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Surrendering investment bonds with mitigation of Inheritance Tax and Income Tax

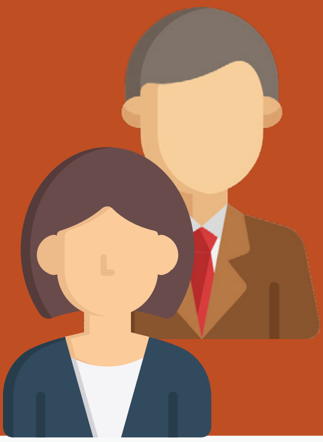
An investment bond is a whole of life assurance policy, usually providing an element of life cover for the holder and with no specified end date or fixed term. Any gain in value of the bond, either by withdrawal or surrender, is subject to income tax.

It's often the case that investors would like to sell an investment bond but are concerned about the tax implications.

Benefits of tax-efficient investments are subject to change and personal circumstances.

Don't invest unless you're prepared to lose all the money you invest. This is a high-risk investment and you are unlikely to be protected if something goes wrong.

Take 2 minutes to learn more on page 5



Meet Pauline and John

Pauline and John are a married couple in their late sixties, retired, with children. The value of their assets is well over the combined nil rate band for Inheritance Tax (IHT) of £650,000 and residence nil rate band of £350,000 due to an increase in the value of their property. The couple have assets including cash, property and an onshore investment bond. The current value of the investment bond is £250,000. Estate planning is a priority, to mitigate their IHT liability and preserve their legacy for their children so they've decided to surrender the bond. However, they'll face a significant Income Tax bill on the £60,000 gain from the bond and now they're unsure how to proceed.

Pauline and John's adviser asks them about the investment objectives and future plans. She identifies their top priority is ensuring their children receive the most inheritance possible, and that to achieve this they will need to tackle both Income Tax and Inheritance Tax. She pays close attention to their ability to absorb losses and checks their understanding of financial returns and risks.

Given their total financial holdings, their adviser suggests a two-pronged approach:

The first is that they use a simple Business Relief qualifying investment which will enable them to mitigate their remaining Inheritance Tax liability.

The second is to use an Enterprise Investment Scheme (EIS). An EIS is a tax-efficient vehicle that could provide Pauline and John with access to tax benefits including 30% Income Tax relief on the amount invested and up to 100% IHT Relief if held for a minimum of two years, and at the time of death.

Their adviser explains that to qualify for Business Relief, their IHT investment will need to be held for a minimum of two years, and at time of death. She then explains that to qualify for Income Tax relief, their EIS will need to be held for a minimum term of three years although realistically could be for much longer and will need to be treated as a long-term investment.

Let's take a look at how their estate could look, comparing two different approaches. Both examples assume the clients have exhausted all applicable reliefs:

John and Pauline's investment bond is surrendered, valued at £250,000

£12,000
Income tax liability on £60,000 gain
(charged at 20% as a higher rate taxpayer)

£238,000 Value of the investment bond after income tax

£95,200 Inheritance tax liability (charged at 40%)

£142,800 Value of investment

Invest **£40,000** into the Blackfinch Ventures EIS Portfolios

Invest **£210,000** into the Blackfinch Adapt IHT Service

£0 Income tax liability (mitigated by EIS)

£0 Inheritance tax liability
(mitigated by EIS and IHT assuming investments held for the qualifying period, and at death)

£250,000 Value of investment (after two years)

Clients must be advised that fees may apply. Please refer to our product literature for further details.

Inheritance Tax

Everyone has an allowance of £325,000, known as the nil rate band, which they can leave to beneficiaries free of IHT. If the individual has an estate valued above this amount, it could be subject to IHT at a rate of up to 40%.

Residence Nil Rate Band

Introduced in 2017, the Residence Nil Rate Band (RNRB) is an additional IHT relief that can be claimed against the value of a main residence. The RNRB is currently £175,000. RNRB rates are frozen until 2027/28 and is only applicable to one home of which the deceased has lived and owned at some point, and is being passed on to direct descendants (e.g. children or grandchildren). RNRB starts to be reduced where the death estate exceeds a £2m taper threshold.

Supporting the UK Economy

Certain businesses qualify for Business Relief, including shares in many AIM-listed firms. Unlike traditional IHT solutions, which can invest globally, clients' money is invested in BR-qualifying firms, that are predominantly UK-based.

Advantages of BR

Can help preserve a family's wealth

BR assets can replace each other

Transfer by way of gift:
If the individual (donor) holds BR-qualifying shares for 2 years before gifting, and the recipient of the gift still holds the shares at the time of the donor's death, the investment retains its IHT exemption for the donor whilst also reducing the value of the estate.

Upon death there are various options

- Shares can be encashed and distributed to beneficiaries.
- Shares can be encashed, and proceeds paid to HMRC to pay any IHT bill due on the estate (Direct Payment Scheme).
- Shares can be passed down to beneficiaries who can then retain them. If the original owner had held the shares for over two years, the shares would be immediately BR qualifying (exempt) in the beneficiary's estate.

Transfer into Trust
If the shares were already held for two years before the transfer into trust, the potential lifetime charge to IHT is reduced from 20% to zero.

Only takes 2 years to qualify for BR
Shares must be held at the time of death.

Enterprise Investment Scheme

Since its introduction over 25 years ago, the EIS has become a valuable tax-planning tool. The UK Government launched it in 1994 to encourage investment in start-ups and early-stage companies.

Multi-Sector Portfolio

Spreading investments across a multi-sector portfolio of ten or more firms helps to mitigate the effect of companies that underperform or fail. We work closely with firms from early growth to profitability and exit. We know some will flourish while others may falter or fail. We make tough decisions as necessary, and keep our focus on firms bound for success.

Tax Reliefs

The EIS offers a range of valuable tax reliefs to encourage investment and reduce the risks involved. For investments to qualify for tax relief, investors must hold them for a minimum of three years.

Advantages of EIS

Up to 30% Income Tax Relief

Up to 100% Inheritance Tax exemption
Shares must be held at the time of death.

Capital Gains Tax (CGT) deferral relief
Up to one year prior to investment and up to three years in advance.

Offsetting of capital losses up to 45%
Dependent on marginal rate of Income Tax at time of loss. Capital losses of one portfolio company can be claimed irrespective of the performance of other companies in the portfolio.

Growth free of CGT
If Income Tax relief has been claimed - subject to three year holding period.

Carry back to previous tax year
Clients can claim Income Tax relief in the tax year the shares are issued, but can also choose to treat some or all of the shares as being issued in the previous tax year, claiming relief in that year if it is available - subject to enough tax being paid in the combined period.

For more help with tax-efficient strategies, please speak with your local Business Development Manager who will be happy to help.

Send us an enquiry →

Find out more about IHT and EIS →

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Risks

Due to the potential for losses, the Financial Conduct Authority (FCA) considers this investment to be high risk.

What are the FCA key risks?

1 - You could lose all the money you invest
If the business you invest in fails, you are likely to lose 100% of the money you invested. Most start-up businesses fail.

2 - You are unlikely to be protected if something goes wrong
Protection from the Financial Services Compensation Scheme (FSCS), in relation to claims against failed regulated firms, does not cover poor investment performance. Try the FSCS investment protection checker. (https://www.fscs.org.uk/check/investment-protection-checker)

Protection from the Financial Ombudsman Service (FOS) does not cover poor investment performance. If you have a complaint against an FCA-regulated firm, FOS may be able to consider it. Learn more about FOS protection. (https://www.financial-ombudsman.org.uk/consumers)

3 - You won't get your money back quickly
Even if the business you invest in is successful, it may take several years to get your money back. You are unlikely to be able to sell your investment early.

The most likely way to get your money back is if the business is bought by another business or lists its shares on an exchange such as the London Stock Exchange. These events are not common.

If you are investing in a start-up business, you should not expect to get your money back through dividends. Start-up businesses rarely pay these. (https://www.financial-ombudsman.org.uk/consumers)

4 - Don't put all your eggs in one basket
Putting all your money into a single business or type of investment for example, is risky. Spreading your money across different investments makes you less dependent on any one to do well.

A good rule of thumb is not to invest more than 10% of your money in high-risk investments. (https://www.fca.org.uk/investsmart/5-questions-ask-you-invest)

5 - The value of your investment can be reduced
The percentage of the business that you own will decrease if the business issues more shares. This could mean that the value of your investment reduces, depending on how much the business grows. Most start-up businesses issue multiple rounds of shares.

These new shares could have additional rights that your shares don't have, such as the right to receive a fixed dividend, which could further reduce your chances of getting a return on your investment.

If you are interested in learning more about how to protect yourself, visit the FCA's website. (https://www.fca.org.uk/investsmart)