## A happy ending for a cautionary investment tale?

***The Treasury has issued a consultation paper on changes to the taxation of single premium investment bonds following a long-running tax tribunal case.***

Single premium investment bonds have long been a popular way of investing for both individuals and trustees. One of their plus points for many investors is that there is generally nothing to put on a tax return and no immediate tax to pay unless the total amount withdrawn on a regular or cumulative basis exceeds 5% a year of the original investment. This so-called 5% rule does not mean withdrawals are exempt from tax, as they are brought into the calculations when the bond is fully encashed or the life assured dies.

The 5% rule was introduced in the 1970s to simplify matters and replace a formula which could produce taxable amounts *greater* than the amount withdrawn. However, the simplification came with a sting in the tail for the unadvised: a large partial encashment early in a bond's life could produce a substantial tax charge, even if the bond were showing no underlying profit.

This anomaly eventually prompted a tax tribunal case in which an unadvised Dutchman, Mr Lobler, who had moved to England found himself facing an effective tax rate of 779%. The First Tier Tribunal found in favour of HM Revenue & Customs with "heavy hearts", but the Upper Tier Tribunal reversed the decision with the help of some creative thinking.

The Treasury has now issued a consultation on ways to prevent such unwarranted tax charges arising in the future. It has made three suggestions, all of which preserve the principle of the 5% rule, but aim to prevent unrealistic tax charges for large partial withdrawals.

The proposals are welcome, but would be unnecessary if all investors took advice before making withdrawals. For many years, life companies have issued bonds as a cluster of identical mini-policies, a structure which allows large withdrawals to be made by encashing *in full* a number of policies. This route avoids the tax trap surrounding *partial* encashments.

Mr Loobler had multiple policies, but no advice, so chose the wrong option. There is a lesson to be learned in his story…

*The value of your investment can go down as well as up and you may not get back the full amount you invested. Past performance is not a reliable indicator of future performance. The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Conduct Authority does not regulate tax and trust advice.*