UK TAX BENEFITS OF USING SEGMENTATION WITH OFFSHORE PLANS

THE FOLLOWING GUIDE OUTLINES THE POTENTIAL TAX PLANNING BENEFITS/ADVANTAGES OF USING A PLAN ISSUED WITH MULTIPLE SEGMENTS FOR A UK TAX RESIDENT INDIVIDUAL, OR A UK TRUST WITH AN OFFSHORE PLAN.

EXAMPLE 1: GIFTING TO SPOUSE/CIVIL PARTNER

Mr Smith, an 'additional rate tax' payer, has opened a plan with a single payment of £150,000. Mr Smith decided to set this up with 100 segments.

Mr Smith is looking at releasing some funds from the plan to make some home improvements. He estimates that the cost will be in the region of £75,000. He would like to do this in the most tax efficient way possible.

> Had the policy had been issued with only one segment, to achieve the required amount of £75,000 by withdrawal would have resulted in the following:
>
> 5% tax deferred allowance
> = £22,500 (£150,000 * 5% x 3 years)
>
> Excess for policy year
> = £52,500 (£75,000 - £22,500)
>
> Tax on liability: £52,500 * 45% = £23,625

The plan is in year 3 and currently has a value of £170,000. To achieve the required withdrawal amount of £75,000 by segment surrender, he would need to surrender 45 segments (£170,000 / 100 = £1,700 * 45 = £76,500)

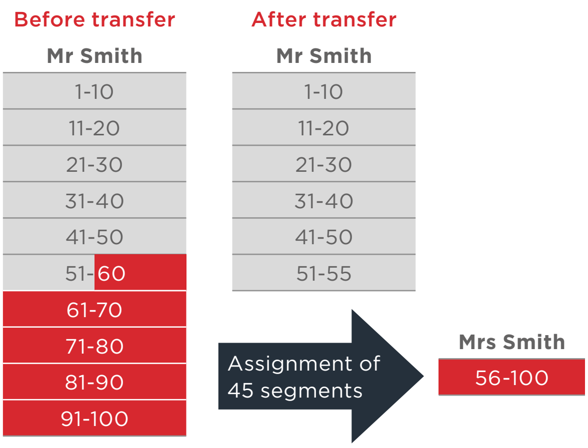
This is more than the required £75,000 as it is not possible to surrender part of a segment.

Surrender value (45 segments)	£76,500
Previous withdrawals	£0
Premium (45 segments)	£67,500
Previous excesses	£0
Chargeable gain	£9,000

The surrender of the 45 segments will therefore have a gain of **£9,000**.

If Mr Smith were to surrender 45 segments while in his own name, as an additional rate tax payer he would be liable for tax on the whole gain at 45%. Gain: £9,000 x 45% = **£4,050**.

Alternatively, Mr Smith could "transfer" the ownership of 45 segments to his wife, Mrs Smith. Mrs Smith would then be able to surrender the segments in her own name.



If Mrs Smith were to surrender 45 segments when held in her own name, as a basic rate tax payer she would only be liable for tax on the gain at 20%. Gain: £9,000 x 20% = **£1,800**.

By transferring the ownership of the 45 segments, prior to surrendering, Mr Smith is able to shift the Income Tax liability and reduce the tax on the gain by **£2,250** (£4,050 - £1,800).

EXAMPLE 2: GIFTING TO CHILD

Adam, 'higher rate tax' payer after taking into account all available allowances, opens a plan with a single payment of £100,000 and decided to set this up with 100 segments.

Adam is looking to release some funds from his plan to assist his adult child Jane with her education. Jane's only income is an amount of £1,500 which all falls within her personal allowance.

Initial payment	£100,000
Initial value of each segment	£1,000
Previous withdrawals	£49,000
Current plan value year 10	£150,000
Current value of each segment	£1,500

If Adam were to gift the amount of £15,000 to Jane by taking a withdrawal this would cause a chargeable event as it exceeds the current remaining available 5% cumulative tax deferred allowance, with the full amount which exceeds the allowance being subject to Income Tax.

Alternatively, Adam can "transfer" the ownership of 10 segments to his daughter, Jane. Jane would then be able to surrender the segments in her own name.

Before transfer	After transfer
Adam	**Adam**
1-10	1-10
11-20	11-20
21-30	21-30
31-40	31-40
41-50	41-50
51-60	51-55
61-70	61-70
71-80	71-80
81-90	81-90
91-100	

Assignment of 10 segments

Jane
91-100

Surrender value (10 segments)	£15,000
Previous withdrawals	£4,900
Premium (10 segments)	£10,000
Previous excesses	£0
Chargeable gain	£9,900

The surrender of the 10 segments will result in a gain of **£9,900.**

If Jane were to surrender the 10 segments, after the assignment, the whole gain of £9,900 would fall within her personal allowance and therefore would not be subject to any Income Tax. Jane would therefore keep the full amount of **£15,000** and have no further Income Tax liability in the current tax year.

However, as a higher rate taxpayer, if Adam were to surrender 10 segments in his own name, prior to gifting the proceeds to Jane he would incur a tax charge of **£3,960** (£9,900*40%), this would only leave **£11,040** (£15,000 - £3,960) to be distributed to Jane to help with her education.

Had Adam's plan been issued with one segment, he would have to have taken the £15,000 as a withdrawal. This would have resulted in the following:

Remaining 5% tax deferred allowance: = £1,000

Excess for policy year = **£14,000** (£15,000 - £1,000)

Tax on liability: £14,000 * 40% = **£5,600**

EXAMPLE 3: TRUSTEES TO BENEFICIARY

Mr Jones has opened a plan with a single payment of £200,000. The plan has been issued with 100 segments. Shortly after commencement, Mr Jones settled the plan into a discretionary trust.

The plan is in year 3 and currently has a value of £275,000. The trustees are now looking at making a distribution of £70,000 (£35,000 each) to help two of the adult beneficiaries with a house purchase.

To achieve the required amount of £70,000 by using segment surrender, the trustees would need to surrender 26 segments (£275,000 / 100 = £2,750 per segment * 26 = £71,500)

Surrender value (26 segments)	£71,500
Previous withdrawals	£0
Premium (26 segments)	£52,000
Previous excesses	£0
Chargeable gain	£19,500

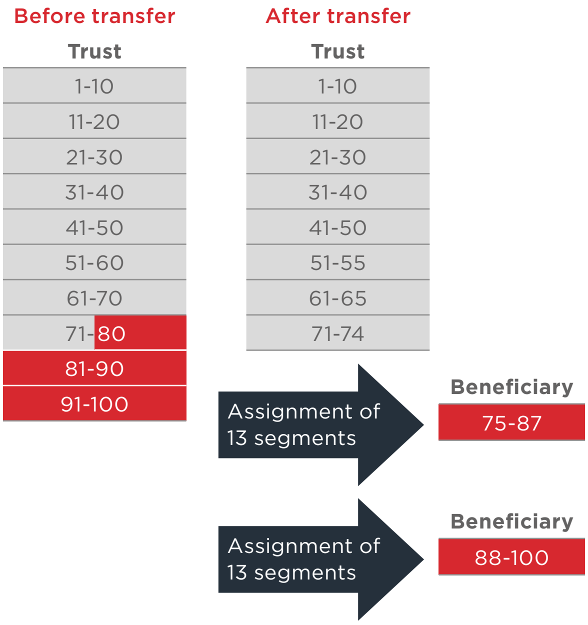
The tax position on the trust would be as follows:

First £1,000 taxed at 20% = £200

Remaining £18,500 (£19,500 - £1,000) taxed at £45% = £8,325

Total Tax on Gain = £8,525 (£200 + £8,325)

Alternatively, the trustees could "transfer" the ownership of 26 segments to the beneficiaries (13 segments to each). The beneficiaries would then be able to surrender the segments in their own name.



Surrender value (13 segments)	£35,750
Previous withdrawals	£0
Premium (13 segments)	£26,000
Previous excesses	£0
Chargeable gain	£9,750

The Income Tax liability would be taxed on the beneficiaries at their own marginal rate. If they were both deemed to be basic rate tax payers when the gain is added to their other income, each of their tax liability would be £1,950 (£9,750 * 20%).

So, the total combined tax liability to the beneficiaries would be £3,900. Therefore, by assigning the segments to the beneficiaries first, prior to surrender, the trust has saved £4,625 (£8,525 - £3,900).

Had the policy had been opened with one segment, to achieve the required amount of £70,000 by a withdrawal would have resulted in the following:

Current 5% tax deferred allowance = **£30,000** (£200,000 * 5% x 3 years)

Excess for policy year = **£40,000** (£70,000 - £30,000)

Tax on excess = **£200** (£1,000 * 20%) + **£17,550** (£39,000 * 45%)

Total liability = **£17,750**

IMPORTANT NOTES

The information contained in this document is based on our current understanding of the law and HM Revenue and Customs (HMRC) practice.

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