

Technical insights - Quick reference guide 3

Taxation of investment bonds - individual policy (segment) surrenders

This guide will provide you with an understanding of individual policy surrenders for Onshore or Offshore investment bonds. This guide is not suitable for investment bonds held by companies.

Calculation for policy surrender

A = (Surrender value per policy + Previous partial surrenders per policy)

B = (Premium per policy + Previous excess gains per policy)

A - B = Gain/loss per policy.

Life assurance bonds are segmented into individual policies.

The number of policies will either be dictated by the product provider, or selected on application. These policies can be assigned or surrendered independently from the other policies which make up the bond.

The individual policies are identical.

Each policy is the same and represents a fraction of the overall bond.

Surrendering an individual policy is a chargeable event.

The calculation of the gain is the same as full bond surrender, but scaled down according to the number of policies. See the example given. The gain is taxed as income.

There is no 5% tax deferred allowance for individual policy surrenders.

The 5% tax deferred allowance only applies to partial withdrawals taken across the policies.

The date of the chargeable event date is the day of the surrender.

It is therefore taxable in the tax year which the surrender occurs.

Surrendering an individual policy can wipe-out excess gains on that policy, with the 'final policy year' rule.

Where a partial surrender across all policies exceeds the 5% tax deferred allowance, an excess gain will arise at the end of the policy year (See quick reference guide 2). The excess gain is apportioned equally across all policies within the bond. If an individual policy is surrendered before the end of the policy year, then the excess gain is never realised.

In addition, if the final policy year (the year of surrender) begins and ends in the same tax year then the start of the final policy year is 'extended back' to the previous anniversary date. This has the effect of removing the excess gain on the anniversary date for the policies surrendered.

Example:

Bond year runs 1st May to 30th April

An excess event happens on 30th April 2024. Some of the policies are surrendered on 12 December 2024.

The final year for the surrendered policies run from 1 May 2024 to 12 December 2024 which are both in the 2024/25 tax year. The final year rule applies and extends the start of the final year back to 1 May 2023. It still ends on 12th December 2024 i.e. more than 12 months.

Because of this there is not bond year ending on 30th April 2025 which removes the excess gain on the policies surrendered.

Chargeable gain calculation – an example.

Year 1 – £100,000 invested into a bond which is segmented into 1,000 policies.

£5,000 partial withdrawal. This was within the 5% tax deferred allowance, so £0 chargeable gain.

Year 2 – £6,000 partial withdrawal. This exceeded the 5% tax deferred allowance; this is £1,000 in excess of the tax deferred allowance available in this bond year.

After the partial withdrawal, 250 Individual policies were surrendered in full leaving 750.

Year 3 – £6,000 partial withdrawal has been made, so far this year. As we have not yet reached the end of the policy year, no chargeable gain for this surrender has been issued.

The surrender value of the bond is currently £90,000.

The bond holder now would like to surrender a further 100 policies.

Calculation for policy surrender

A = (Surrender value per policy + Previous partial surrenders per policy)

B = (Premium per policy + Previous excess gains per policy)

A – B = Gain/loss per policy.

Taking each part in turn;

Surrender value per policy =	£90,000 / 750* = £120
Previous partial surrenders per policy =	Year 1 = £5,000 / 1,000* = £5 per policy Year 2 = £6,000 / 1,000* = £6 per policy Year 3 = £6,000 / 750* = £8 per policy Total = £19 per policy (£5 + £6 +£8)
Premium per policy =	£100,000 / 1000* = £100
Previous excess gains per policy =	Year 1 = £0 Year 2 = £750/ 750** = £1 per policy Year 3 = £0*** Total = £1 per policy

* The number of policies at the time.

**The excess gain doesn't actually occur until the end of the policy year when there are 750 policies; no excess gain arises for those 250 surrendered. So, £1,000 (the excess in year 2) / 1,000* = £1. £1 x 750 = £750 excess gain. For ease, consult the chargeable event certificate for the excess event.

***The excess gain doesn't actually occur until the end of the policy year, so no gain has yet arisen for year 3.

Calculation for policy surrender

A = (£120 + £19)

B = (£100 + £1)

A – B = £38 gain per policy. The bond holder has requested 100 policies. 100 x £38 = **£3,800 gain**

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