

Consider the tax implications of how you draw money from your plan

There are often good reasons to take money from your plan. For example, to pay off a debt, to pay for a holiday, and so on. However, there are different income tax consequences depending on how you take out some of the cash in your plan.

How can I take some money from my plan? What are the tax implications?

Your plan is divided into a series of individual identical policies (sometimes known as 'segments' or 'clusters'). What you pay into your plan is spread evenly across all the policies in your plan and is used to buy investment units in each policy.

By setting up your plan in this way, if you want to take some of the money, you don't have to cash-in your whole plan, as this may result in you paying more income tax. Instead you can cash-in enough individual policies to give you the money you are looking for.

However, you still have a choice. You can still take the money you are looking for by partially cashing-in all of the policies in your plan.

The diagrams below show the different options:

(A) partially cashing-in all the policies in your plan.

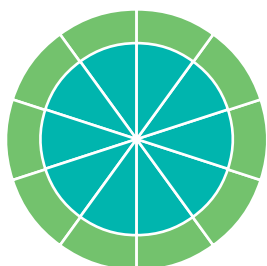
OR

(B) cashing-in complete policies in your plan, leaving some untouched.

It is also possible to combine both A and B.

Option A

Partially cash-in each policy within your plan



Option B

Cash in complete policies within your plan



'Option A shows 10 partially encashed policy segments, while Option B shows 3 of 10 policy segments being fully encashed'.

A liability to income tax above the basic rate may arise if you use:

- option A to withdraw more than an allowance we describe below, or
- option B and a profit is made over the premium paid into each segment/cluster you cash in.

Both of these situations create what is known as a 'chargeable event gain'. You may be liable to income tax on a gain, depending on your circumstances. It is important to understand that if you use option A, a gain may be made even where your plan has made little or no overall profit at that time.

If you choose option A

You are allowed to withdraw an amount in each policy year equal to 5% of the amount you invested. You can take withdrawals within this "5% allowance" without any immediate income tax liability. If you don't use any or all of the allowance in any policy year, the unused portion rolls over to the following policy year (and so on) until 100% of the amount invested has been taken. If you use option A to withdraw more than this allowance in any policy year, the excess you partially cash in over the 5% allowance will create a chargeable event gain and a possible income tax liability.

If you choose option B

And the plan is not yet in profit, you would not have made a gain and would not incur income tax, regardless of your personal rate of income tax.

The impact of taxation (and any tax relief(s)) depends on your circumstances.

If a gain is made

If a gain is made under option A or B and you remain a basic rate tax payer once the gain is added to your income, you would not have any further income tax liability. If you already pay income tax above the basic rate you will be liable for income tax on the gain. If you are a basic rate tax payer and adding the gain means you start to pay above the basic rate then you may be liable. In this situation, if any of the gain falls in the higher rate tax band you may get a reduction in your tax through top slicing relief, depending on your circumstances. The maximum rate of income tax you would be liable for would equal the difference between the higher rate (or additional rate, if applicable) and basic rate tax, as appropriate to your tax situation. A gain may also affect your eligibility for personal allowances and certain tax credits.

Here's an example of what could happen

Mr Smith took out an investment bond with Prudential in the UK for £50,000 in March 2018. The plan was issued as a group of 10 identical policies of £5,000 each.

Let's assume that the bond hasn't increased in value.

In January 2023, Mr Smith requested a partial withdrawal of £40,000 and he is a higher rate tax payer.

If Mr Smith took this as a partial withdrawal across all the policies (Option A), this would create a gain on the whole plan of £27,500*, even though the plan has not grown in value. As a result Mr Smith would have an income tax liability of £5,500**.

Had Mr Smith decided to cash-in eight complete policies (Option B), no gain would have arisen, and no income tax to pay.

* £40,000 withdrawn, less the cumulative 5% allowance of £12,500 (5 years x 5% x £50,000).

** 40% X £27,500 (less basic rate credit for a bond taken out in the UK of 20% x £27,500). This assumes the full gain sits in the higher rate band and Mr Smith had no Personal Savings Allowance available due to other savings income.

This isn't a real life example or a recommendation. This example demonstrates that the method of withdrawal which produces the smallest gain is dependent on particular circumstances. However, it should be considered that creating the smallest gain is not always the best option. Whilst this will often be the case, there may be good reasons why you may wish to use the method that produces the larger gain.

The value of your investment can go down as well as up, so you might get back less than you put in. If you take more money from the plan than the amount your investment has grown by, the value of your investment will be less than you've put in.

This information is based on our understanding of current UK taxation, legislation and HM Revenue & Customs practice, all of which are liable to change without notice and we assume you are an individual and a UK resident for UK tax purposes.

Download our useful quick guide: **A guide to tax on your investment bond**. Alternatively, call us on 0800 000 000 and request this by post.

Tax can be a complicated subject, so before withdrawing money from your plan, please speak to a Financial Adviser.