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TECHNICAL SALES BRIEFING

TAX PLANNING USING BONDS
TIME APPORTIONED REDUCTIONS

- This technical briefing is part of a series of technical briefings intended to shine a light on various areas of overseas single premium bond taxation from the point of view of a UK resident investor
- It considers Time Apportioned Reductions (TAR), when TAR are applicable and how TAR are calculated.

WHAT ARE TIME APPORTIONED REDUCTIONS?

TAR have been available for many years in respect of overseas bond policyholders who have been non-UK resident during the term of the policy.

The relief operates so that when a chargeable event gain arises under a policy, the gain is worked out in the normal way but could be reduced by the period of non-UK residence as a proportion of the total period the policy has been in force.

This relief was extended in the Finance Act 2013 to include policyholders of onshore bonds issued on or after 6 April 2013. Further, in certain circumstances the relief will also apply to onshore bonds issued before 6 April 2013, for example where the bond is 'topped up' by an additional premium. The specific rules here are beyond the scope of this briefing.

From 6 April 2013 the Statutory Residence Test determines whether or not an individual is resident in the UK for tax purposes.

HOW DO THEY WORK?

If a chargeable event occurs on or after 6 April 2013, the gain is apportioned using the following formula:

$$\frac{A}{B}$$

where, A is the number of days that are foreign days in the material interest period (see next page).

B is the total number of days in the material interest period.

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The following are important definitions:

FOREIGN DAYS

The meaning of foreign days for the purposes of the calculation on the previous page depends on whether the policy held falls under the new rules applicable from 6 April 2013 or the previous rules for time apportioned reductions.

Under the old rules, foreign days are:

- Days on which the **policyholder** is not UK resident, and
- Days falling within the overseas part of any tax year that is a split year in respect of the **policyholder**, provided the policyholder is an individual.

Under the new rules, foreign days are:

- Days falling within any tax year for which the **individual liable to tax** on the gain is not UK resident, and
- Days falling within the overseas part of any tax year that is a split year in respect of the **individual liable to UK tax** on the gain.

THE MATERIAL INTEREST PERIOD

The material interest period is the part of the policy period during which the individual meets one of the following conditions:

- The individual beneficially owns the rights under the policy or contract
- The rights are held on non-charitable trusts which the individual created
- The rights are held as security for the individual's debt.

THE POLICY PERIOD

The policy period is the period for which the policy has run prior to the chargeable event.

INTERACTION WITH TOP SLICING RELIEF

Top-slicing relief can be applied to the chargeable gain once it is reduced by utilising the above formula. However, it can only be applied for any complete policy years the policyholder was a UK resident. Top-slicing relief cannot be claimed for the period where they were not UK resident.

It is important to note that TAR does not apply where the policy has been held in a non-resident trust prior to 6 April 2013 and the policy has not been varied after this date. However, where the policy is varied the new rules will apply and TAR can then apply based on the material interest period of the person liable to tax. This can allow for TAR to apply for policies that were previously held under overseas trusts. Variations would include:

- Bond is altered to increase the benefits payable (i.e. it is topped up)
- Bond is assigned to another individual (except between a spouse or civil partner who live together) or into trust - whether any of these are for consideration is irrelevant
- Bond rights are assigned for security for a debt of the individual.

It is also important to note that, under the new rules, it is the residence history of the individual liable to tax that is taken into account. The relevant period of time is the period that individual materially owns (as defined above) the policy in question.

Finally, TAR is only relevant where the individual is UK resident for tax purposes at the time of encashment. If the individual is non-UK resident when the bond is encashed, the tax regime of the country where they are resident will apply.

UL PR 0041 | 11/22

EXAMPLE OF INTERACTION OF TAR AND TRUSTS

Jose, Spanish national, is 45 years old and a senior partner of an international law firm with offices in Madrid. Prior to taking up this partnership, he previously owned several profitable companies, which he has now sold. He currently lives in Madrid (Spain) and has two adult children who are financially independent and a wife who was born in the United Kingdom. He decided to takeout a Spanish compliant life assurance policy on 1 Jan 2017 for EUR 10,000,000 using part of the proceeds from the sale of a previous business venture sold several years ago.

In February 2022, Jose and his wife moved to the UK as his wife decides she needs to spend more time near her parents as they are currently unwell. Jose was transferred to the London office and they decided to retain their property in Spain,as both were unsure at the time of the move how long they intend to be in the UK. Jose has been advised that he is currently still considered non-UK domicile. On their return to the UK their policy is valued at EUR 12,000,000 and therefore currently has a EUR 2,000,000 gain.

Jose, as policyholder, can continue to enjoy the benefits of gross roll-up and any chargeable gains on surrender or withdrawal would be subject to UK income tax.

However, as Jose lived outside the UK, the chargeable gain will be reduced by applying Time Apportioned Reductions. Jose can therefore choose to leave the policy in force in the knowledge that future gains realised whilst he is UK resident would benefit from this important tax benefit.

Alternatively, Jose could chrystallise the gains a short time after taking up residence in the UK (once he has established non-resident status from a Spanish perspective) and reinvest the proceeds into another Spanish compliant policy. The benefit of this strategy is that it would allow him to 'reset' and increase the available tax-deferred 5% withdrawal allowance, as this would be based on the full premium of EUR 12,000,000.

Furthermore, Jose could assign the policy to an excluded property trust as this will ensure that, should Jose be considered UK domiciled under general law, or deemed domiciled in the future,the policy will remain outside of the UK for IHT purposes.

If Jose returns to Spain in the future, the trustees could also assign the policy out of trust to him, and it will not be subject to UK IHT once his deemed domiciled status has fallen away. He could also make the policy subject to a beneficiary nomination in order to ensure that the policy benefits are transferred in accordance with Spanish estate planning techniques.

Further information on excluded property trusts can be read in our **Guide to Domicile, Remittance Basis and Excluded Property Trust**. For information on portability options please speak to your Utmost Wealth Solutions sales representative.

OTHER POINTS TO NOTE

For policies issued by UK providers, time apportionment relief will only ever be available on the net gain, whereas, for policies effected through non-UK providers (i.e. overseas policies), the relief will be available on the gross gain. This would appear to make such policies more attractive where it is known that policyholders are likely to have periods of non-UK residence during the term of the policy.

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