FRIENDLY SOCIETY POLICIES

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Friendly Societies are governed by special legislation enabling them to offer **a type of life assurance** policy with additional tax advantages. However, the size of qualifying contracts they can offer is now very limited and there are only a few societies actively marketing such policies (also sometimes called **baby bonds**).

As with all investments, the tax considerations should only be a part of the overall reason for investing, and we suggest that investors look at the **quality of the investment funds** offered, the **charging structure**, and the **accessibility/flexibility** prior to investment.

This note looks briefly at the rules surrounding these policies.

BACKGROUND

Friendly societies **do not have to pay income or capital gains tax** on the investment returns achieved on their funds. Please see the Research Note on Life Assurance Policies for a comparison of the usual situation, where the internal return is usually subject to tax, prior to any tax payable by the investor.

However, the investor has no special tax position. The policies are usually written as 10 year qualifying endowment policies. This means that, **for any gain to be non-taxable on the investor, the policy must be held for at least seven and a half years** (i.e. three-quarters of the original term), with **regular premiums** being maintained during this time. In addition, the policies have to have a **minimum level of life cover** to remain **'qualifying'** (75% of total premiums), which the investor will pay for (e.g. by cancellation of sufficient units each month for the life cover cost). Again, please refer to the Research Note on Life Assurance policies for a full explanation of the taxation of qualifying and non-qualifying insurance policies.

These policies must also include an element of **life cover**, thereby increasing **charges**. **Early redemption penalties** may also apply. The tax advantages of many such policies are significantly reduced by the level of charges made on them. In addition, **investment choice** may be limited.

INVESTMENT CHOICE

Historically, friendly societies had to invest at least half of their funds in 'safe' investments such as cash and gilts. Although this restriction no longer applies, investment choice has not, in general, greatly increased. The usual choice of funds is cash, managed or with-profits funds. Please see our separate Research Notes on Risk and Asset Allocation for further details on choosing a suitable asset allocation.

POLICY INVESTMENT LIMITS

The limit on annual premiums, for tax-exempt business, is £270 per annum. If made more regularly, this limit rises to £300 per annum (equivalent to £5.70 per week, or £25 per month). This limit applies to the total of all friendly society policies owned by an individual.

Policies can also be taken out by children under 18 ('baby bonds'), which do not count towards the parents' limits.

Some societies also offer a lump sum policy, where the lump sum purchases a capital protected annuity or insurance bond, which in turn pays the regular premiums into the friendly society policy. This can introduce an additional layer of charges and complexity into the policy.

Friendly societies can also take other types of business through subsidiaries (e.g. ISAs, unit trusts, mortgages), which have no unique tax benefits in comparison to the same products offered by other providers.

Important information: Our views are based upon our understanding of current legislation in England, unless stated otherwise. Levels and bases of, and reliefs from, taxation are subject to change and their value to you will depend upon your personal circumstances.

Risk Warning: The past is not necessarily a guide to future performance. The value of your investment and the income from it can fall as well as rise and is not guaranteed. You may not get back the full amount invested. This document is provided for information only and does not constitute advice. You should not act on any of the information without seeking professional advice.