

Technical insights - Quick reference guide 5

Taxation of investment bonds - top slicing relief

This guide will provide you with an understanding of top slicing relief for Onshore and Offshore investment bonds. This guide is not suitable for investment bonds held by companies.

We have a calculator which can perform the calculation described within this guide. The calculator can be found on our website: quilter.com/cehub

Chargeable event gains are taxed as income. A chargeable event gain is treated as savings income and taxed at the marginal rate of the person liable for it. Quick reference guide 1 explains who is liable in different cases.

Top slicing is an income tax relief. Investment bonds defer tax until a chargeable event. This means gains built up over several years may arise in one tax year. Top slicing relief limits the higher or additional rate tax due by looking at the tax that would apply if the gain were spread over the relevant years.

The gain is divided by the number of relevant years. This gives the average slice used in the relief calculation. The number of relevant years depends on several factors, including the type of chargeable event. This guide includes a flowchart to help identify the correct number.

The relief compares two tax calculations. It compares the income tax due on the full gain with the tax due if the gain were averaged over the relevant years. The relief is the difference between the two amounts and is deducted from the individual's income tax bill.

Special rules apply when working out the relief. Calculating the relief looks similar to a standard income tax calculation, but there are key differences, in particular:

- The average slice is used to work out the personal allowance and personal savings allowance for the relieved liability.
- Offshore bond gains are reordered so they sit at the top of income.
- Offshore bond gains are given a deemed basic rate credit of 20% to give the same level of relief as onshore bonds.

The full gain still affects the wider tax position. Top slicing does not reduce the gain itself, so the full amount is still used to calculate adjusted net income. This means it can affect personal allowance tapering, the personal savings allowance and the starting rate for savings.

- Personal allowance starts to taper once adjusted net income exceeds £100,000, reducing by £1 for every £2 over the limit. As non-savings income rises above the personal allowance, the starting rate for savings also falls by £1 for every £1 until the £5,000 band is lost.
- The personal savings allowance falls from £1,000 to £500 for higher rate taxpayers and is not available to additional rate taxpayers.

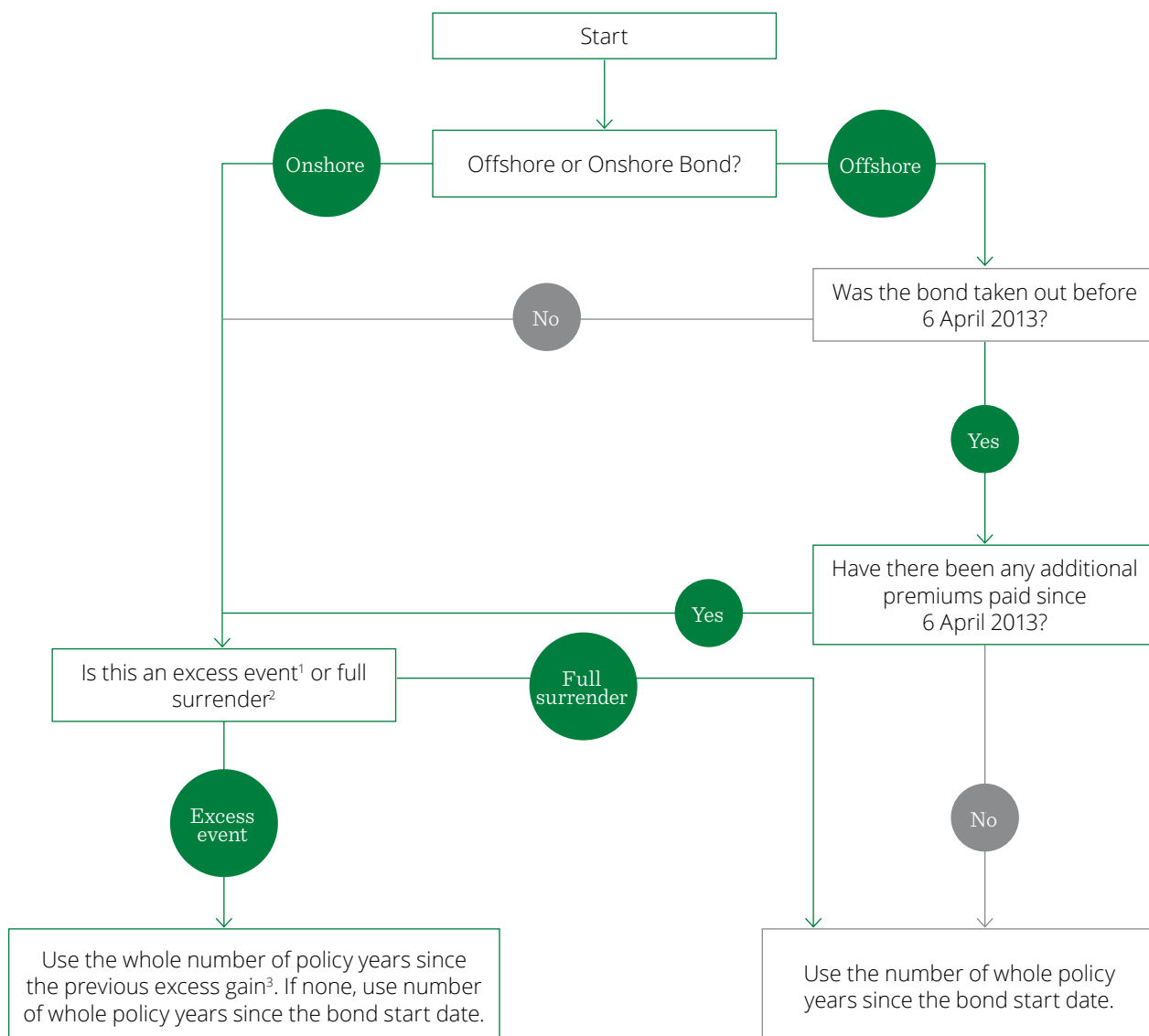
The maximum offshore bond gain that may be taxed at 0% is £18,570. This is made up of the personal allowance (£12,570), 0% starting rate for savings (£5,000) and the personal savings allowance £1,000. Where the gain exceeds this, the excess is taxable. It is not possible to reduce tax on larger offshore gains to zero by dividing the gain by the number of relevant years. See example 3

Trustees cannot use top slicing relief. Where trustees are liable for the tax on a chargeable gain, they pay tax at the trust rate, although up to £500 may fall within the 0% band. Top slicing relief is not available.

Scottish taxpayers use the same process. Scottish income tax rates do not apply to savings income. The tax on the gain and top slicing relief is calculated using the standard UK bands and rates.

Relevant years flowchart.

Use this flowchart to determine how many relevant years to apply to the gain.



¹ Excess event occurs at the end of a policy year where the 5% tax deferred allowance has been exceeded.

² A full surrender of either the whole bond OR the individual policies (segments) within the bond.

³ Unless Time Apportionment Relief is claimed. In which case the policy years will be from the bond start date but reduced by any complete years spent non-UK resident.

Example calculations.

Example 1 - Onshore Bond, total income below £100,000

Chargeable gain:	£50,000	Your client has fully surrendered their onshore bond, realising a gain of £50,000. The bond had been in force for 10 complete policy years. They have income from earnings of £31,350. As this is an onshore bond, your client has basic rate savings income tax credit of 20% (this increases to 22% from 6 April 2027) (£10,000), due to the life fund taxation within the bond.
Onshore bond tax credit:	£10,000	
Average gain (£50,000 / 10 years)	£5,000	
Earned income:	£31,350	

1. Check which allowances are available

For steps 2 & 4 - Your client's total income is £81,350. There is no tapering of the personal allowance. Their personal savings allowance will be reduced to £500 as they have income in the higher rate band.

For step 3 - Your client's total income is deemed to be £36,350. There is no tapering of the personal allowance in this step. Their personal savings allowance is £1,000 as all income is deemed to be in the basic rate band.

2. Calculate the total liability, above the basic rate tax credit

Source	Amount	Band	Rate	Tax
Earnings	£12,570	Personal Allowance	0%	£0
Earnings	£18,780	Basic Rate	20%	£3,756
Bond Gain	£500	Personal Savings Allowance	0%	£0
Bond Gain	£18,420	Basic Rate	20%	£3,684
Bond Gain	£31,080	Higher Rate	40%	£12,432
Total tax on Bond Gains				£16,116
Onshore Bond tax credit				£10,000
Total tax on bond gains, after credit				£6,116

3. Calculate the relieved liability

Source	Amount	Band	Rate	Tax
Earnings	£12,570	Personal Allowance	0%	£0
Earnings	£18,780	Basic Rate	20%	£3,756
Bond Gain	£1,000	Personal Savings Allowance*	0%	£0
Bond Gain	£4,000	Basic Rate	20%	£800
Bond Gain	£0	Higher Rate	40%	£0
Total tax on average slice				£800
Onshore Bond tax credit for the slice (£10,000 / 10 years)				£1,000
Total tax on average slice, after credit				£0
Tax on average slice x 10 Years				£0

} Note: Personal savings allowance is restored to £1,000 for this step

4. Calculate the top slicing relief

£6,116 (step 2) minus £0 (step 3) = £6,116

5. Tax on bond gain after applying the relief

Source	Amount	Band	Rate	Tax
Earnings	£12,570	Personal Allowance	0%	£0
Earnings	£18,780	Basic Rate	20%	£3,756
Bond Gain	£500	Personal Savings Allowance*	0%	£0
Bond Gain	£18,420	Basic Rate	20%	£3,684
Bond Gain	£31,080	Higher Rate	40%	£12,432
Total tax on Bond Gains				£16,116
Onshore Bond tax credit				£10,000
Top slicing relief (step 4)				£6,116
Total tax on bond gains, after top slicing relief				£0

} Note: Personal allowance and personal savings allowance is still lost

Example 2 - Onshore Bond, total income above £100,000

Chargeable gain:	£100,000	Your client has fully surrendered their onshore bond, realising a gain of £100,000. The bond had been in force for 10 complete policy years. They have income from earnings of £90,000. As this is an onshore bond, your client has basic rate savings income tax credit of 20% (this increases to 22% from 6 April 2027) (£20,000), due to the life fund taxation within the bond.
Onshore bond tax credit:	£20,000	
Average gain (£100,000 /10 years)	£10,000	
Earned income:	£90,000	

1. Check which allowances are available

For steps 2 & 4 - Your client's total income is £190,000. Their personal allowance has been tapered to £0. Their personal savings allowance will also be reduced to £0 as they have income in the additional rate band.

For step 3 - Your client's total income is deemed to be £100,000. There is no tapering of the personal allowance in this step. Their personal savings allowance is £500 as they have income in the higher rate band.

2. Calculate the total liability, above the basic rate tax credit

Source	Amount	Band	Rate	Tax
Earnings	£37,700	Basic Rate	20%	£7,540
Earnings	£52,300	Higher Rate	40%	£20,920
Bond Gain	£35,140	Higher Rate	40%	£14,056
Bond Gain	£64,860	Higher Rate	45%	£29,187
Total tax on Bond Gains				£43,243
Onshore Bond tax credit				£20,000
Total tax on bond gains, after credit				£23,243

3. Calculate the relieved liability

Source	Amount	Band	Rate	Tax
Earnings	£12,570	Personal Allowance*	0%	£0
Earnings	£37,700	Basic Rate	20%	£7,540
Earnings	£39,730	Higher Rate	40%	£15,892
Bond Gain	£500	Personal Savings Allowance*	0%	£0
Bond Gain	£9,500	Higher Rate	40%	£3,800
Total tax on average slice				£3,800
Onshore Bond tax credit for the slice (£20,000 / 10 years)				£2,000
Total tax on average slice, after credit				£1,800
Tax on average slice x 10 Years				£18,000

Note: Personal allowance is restored and personal savings allowance is £500 for this step

4. Calculate the top slicing relief

£23,243 (step 2) minus £18,000 (step 3) = £5,243

5. Tax on bond gain after applying the relief

Source	Amount	Band	Rate	Tax
Earnings	£37,700	Basic Rate	20%	£7,540
Earnings	£52,300	Higher Rate	40%	£20,920
Bond Gain	£35,140	Higher Rate	40%	£14,056
Bond Gain	£64,860	Higher Rate	45%	£29,187
Total tax on Bond Gains				£43,243
Onshore Bond tax credit				£20,000
Top slicing relief (step 4)				£5,243
Total tax on bond gains, after credit				£18,000

Note: Personal allowance and personal savings allowance is still lost

Example 3 – Offshore Bond

This example will demonstrate how top slicing relief applies to offshore bonds and the part played by the savings allowances. It shows that, whilst the allowances are used in the calculation, they cannot be combined with top slicing relief to reduce the total tax liability on the gain to £0.

Chargeable gain:	£30,000	Your client has fully surrendered their offshore bond, realising a gain of £30,000. The bond had been in force for 10 complete policy years. They have an income from pensions of £14,000. Though an offshore bond has no tax paid at source, there is a notional basic rate savings income tax credit of 20% (this increases to 22% from 6 April 2027) - this credit is used for the top slicing relief calculation only (steps 2,3 &4) and will not reduce your client's income tax liability (step 5).
Deemed tax credit:	£6,000	
Average gain (£30,000/10 years):	£3,000	
Pension income:	£14,000	

1. Check which allowances are available

For steps 2 & 4 Your client's total income is £44,000. There is no tapering of the personal allowance as income is below £100,000. Personal savings allowance (PSA) is £1,000 as total income is within the basic rate band.

The 0% starting rate for savings band is reduced from £5,000 to £3,570 because pension income exceeds the personal allowance.

For step 3 – Your client's total income is £17,000 after adding the averaged gain of £3,000 to their pension income of £14,000. This still falls within the basic rate band, so the available allowances are the same as in steps 2 and 4.

2. Calculate the total liability, above the deemed basic rate credit

Source	Amount	Band	Rate	Tax
Pension	£12,570	Personal Allowance	0%	£0
Pension	£1,430	Basic Rate	20%	£286
Bond Gain	£3,570	0% Starting Rate for Savings Band	0%	£0
Bond Gain	£1,000	Personal Savings Allowance	0%	£0
Bond Gain	£25,430	Basic Rate	20%	£5,086
Total tax on Bond Gains				£5,086
Deemed basic rate tax credit				£6,000
Total tax on bond gains, after credit				£0

3. Calculate the relieved liability

Source	Amount	Band	Rate	Tax
Pension	£12,570	Personal Allowance	0%	£0
Pension	£1,430	Basic Rate	20%	£286
Bond Gain	£3,000	0% Starting Rate for Savings Band	0%	£0
Total tax on Bond Gains	£0	Personal Savings Allowance	0%	£0
Deemed basic rate tax credit for the slice (£6,000 / 10 years)				£600
Total tax on average slice, after credit				£0
Tax on average slice x 10 years				£0
Total tax on bond gains, after credit				£0

4. Calculate the top slicing relief

£0 (step 2) minus £0 (step 3) = £0

5. Tax on bond gain after applying the relief

Source	Amount	Band	Rate	Tax
Pension	£12,570	Personal Allowance	0%	£0
Pension	£1,430	Basic Rate	20%	£286
Bond Gain	£3,570	0% Starting Rate for Savings Band	0%	£0
Bond Gain	£1,000	Personal Savings Allowance	0%	£0
Bond Gain	£25,430	Basic Rate	20%	£5,086
Total tax on Bond Gains				£5,086
Top slicing relief (step 4)				£0
Total tax on bond gains, after top slicing relief				£5,086

In this example, no top slicing relief is available as the tax on the bond gain does not exceed the notional tax credit - this is because part of the gain falls within the savings allowances.

The value of your client's investments may fall as well as rise and they may not get back what they put in.

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