments. Dividend income is not taxable.

The rate of corporation tax applied to the gains and taxable income is 20% (and not the current corporation tax rate of 25%). The investor gets a basic rate tax credit (see below) so the rate of corporation tax applied to life funds is equivalent to the basic rate of income tax.

Countrywide Assured plc must pay this corporation tax quarterly and the tax is taken from each onshore bond account shortly after each quarter end. Countrywide Assured plc calculates the tax due from each account. Nucleus collects this, either from cash balances or following a sell down, and sends the amounts deducted to Countrywide Assured plc for onward payment to HMRC.

Because the investment income and gains are taxed the investor gets a basic rate tax credit. This means that only investors with a marginal rate of 40% or 45% will have to pay tax.

Onshore Bond tax account

If the Onshore Bond account only showed the value of the underlying investments, a misleading picture would be given. The value of the account should reflect the fact that a quarterly tax deduction will be made. The tax liability grows from quarter to quarter on a daily basis and the estimated liability should be disclosed to advisers and clients.

To achieve this disclosure the Onshore Bond account has two parts to it:

- An investment account that shows the value of the assets (e.g. collectives, cash); and
- An Onshore Bond tax account that shows the estimated tax liability accruing since the last quarterly tax payment.

The Onshore Bond tax account is updated by us daily. The tax liability is computed on a basis agreed by Countrywide Assured plc.

The Onshore Bond tax account will show a negative value when tax liability is accruing. It will show a positive value if any tax-relievable losses or expenses accrue.

Where the Onshore Bond tax account is negative, the value of the tax accrued will be deducted from available cash in the bond's investment account for value at each quarter end i.e. 31 March, 30 June, 30 September and 31 December. Any positive balance on the Onshore Bond tax account will be carried forward to offset against any future tax charges.

How can a policyholder or adviser find out what the Onshore Bond tax account is?

The value of the Onshore Bond account and its associated Onshore Bond tax account can be seen on the platform. The value of the Nucleus Onshore Bond tax account shown online and on client valuation statements is an estimate, and may change once final tax calculations are performed by the bond provider.

Positive balances

If there's a positive balance on the Onshore Bond tax account it will be carried forward to subsequent periods and set against negative balances.

If there's a positive balance when the bond is fully surrendered it will be added to the value of the underlying assets and the total paid to the policyholder.

Policies issued by Scottish Friendly Assurance (SFA)

Earlier versions of the Nucleus Onshore Bond account were offered by SFA.

Each account has a 'final tax charge' associated with it. The aim of the 'final tax charge' is to cover the tax liability that SFA has incurred on some of the income and gains on assets held for each account.

So, in effect, the Onshore Bond account has two parts to it:

- an 'investment account' that holds the assets, growing gross of any tax; and
- a 'final tax charge' account that holds the tax liability that has accrued.

The final tax charge will only be deducted from the investment account when the bond is fully cashed in unless it reaches a value of greater than 10% of the investment account. If this happens the investor must reduce the final tax charge to a value of 5% of the investment account. Nucleus will review each client's Onshore bond tax account quarterly and issue a communication when asset sales are required to reduce the tax account value to 5% of the investment account. Ad-hoc tax deductions can also be requested.

As payment of the final tax charge is being deferred until the bond is fully cashed-in it is increased at a rate of interest specified by SFA. This interest charge is applied whether the final tax charge is positive or negative. The final tax charge will show a negative value when tax liability is accruing. It will show a positive value if any tax-relievable losses or expenses accrue.

If the final tax charge is positive when the bond is cashed in, and the investor has made no prior payments towards the tax charge, then the positive tax charge is reduced to zero as there will be no future tax gains to offset the accrued tax losses. If the investor has made at least one payment towards the tax charge, then the minimum of the sum of all investor tax payments and the positive tax charge will be added to the investment account before payment of benefits to the policyholder is made.

How to incorporate the tax account when valuing segments for the Countrywide Assured and SFA Onshore bonds

To calculate the value of segments for Countrywide Assured and SFA Onshore bonds, calculate the gross value of the account and divide the number of segments being surrendered by the number of segments the bond currently holds.

For example, the account is showing a platform (net) value of £176,828.62. The tax account is -£14,943.29, the gross value is £176,828.62 + £14,943.29 = £191,771.91

The bond has 100 segments, and the client wishes to surrender 20, the calculation to determine the value would be; £191,771.91 x (20/100) = £38,354.38

The client wants a £20,000 withdrawal - how many segments do I need to surrender?

The client has a bond valued at £75,000 (net) and a tax account value of -£3,000. The gross value therefore is £78,000. The bond has 100 segments. To work out the value of 1 segment, take £78,000/100 segments = £780

To raise £20,000 at £780 per segment the client needs to sell 25.6 segments (£20,000/£780). Only whole segments can be surrendered so the client will need to decide if they want to surrender 25 or 26 segments. 25 segments will provide slightly less for the client and 26 slightly more than the £20,000 requested:

25 segments; £780 x 25 = £19,500 or 26 segments; £780 x 26 = £20,280

What if the tax account value is positive?

Where the tax account value is positive, the following calculation applies: For example, the account is showing a platform (net) value of £34,800. The tax account is £500, the gross value is £34,800 - £500 = £34,300

The bond has 100 segments, and the client wants to surrender 80, the calculation to determine the value would be; £34,300 x (80/100) = £27,440

What if the client has less than 100 segments?

For example, the account is showing a platform (net) value of £80,000. The tax account is -£4,000, the gross value is £80,000 + £4,000 = £84,000

The bond has 60 segments, and the client wants to surrender 20, the calculation to determine the value would be; £84,000 x (20/60) = £28,000

If the client wanted to withdraw £28,000 but didn't know how many segments to surrender the calculation would be as follows;

To raise £28,000, one segment would be valued at £1,400 (£84,000/60)

To calculate the number of segments: £28,000/£1,400 = 20 segments

Important note

Following any withdrawal the gross asset value remaining in the Onshore bond account should never be less than the tax account value.

If a shortfall in tax arises following any withdrawal, the amount due in tax should be paid back when Nucleus requests this.

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