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Comparing Part Surrender and Segment Surrender Gains

This guide demonstrates how the two methods for making a bond withdrawal can trigger very different gains.

Part surrenders, using the 5% tax deferred allowance

Each policy year, 5% of the total premiums can be withdrawn by part surrender without creating an immediate tax charge. Unused allowance rolls forward, allowing larger withdrawals in later years.

A chargeable event will arise if the available allowance is exceeded - each £1 surrendered above the allowance is £1 of taxable gain. This is known as the excess gain. This method of calculation can produce gains that bear little resemblance to the bond's actual investment growth — and in some cases can be significantly higher.

Surrendering segments realises the 'economic' gain

Bonds are made up of multiple individual policy segments, each of which can be surrendered independently. The premium, surrender value and resulting gain are spread across these segments.

When segments are surrendered, the gain is calculated by considering factors such as previous withdrawals and the current surrender value to arrive at the true economic gain. It mirrors the calculation used on a full surrender, but scaled proportionately based on the number of segments surrendered.

Example - Danny's Onshore Bond

- Invested £100,000
- During policy year 5, he needs to withdraw £60,000
- No previous withdrawals
- Current surrender value: £130,000
- The bond has 1,000 policy segments

Option 1 - Part Surrender

- 5% allowance per year: £5,000
- Available allowance (5 years): £25,000
- Taxable excess gain: £60,000 – £25,000 = **£35,000 taxable gain**

£35,000
taxable gain

Option 2 - Segment Surrender

- Gain on full bond surrender: £130,000 – £100,000 = £30,000
- Gain per segment: £30,000 / 1,000 segments = £30 per segment
- Surrender value per segment: £130,000 / 1,000 = £130 per segment
- Segments required: £60,000 / £130 = 462 whole segments
- Total gain: 462 × £30 = **£13,860 taxable gain**

£13,860
taxable gain

Part surrender would add an extra **£21,140** to Danny's income, compared to segment surrender.

Suitable for financial advice professionals only

Always checks both options

For larger withdrawals, a segment surrender will usually produce the lower gain - but it's by no means a guarantee. It's always best to calculate and compare the gain. ***Our gain calculator can help you do this quickly***.

What else might influence your choice?

Larger gain doesn't always mean more tax

If Danny's income were £15,000, neither method would push him beyond the basic rate band. For an onshore bond, basic rate tax is already treated as paid, so no additional tax would be due. Even when a gain does tip a client over the basic rate threshold, top slicing relief may reduce, or remove, any higher-rate liability.

Large excess gains can be useful later on

When the bond (or segments of the bond) is surrendered in full, previous excess gains are brought into the calculation of the economic gain. This has the effect of reducing the final taxable gain.

Put simply, Danny could consciously use his basic rate band and the onshore bond tax credit to realise a higher excess gain now without creating a tax liability, which then reduces the gain on eventual full surrender.

Segment surrenders reduce the available 5% allowance

The bond's premium, and therefore the 5% allowance, is spread across all segments. Fully surrendering a segment permanently removes that segment's accumulated and future allowance. In some cases, this loss of future allowance may outweigh the benefit of realising a lower economic gain today.

The date of the chargeable event is different

When you surrender a segment, the gain arises in the tax year of the surrender. But if you exceed the 5% allowance, the gain is assessed at the end of the bond's policy year instead. This timing difference can mean the gain falls into the following tax year. For some clients, that delay is helpful; others may prefer the gain to fall in the current year to make full use of their allowances.

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