

Capital Investment Bonds

Capital Investment Bonds are offered by most leading Life Assurance Companies. They offer you the opportunity to invest in a variety of unitised investment funds, professionally managed by the companies' investment departments. In particular, they offer access to the with profits fund and to the managed, or mixed, fund in which your capital is spread over a number of types of investment with the fund manager varying the spread as investment conditions change. You also have the facility to switch between these alternative forms of investment and into more specialist investment funds should you wish to do so. We are also able to offer our clients a capital investment bond investing in The Nevis Fund portfolios.

The bond is an extremely flexible investment in that it can be encashed at any time in whole or in part. In addition, regular cash withdrawals can be made at any level that you may decide upon. Under current legislation, withdrawals of up to 5% per annum of the original investment, will be **tax-deferred** for twenty years. This means there is **no tax** payable at the time of the withdrawal. The taxation of withdrawals in excess of this including partial or total encashment of the bond, will depend upon your tax rate at the time of the encashment.

*If you are a basic rate taxpayer at that time after allowing for the gain on the bond, which includes the amount of any tax deferred withdrawals, the withdrawals or encashment will still be **tax-free**.*

If you are a *higher rate tax payer*, or the gain on the bond (including the total of tax deferred withdrawals) could take you into that bracket, there will be an "excess rate" tax charge which is equivalent to being charged tax on the investment gain on the bond at the rate of your highest rate of tax less the savings rate (i.e. 40% less 20% = 20%). This tax charge can be reduced or avoided by a relief known as "top slicing relief".

Top slicing relief

As the gain on a capital investment bond arises over the life of the investment, it would be unfair to tax it as if the gain all arose in one year as it would surely force many investors in to the higher rate tax bracket in the year of encashment. To reflect that, top slicing relief may apply.

The "gain" is divided by the number of complete years over which it has arisen and the resulting figure is added to taxable income as the "top slice". The "excess rate" referred to above is calculated on the top slice. That amount of tax is then multiplied by the same figure as the gain was divided by to work out the tax on the whole gain.

For many people, this will be nil as the top slice will not be enough to take them into the higher rate tax band.

Example

Mr Macdonald invested £25,000 in a capital investment bond. After 10 years he surrendered it and received £45,000. In that year, his taxable income is £25,000. The starting level for higher rate tax in that year is £30,000.

The “gain” is £20,000 and if all of that was added to his income, he would have to pay “Excess Rate” tax (40% - 20% = 20%) on £15,000 amounting to £3,000. However, top slicing relief means that he pays no tax.

Gain = £20,000 ÷ 10 years = a “top slice” of £2,000.

Taxable income of £25,000 + top slice of £2,000 = £27,000.

This is below the higher rate tax threshold of £30,000, so not excess rate tax payable.

If the bond is effected by trustees, or subsequently becomes an asset of a trust and is encashed in a tax year starting after the death of the creator of the trust, the gain on the bond will be taxed against the trustees at the “rate applicable to trusts” less the savings rate, (i.e. 40% less 20% = 20%). This charge may be avoidable by a fairly straight forward technique of assigning the bond or portions of it to beneficiaries for them to encash if they are not higher rate tax payers. We would be happy to offer guidance at the time.

A capital investment bond is an excellent investment to hold as a trust investment where income is not immediately required. The bond is classed by HMRC as a non income producing asset. Accordingly, there is almost no administration involved in holding a bond within a trust and a bond investment will not require the trust to do a self assessment tax return when other forms of investment invariably will.

It is possible to withdraw a regular sum each month/quarter/year from a bond. These withdrawals are not income for income tax purposes, but capital withdrawals. Where regular withdrawals are taken from a capital investment bond, there is the risk of the capital falling below the value of the original investment unless the growth in the investment, after charges, is enough to match the sums withdrawn from the bond. The higher the amount of the withdrawals, the higher the growth required to cover them. The amount of withdrawals should therefore be based on a realistic assessment of future growth potential and reviewed in the light of experience.

The life assurance company bears an internal corporation tax charge on the income and capital gains of the bond's investment fund. This is equivalent to the savings rate of income tax and is the reason for the tax arrangements detailed above.

In contrast to any withdrawals you may take from the bond, all income earned internally by the investment funds is rolled up in the funds for capital growth. Like all investments, capital investment bonds carry management charges which vary from company to company. They are normally in the form of an annual fund charge and either (or both) an initial charge and an early encashment charge. Full details of these are contained in each company's literature.

Capital investment bonds are a medium term investment, by which we mean that we expect it under normal circumstances to last for more than 5 years. The bond can still be encashed earlier, in fact at any time from day one. However, the life assurance company will base its costs on a minimum term of five years and if the bond is cashed in early they will make a withdrawal charge as set out in their personal illustrations and key features documents. After this initial period there is no withdrawal charge.

Before investing in a capital investment bond, you will be given a personal illustration and key features document. You should read, carefully, the section entitled "Risk Factors" on the Key Features Document which highlights any possible disadvantages of effecting this contract.

It should be noted that the price of units can fall as well as rise. In addition, past performance is not necessarily a guide to future performance.