

Calculating top-slice relief on a chargeable gain

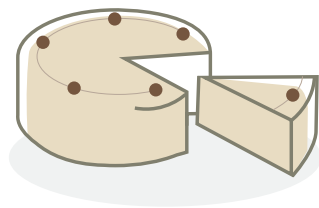
Briefing Note

This briefing note has been designed to help you understand how chargeable gains are calculated on both UK and international bonds held by individuals.

Individual taxpayers may suffer extra tax by being charged in a single year on gains that have accrued over a period of time.

Top-slicing relief may assist. It allows chargeable gains to be divided by the number of complete years the bond has been in force to recognise the fact that the chargeable gain has accrued over the whole period for which the bond was in force and not merely in the tax year in which tax is to be assessed on the chargeable gain.

Top-slicing relief may still be of benefit even if the chargeable gain does not move the taxpayer into a higher rate tax bracket due to the effect of the personal savings allowance and the starting rate for savings band.



Points to remember

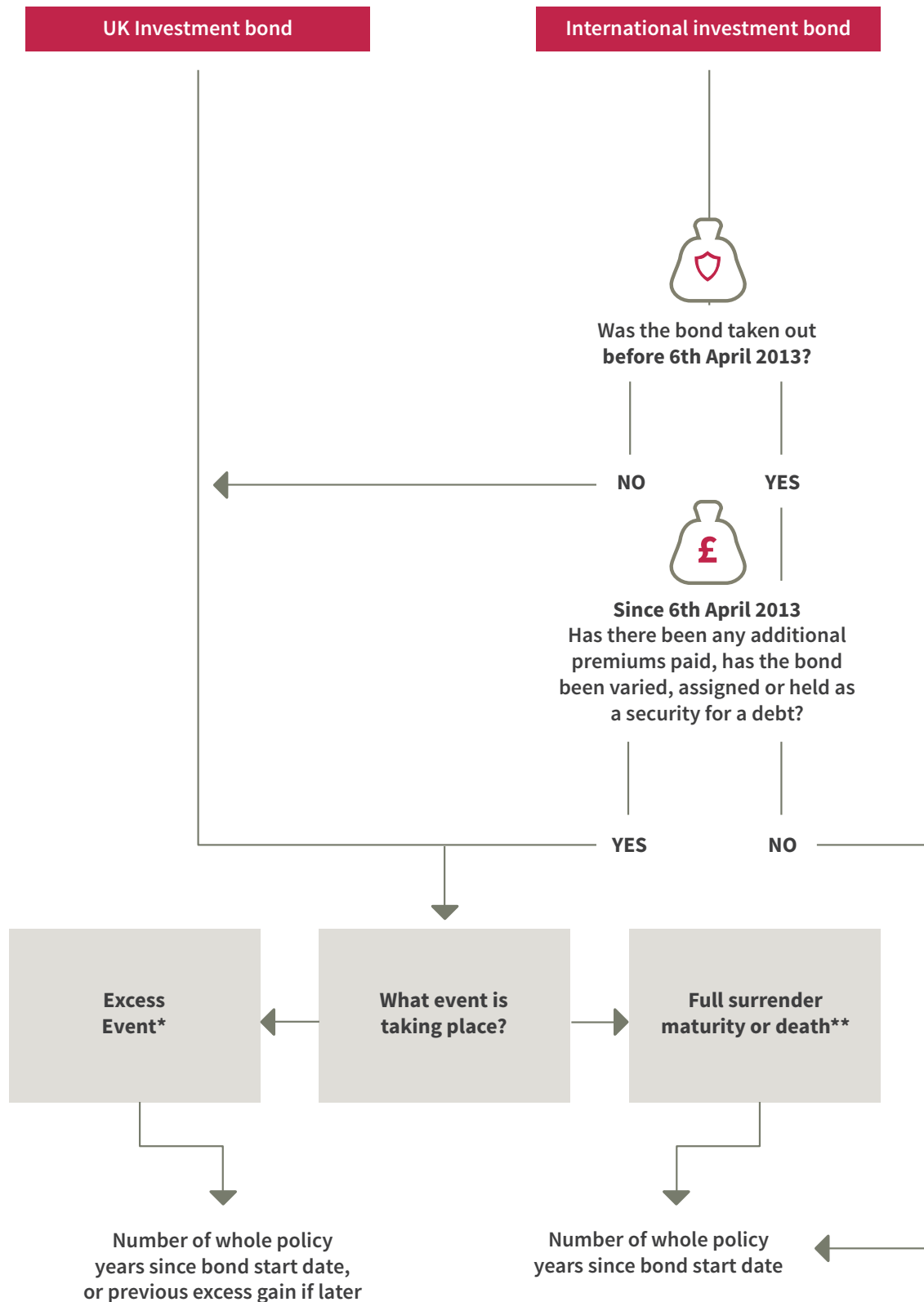
- Gains made under investment bonds, whether UK or international, are classed as savings income.
- Top-slicing is a tax relief and, in some circumstances, can be used to reduce or eliminate the liability to higher and/or additional rate income tax when a chargeable gain arises.

- Gains can be used, in some circumstances, against any unused:
 - personal allowance
 - starting rate for savings band (SRSB) of up to £5,000 depending on other income
 - personal savings allowance (PSA) of up to £1,000 depending on income tax band
- The amount of tax that can be relieved under the top-slicing calculations for both UK and international bonds, has always been restricted by basic rate tax (S530 ITTOIA 2005)
- Top-slicing is not available to trustees or personal representatives. Where trustees are assessed for a chargeable gain, they will have an allowance of up to £1,000 at 20% and 45% on the balance.
- When terminating a bond, the number of complete relevant years is always back to the start of the bond. Where an excess withdrawal has been taken, this can change.

Please see the flow chart on the next page.
- For more than one chargeable gain in the same tax year over multiple policies, the gains are aggregated. Please refer to our Briefing Note on Calculating multiple chargeable gains.
- As of 11 March 2020, HMRC confirmed that for the top-slicing calculation only, the personal allowance should be reinstated and adjusted by reference to the client's income and top-sliced gain. However, other allowances and reliefs are not recalculated for the purposes of the hypothetical top-slicing relief calculation. HMRC also confirmed that this new rule will apply to all gains arising from tax year 2018/19, as a concessionary treatment.

Calculating top-slice relief on a chargeable gain

How to calculate the correct number of complete relevant years:



*An "excess event" refers to withdrawals above the 5% allowance and the chargeable gain occurs at the end of the policy year.

**A "full surrender" refers to either the whole bond or individual policies held within the bond.

Calculating top-slice relief on a chargeable gain

Five steps to help calculate the tax on a chargeable gain:

1. Calculate the total taxable income for the year

Identify how much of the gain falls within the SRSB, PSA, basic, higher or additional rate bands as appropriate.

Remember, if an individual's adjusted net income exceeds £100,000 tapering of their personal allowance will apply at £1 for every £2 in excess of the £100,000 limit. For the tax year 2020/21, this means their personal allowance is zero if adjusted net income, including the total gain, £125,000 or above.

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

The PSA is applied to the first £1,000 of savings income for basic rate taxpayers and the first £500 for higher rate taxpayers. Additional taxpayers do not benefit from the PSA.

2. Calculate the total tax due on the gain across all tax bands.

Deduct basic rate tax treated as paid to find the individual's liability for the tax year.

3. Calculate the annual equivalent of the gain.

The annual equivalent is calculated by dividing the gain by N, this being the number of years the policy has been held or since the last chargeable event.

4. Calculate the individual's liability to tax on the annual equivalent.

For gains arising from the 2019/20 year onwards, the personal allowance is recalculated where appropriate by adding the taxpayer's non-savings/non-dividend income to the annual equivalent of the gain which gives a notional adjusted income.

If this is less than £100,000 the full personal allowance will be available for this step.

Deduct basic rate tax treated as paid on the annual equivalent and multiply the result by N. This gives the individual's relieved liability.

5. Calculate the top-slice relief.

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

Case Studies

The following case studies are based on the 2020/21 tax year and provide the calculations for both UK and international bonds for different client scenarios, following the five steps above.



Calculating top-slice relief on a chargeable gain

Case Study I

Gain moves client into higher tax bracket

Monica has earned income of £42,000 gross.
She fully surrenders her investment bond, with a total chargeable gain of £55,000.
She has held the investment bond for a total of 11 relevant years.



1. Calculate total taxable income for the year and identify how much of the gain falls within the relevant tax bands.

$£42,000 + £55,000 = £97,000$

No loss of personal allowance. Personal savings allowance reduced to £500

Source	Amount	Band	Rate	Tax Due
Employment	£12,500	Personal Allowance	0%	
	£29,500	Basic rate	20%	
Chargeable event gain	£500	Personal Savings Allowance	0%	£0
	£7,500	Basic rate	20%	£1,500
	£47,000	Higher rate	40%	£18,800

2. Calculate total liability for the year

Tax liability on the gain - £20,300

Less tax treated as paid (£55,000 @ 20% = £11,000)

Total liability £9,300

3. Calculate the annual equivalent

$£55,000/11 = £5,000$

4. Find the total relieved liability

For the purposes of this calculation, we add the taxpayer's employment income of £42,000 to the £5,000 annual equivalent of the gain which gives a notional adjusted income of £47,000. As this is less than £100,000, the full personal allowance will be available in this step.

Source	Amount	Band	Rate	Tax Due
Employment	£12,500	Personal Allowance	0%	
	£29,500	Basic rate	20%	
Top-slice gain	£500	Personal Savings Allowance	0%	£0
	£4,500	Basic rate	20%	£900

The total liability on the annual equivalent of the gain is £900. Less tax treated as paid on the annual equivalent - £5,000 @ 20% = £1,000

The total relieved liability is £900 - £1,000 = £0 x 11 years = £0

5. Calculate top slicing relief due

Top-slicing relief is the difference between the total liability and the total relieved liability:

Top-slice relief = £9,300 - £0 = £9,300

a) International bond

Tax on gain: £20,300

Less top-slice relief: £9,300

= £11,000 income tax to pay on gain

b) UK bond

Tax on gain: £9,300

Less top-slice relief: £9,300

= £0 income tax to pay on gain

Calculating top-slice relief on a chargeable gain

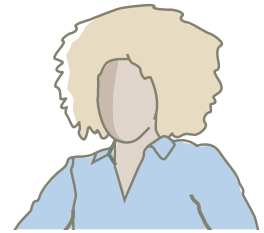
Case Study 2

Personal Allowance affected by gain

Janice has earned income of £33,600

She fully surrenders her investment bond, with a total chargeable gain of £91,000

She has held the investment bond for a total of 7 relevant years.



1. Calculate total taxable income for the year and identify how much of the gain falls within the relevant tax bands.

$£33,600 + £91,000 = £124,600$

Personal allowance reduced to £200. Personal savings allowance reduced to £500

Source	Amount	Band	Rate	Tax Due
Employment	£200	Personal Allowance	0%	
	£33,400	Basic rate	20%	
Chargeable event gain	£500	Personal Savings Allowance	0%	£0
	£3,600	Basic rate	20%	£720
	£86,900	Higher rate	40%	£34,760

2. Calculate total liability for the year

Tax liability on the gain = £35,480

Less tax treated as paid (£91,000 @ 20% = £18,200)

Total liability = £17,280

3. Calculate the annual equivalent

$£91,000/7 = £13,000$

4. Find the total relieved liability

For the purposes of this calculation, we add the taxpayer's employment income of £33,600 to the £13,000 annual equivalent of the gain which gives a notional adjusted income of £46,600. As this is less than £100,000, the full personal allowance will be available in this step.

Source	Amount	Band	Rate	Tax Due
Employment	£12,500	Personal Allowance	0%	
	£21,100	Basic rate	20%	
Top-slice gain	£500	Personal Savings Allowance	0%	£0
	£12,500	Basic rate	20%	£2,500

The total liability on the annual equivalent of the gain is £2,500. Less tax treated as paid on the annual equivalent - £13,000 @ 20% = £2,600

The total relieved liability is £2,500 minus £2,600 which is £0 x 7 years = £0

5. Calculate top slicing relief due

Top-slicing relief is the difference between the total liability and the total relieved liability:

Top-slice relief = £17,280 - £0 = £17,280

a) International bond

Tax on gain: £35,480

Less top-slice relief: £17,280

= £18,200 income tax to pay on gain

b) UK bond

Tax on gain: £17,280

Less top-slice relief: £17,280

= £0 income tax to pay on gain

Calculating top-slice relief on a chargeable gain

Case Study 3

Client has starting rate for savings band available

Phoebe has earned income of £16,500 gross
She fully surrenders her investment bond, with a total chargeable gain of £60,000
She has held the investment bond for a total of 2 relevant years.



1. Calculate total taxable income for the year and identify how much of the gain falls within the relevant tax bands.

$£16,500 + £60,000 = £76,500$

No loss of Personal allowance. Personal savings allowance reduced to £500

The £5,000 starting rate for savings band is reduced by £1 for every £1 of non-savings or earned income above the personal allowance and is used against the savings income. In this case $£16,500 - £12,500 = £4,000$ which leaves £1,000 of the starting rate available.

Source	Amount	Band	Rate	Tax Due
Employment	£12,500	Personal Allowance	0%	
	£4,000	Basic rate	20%	
Chargeable event gain	£1,000	Starting rate for Savings Band	0%	£0
	£500	Personal Savings Allowance	0%	£0
	£32,000	Basic rate	20%	£6,400
	£26,500	Higher rate	40%	£10,600

2. Calculate total liability for the year

Tax liability on the gain = £17,000

Less tax treated as paid (£60,000 @ 20% = £12,000)

Total liability = £5,000

3. Calculate the annual equivalent

$£60,000 / 2 = £30,000$

4. Find the total relieved liability

Add the taxpayer's employment income of £16,500 to the £30,000 annual equivalent of the gain which gives a notional adjusted income of £46,500. The full personal allowance will be available in this step.

Source	Amount	Band	Rate	Tax Due
Employment	£12,500	Personal Allowance	0%	
	£4,000	Basic rate	20%	
Top-slice gain	£1,000	Starting rate for Savings Band	0%	£0
	£500	Personal Savings Allowance	0%	£0
	£28,500	Basic rate	20%	£5,700

The total liability on the annual equivalent of the gain is £5,700

Less tax treated as paid on the annual equivalent - £30,000 @ 20% = £6,000

The total relieved liability is £5,700 - £6,000 which is £0 x 2 years = £0

5. Calculate top slicing relief due

Top-slicing relief is the difference between the total liability and the total relieved liability:

Top-slice relief = £5,000 - £0 = £5,000

a) International bond

Tax on gain: £17,000

Less top-slice relief: £5,000

= £12,000 income tax to pay on gain

b) UK bond

Tax on gain: £5,000

Less top-slice relief: £5,000

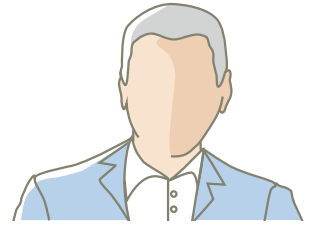
= £0 income tax to pay on gain

Calculating top-slice relief on a chargeable gain

Case Study 4

Client loses all allowances and moves into higher tax bracket

Chandler has earned income of £38,625 gross
He fully surrenders his investment bond, with a total chargeable gain of £229,391
He has held the investment bond for a total of 18 relevant years.



1. Calculate total taxable income for the year and identify how much of the gain falls within the relevant tax bands.

$£36,625 + £229,391 = £266,016$

Loss of Personal allowance. Loss of Personal Savings Allowance.

Source	Amount	Band	Rate	Tax Due
Employment	£37,500	Basic rate	20%	
	£1,125	Higher rate	40%	
Chargeable event gain	£111,375	Higher rate	40%	£44,550
	£118,016	Additional rate	45%	£53,107

2. Calculate total liability for the year

Tax liability on the gain = £97,657

Less tax treated as paid (£229,391 @ 20% = £45,878)

Total liability = £51,779

3. Calculate the annual equivalent

$£229,391/18 = £12,744$

4. Find the total relieved liability

Add the taxpayer's employment income of £38,625 to the £12,744 annual equivalent of the gain which gives a notional adjusted income of £51,369

The full personal allowance will be available in this step but still no PSA.

Source	Amount	Band	Rate	Tax Due
Employment	£12,500	Personal Allowance	0%	
	£26,125	Basic rate	20%	
Top-slice gain	£11,375	Basic rate	20%	£2,275
	£1,369	Higher rate	40%	£547

The total liability on the annual equivalent of the gain is £2,822

Less tax treated as paid on the annual equivalent

- £12,744 @ 20% = £2,548

The total relieved liability is £2,822 - £2,548 which is £274 x 18 years = £4,932

5. Calculate top slicing relief due

Top-slicing relief is the difference between the total liability and the total relieved liability:

Top-slice relief = £51,779 - £4,932 = £46,847

a) International bond

Tax on gain: £97,657

Less top-slice relief: £46,847

= £50,810 income tax to pay on gain

b) UK bond

Tax on gain: £51,779

Less top-slice relief: £46,847

= £4,932 income tax to pay on gain

Calculating top-slice relief on a chargeable gain

Case Study 5

Low income

Richard only has savings income from his bank account of £3,800 gross
He fully surrenders his investment bond, with a total chargeable gain of £52,980
He has held the investment bond for a total of 15 relevant years.



1. Calculate total taxable income for the year and identify how much of the gain falls within the relevant tax bands.

$£3,800 + £52,980 = £56,780$

No loss of Personal allowance. Reduction of Personal Savings Allowance to £500.

Source	Amount	Band	Rate	Tax Due
Bank interest	£3,800	Personal Allowance	0%	
Chargeable gain	£8,700	Personal Allowance	0%	£0
	£5,000	Starting Rate for Savings Band	0%	£0
	£500	Personal Savings Allowance	0%	£0
	£32,000	Basic rate	20%	£6,400
	£6,780	Higher rate	40%	£2,712

2. Calculate total liability for the year

Tax liability on the gain = £9,112

Less tax treated as paid

$(£52,980 - £8,700) \times 20\% = £8,856$

Total liability = £256

3. Calculate the annual equivalent

$£52,980/15 = £3,532$

4. Find the total relieved liability

Add the taxpayer's income of £3,800 to the £3,532 annual equivalent of the gain which gives a notional adjusted income of £7,332

The full personal allowance and reduced PSA of £500 will be available in this step.

Source	Amount	Band	Rate	Tax Due
Bank interest	£3,800	Personal Allowance	0%	
Top-slice gain	£3,532	Personal Allowance	0%	£0

The total liability on the annual equivalent of the gain is £0

Less tax treated as paid on the annual equivalent - $£3,532 \times 20\% = £0$

The total relieved liability is £0 - £0 which is £0 x 15 years = £0

5. Calculate top slicing relief due

Top-slicing relief is the difference between the total liability and the total relieved liability:

Top-slice relief = £256 - £0 = £256

a) International bond

Tax on gain: £9,112

Less top-slice relief: £256

= £8,856 income tax to pay on gain

b) UK bond

Tax on gain: £256

Less top-slice relief: £256

= £0 income tax to pay on gain

* tax credit is only applied to "total liability to income tax on income charged to tax" s535 (3) <http://www.legislation.gov.uk/ukpga/2005/5/part/4/chapter/9/crossheading/income-tax-treated-as-paid-and-reliefs>

This document is based on Canada Life's understanding of applicable legislation, law and current HM Revenue & Customs practice as at August 2020. The information regarding taxation is based on our understanding of current legislation, which may be altered and depends upon the individual circumstances of the investor. We recommend that investors seek their own professional advice.



www.canadalife.co.uk/ican

Canada Life Limited, registered in England no. 973271. Registered office: Canada Life Place, Potters Bar, Hertfordshire EN6 5BA.
Telephone: 0345 6060708 Fax: 01707 646088 www.canadalife.co.uk Member of the Association of British Insurers.

Canada Life International Limited, registered in the Isle of Man no. 33178. Registered office: Canada Life House, Isle of Man Business Park, Douglas, Isle of Man IM2 2QJ.
Telephone: +44 (0) 1624 820200 Fax: +44 (0) 1624 820201 www.canadalifeint.com Member of the Association of International Life Offices.

CLI Institutional Limited, registered in the Isle of Man no. 108017C. Registered office: Canada Life House, Isle of Man Business Park, Douglas, Isle of Man IM2 2QJ.
Telephone: +44 (0) 1624 820200 Fax: +44 (0) 1624 820201 Member of the Association of International Life Offices.

Canada Life International Assurance (Ireland) DAC, registered in Ireland no. 440141. Registered office: Irish Life Centre, Lower Abbey Street, Dublin 1, Ireland
Telephone: +44 (0) 1624 820200 Fax: +44 (0) 1624 820201 www.canadalifeinternational.ie Member of the Association of International Life Offices.

Canada Life Limited is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.
Canada Life International Limited and CLI Institutional Limited are Isle of Man registered companies authorised and regulated by the Isle of Man Financial Services Authority.
Canada Life International Assurance (Ireland) DAC is authorised and regulated by the Central Bank of Ireland.