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Adviser factsheet

nucleus

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UK taxation of offshore single premium bonds

Non-qualifying policies

For tax purposes, an offshore single premium investment bond is a non-qualifying life assurance policy. Investment bonds are designed to accumulate income and gains within their funds. Consequently, policyholders do not have an ongoing liability to tax if benefits are not taken. In any event, the normal Capital Gains Tax rules, which apply to most UK investments, do not, in most circumstances, apply to investment bond capital. Special rules were introduced in the form of "chargeable events" which, when they arise, give rise to a potential charge to income tax.

Circumstances where a tax liability may arise

For non-qualifying policies, a chargeable event will occur on:

1. Death giving rise to a benefit. For example, death of the life assured, or last life assured in the case of last survivor policies.
2. The maturity of the policy.
3. Full surrender of individual policies or the bond policy in full.
4. The assignment of the policy in exchange for money or money's worth.
5. Any excesses on partial surrenders arising in any policy year.
6. A personalised bond, a gain will arise on the final day of the policy year.
7. A fundamental reconstruction of the policy (i.e. adding or removing a life assured).

Calculation of the gain

When all the benefits are taken from a bond by way of maturity, full surrender, death or assignment for money, the amount chargeable to tax is calculated using the following formula:

surrender value plus all previous withdrawals

less

total premiums paid plus all previous chargeable excesses

Where the chargeable event is as a result of the death of the life assured (or last life assured) the taxable gain (if any) is calculated following notification of death and will not include any additional life cover.

Example 1

Gain = [a + b] – [c + d]

Where

a = surrender value
b = all previous withdrawals
c = total premiums paid
d = all previous chargeable excesses

i) Initial premium £45,000

Surrender value after 10 years = £89,000

Gain = [£89,000 + £0] – [£45,000 + £0]

Gain = £44,000

ii) Initial premium £45,000

5% withdrawal each year for 10 years i.e. £45,000 x 5% x 10 = £22,500

Surrender value after 10 years = £66,500

Gain = [£66,500 + £22,500] – [£45,000 + £0]

Gain = £44,000

iii) Initial premium £45,000

6% withdrawal each year for 10 years i.e. £45,000 x 6% x 10 = £27,000

Surrender value after 10 years = £62,000

Chargeable excess = 6% (£2,700) – 5% (£2,250) x 10 = £4,500

Gain = [£62,000 + £27,000] – [£45,000 + £4,500]

Gain = £39,500

Partial surrenders

For each premium paid into an investment bond, an amount equal to 5% of that premium can be withdrawn each policy year for 20 years without an immediate liability to income tax.

If this 5% tax deferred allowance is not fully used up in any year, the unused allowance will be carried forward to the next policy year and so on, on a cumulative basis. The total allowance is limited to 100% (5% x 20 years) of each premium paid.

Where a partial surrender is made, the total amount withdrawn in that policy year will be compared with the cumulative total of unused 5% allowances at the end of that policy year and any excess will be the chargeable gain which may be liable to tax. It should be noted that where a partial surrender is taken the chargeable event (if applicable) occurs on the last day of that policy year.

Example 2: partial surrender

£45,000 premium

Partial surrender of £10,000 is taken at the end of year 3

Cumulative allowance =
£45,000 x 5% x 3 = £6,750

Therefore the taxable excess =
£10,000 – £6,750 = **£3,250**

Policy segmentation

Most investment bonds can be issued as multiple individual and identical policies. This gives the investment bond greater flexibility especially when it comes to tax and estate planning. The calculation to determine chargeable excesses ignores actual investment performance. In example 2, it may be in the investor's interest to make a withdrawal by way of full surrender of individual segments rather than by partial surrender. N.B. surrendering a segment will reduce the number of original policies on which to calculate the 5% p.a. allowance.

Example 3: full surrender of segments

£45,000 premium (100 segments)

Current value £50,000 (i.e. £500 per segment)

Year 3 £10,000 is taken by surrendering 20 policy segments

£10,000 (20 x £500) - £9,000 (20 x £450) =
£1,000 chargeable gain

Personal portfolio bonds (PPB)

In simple terms, a PPB is a life assurance or capital redemption policy which gives investors the freedom to invest in a wide range of assets beyond those described within the PPB legislation.

For example, where a UK resident policyholder invests in equities through their policy, the PPB legislation imposes a yearly tax charge on the PPB deemed gain. The PPB deemed gain is not based on actual gains. It assumes a gain of 15% of the premium and the cumulative gains for each year the policy has been in force. The tax charge on the PPB deemed gain will be at the highest rate of tax paid by the investor without top slicing relief.

Calculation of the tax liability on a chargeable gain

Top slicing relief allows individuals to reduce the tax payable on a chargeable gain on a bond. In the simplest of terms, where a bond is being fully surrendered, the relief works by averaging the gain over the total full number of years the gain has accrued, rather than taxing the full gain in the tax year it's crystallised.

Key points in relation to the personal allowance (PA), starting rate for savings (SRSB) and personal savings allowance (PSA)

If an individual's adjusted net income (ANI) exceeds £100,000 then their PA is tapered by £1 for every £2 of income above this amount. So, where ANI exceeds £125,140 then the PA of £12,570 is lost completely. ANI is your total taxable income, including full chargeable gains, less certain tax reliefs such as trading losses, pension contributions paid gross, grossed up pension contributions where relief has been given at source and gross Gift Aid payments. So the ANI using the full gain is used for calculating the amount of PA available in step 1, but in step 4, it's the top sliced gain that is used for determining the ANI. Therefore the PA personal savings allowance and starting rate band for savings income can be reinstated if lost in step 1.

The SRSB of £5,000 is reduced by £1 for every £1 of non-savings income above the available PA.

The PSA is applied after the SRSB. Where the individual is a basic rate taxpayer, then the first £1,000 of savings income is tax free. If they are a higher rate taxpayer, then the first £500 is free of tax. The PSA is not available to additional rate taxpayers.

Rules when calculating top slicing relief (steps 2 and 4)

When calculating top slicing relief the gains on both offshore and UK bonds are taxed after dividends, forming the highest part of income. See www.gov.uk/hmrc-internal-manuals/savings-and-investment-manual/saim1090.

UK investment bonds have paid corporation tax on income and gains so benefit from a non-refundable 20% tax credit. As income and gains on offshore bonds have not been subject to UK corporation tax there is no tax credit available.

As confirmed by the Finance Act 2020, the PA should be determined by reference to the client's income and top sliced gain, and reinstated at step 4 of the top slicing calculation.

HMRC updated the IPTM, on 12 May 2023, to confirm that the SRSB and PSA should be recalculated by reference to the client's income and top sliced gain at step 4 of the top slicing calculation. This new rule will apply to gains arising from the tax year 2021-22 not gains before this.

Step 1 – Establish the total taxable income and total income tax for the year and how much of the PA, SRSB and PSA are available

First work out the ANI for the tax year which includes the full chargeable gain. From this figure you establish the individual's entitlement to the PA, SRSB, and PSA. Then calculate the income tax liability using the normal order of income rules. It's important to note that at this stage gains on offshore bonds are taxed before dividends, and gains on UK bonds are taxed after dividends. So, the order is:

a. non-savings income

b. savings income (including full offshore bond gains)

c. dividends

d. full UK bond gains

However, remember following the rules used when calculating top slicing relief that the top sliced gain is the highest point of income and so the order of tax needs to be reordered, which means that the income order is:

a. non-savings income

b. savings income

c. dividends

d. full UK and offshore bond gains

Step 2 – Calculate the tax and deduct basic rate

Work out the tax due on the total of the chargeable and then notional basic rate tax needs to be deducted at this stage from the full tax liability due. This is the case for both UK and offshore bonds. If any part of the chargeable gain is covered by the PA, the deemed basic rate tax credit on the gain is reduced accordingly.

The resultant figure is called the total liability.

Step 3 – Calculate the top slice

Divide the gain by the number of relevant years.

For full surrender of the bond, relevant years is the number of complete years the bond has been in force.

For part surrenders (in excess of the 5% allowance), the relevant years is the number of full years between the current chargeable event and the previous one. The exception to this is for offshore bonds established before 6 April 2013, where the relevant years will be the complete number of years the bond has been in force, providing that since that date:

- it has not been varied to increase benefits payable
- it has not been assigned by way of gift or for money or money's worth
- the rights under it have not been held as security for debt of the individual

Step 4 – Calculate the tax liability on the top slice less notional basic rate tax

Re-do the calculation in step 2 but substitute the full gain with the top sliced gain. As in step 2, for both UK and offshore bonds, a deduction should be made for basic rate tax treated as paid but this time on the top sliced gain. The resulting figure should then be multiplied by the number of relevant years used for working out the top slice.

If a negative tax liability arises on the top sliced gain, it is treated as zero.

This is called the relieved liability.

Step 5 – Calculate the top slicing relief and net tax on the gain.

Deduct the relieved liability at step 4 from the total liability at step 2 to give the amount of top slicing relief due and apply the top slice relief to the tax liability.

Example 4

John had pension income of £30,600 and dividend income of £3,000 in 2024-25. In the same tax year, he fully surrendered an offshore bond creating a chargeable gain of £91,000. He had held the bond for just over seven years.

Step 1 – Establish the total taxable income and total income tax for the year, and how much of the PA, SRSB and PSA are available

Calculate ANI

Income	£
Pension	30,600
Chargeable gain	91,000
Dividends	3,000
	124,600

PA reduced to £270
(£12,570 – (£124,600 – £100,000)/2)

Higher rate taxpayer so PSA = £500

Non-savings income exceeds £17,570 so no SRSB

Step 2 - calculate the tax on the whole gain and deduct basic rate tax

Income	Tax rate	Tax due £
Pension £270	@ 0%	0
Pension £30,330	@ 20%	6,066
Bond £500	@0%	0
Bond £6,870	@20%	1,374
Bond £83,630	@40%	33,452
Dividend £500	@0%	0
Dividend £2,500	@ 33.75%	843.75
		41,735.75

Remember to adjust order of income

Income	Tax rate	Tax due £
Pension £270	@ 0%	0
Pension £30,330	@ 20%	6,066
Dividend £500	@0%	0
Dividend £2,500	@8.75%	218.75
Bond £500	@0%	0
Bond £3,870	@20%	774
Bond £86,630	@40%	34,652
Tax due		41,710.75
Tax on gain	£774 + £34,652	35,426
Tax deemed paid	£91,000 x 20%	18,200
Tax liability on gain		17,226

Step 3 – Calculate the top slice

£91,000 / 7 = £13,000

Step 4 – Calculate the tax liability on the top slice less notional basic rate tax

Income	Tax rate	Tax due £
Pension £12,570	@ 0%	0
Pension £18,030	@ 20%	3,606
Dividend £500	@0%	0
Dividend £2,500	@8.75%	218.75
Bond £1,000	@0%	0
Bond £12,000	@20%	2,400
Tax due		6,224.75
Tax on gain		2,400
Tax deemed paid on top slice	£13,000 x 20%	2,600
Relieved liability on top slice		0
Relieved liability	£0 x 7 years	0

ANI calculated using top slice is £46,600 (£30,600 + £3,000 + £13,000). Therefore, full PA of £12,570 and PSA of £1,000 are available.

Step 5 – Calculate the top slicing relief and apply to work out the tax liability

Deduct the relieved liability at step 4 from the total liability at step 2 to give the amount of top slicing relief due.

£17,226 – 0 = £17,226

Deduct the top slicing relief from step 5 from the tax liability at step 1.

£41,567 – £17,226 = £24,341 tax due for an offshore bond.

Note that if the chargeable gain was on a UK bond a non-refundable tax credit of £18,200 (£91,000 x 20%) would be available to offset against the total tax liability, therefore:

£24,341-£18,200 = £6,141

Time apportionment relief

If the bondholder has been non-UK resident whilst owning the bond and subsequently becomes UK resident, the gain is reduced by a fraction relating to the number of years the bondholder has been non-UK resident and the number of years the bond has been held. The gains calculated in example 1, would be multiplied by the following fraction:

$$\frac{\text{Period of ownership as a non-UK resident (days)}}{\text{Period plan has been in force (days)}}$$

The periods in question are calculated from the policy commencement date to the date on which the chargeable event occurs.

Corresponding deficiency relief

It is not possible to offset the loss on one offshore bond against a loss on another offshore bond, but it is possible to offset it against other income which falls into the higher rate tax bracket.

This relief is called 'corresponding deficiency relief'.

However, there is a limit on the amount of income subject to higher rate tax against which the loss on an offshore bond can be offset. This is determined by the amount of any previous chargeable gains. The amount used to offset against higher rate tax cannot be any more than the total amount of the previous chargeable gains.

Important notes

Please note that every care has been taken to ensure that the information provided is correct and in accordance with our current understanding of the law and Her Majesty's Revenue and Customs (HMRC) practice as at April 2025.

You should note, however, that we cannot take upon ourselves the role of an individual taxation adviser and independent confirmation should be obtained before acting or refraining from acting upon the information given. The law and HMRC practice are subject to change. Legislation varies from country to country and the policyholder's country of residence may impact on any of the above.

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