

Technical insights - Quick reference guide 4

Taxation of investment bonds - full bond surrenders

This guide will provide you with an understanding of full bond surrenders for onshore investment bonds. This guide is not suitable for investment bonds held by companies.

Calculation for bond surrender

A = (Surrender value + Previous partial surrenders)

B = (Premiums paid + Previous excess gains)

A - B = Gain/loss.

Surrendering a bond is a chargeable event

The method of calculation of the gain is shown above. The gain is taxed as income.

There is no 5% tax deferred allowance for bond surrenders

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

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 the bond in full can wipe-out excess gains, 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). If the bond is fully 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, death or maturity) 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.

Example:

Bond year runs 1st May to 30th April

And excess event happens on 30th April 2021. The bond is surrendered on 12 December 2021.

The final year runs from 1 May 2021 to 12 December 2021 which are both in the 2021/22 tax year. The final year rule applies and extends the start of the final year back to 1 May 2020. It still ends on 12th December 2021 i.e. more than 12 months.

Because of this there is not bond year ending on 30th April 2021 which removes the excess gain.

Chargeable gain calculation – An example

Year 1 – £100,000 invested into a bond.

£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.

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 the bond in full.

Calculation for bond surrender

A = (Surrender value + Previous partial surrenders)

B = (Premiums paid + Previous excess gains)

A – B = Gain/loss.

Taking each part in turn;

Surrender value =	£90,000
Previous partial surrenders =	Year 1 = £5,000 Year 2 = £6,000 Year 3 = £6,000 Total = £17,000
Premium =	£100,000
Previous excess gains =	Year 1 = £0 Year 2 = £1,000 Year 3 = £0* Total = £1,000

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

Calculation for policy surrender

A = (£90,000 + £17,000)

B = (£100,000 + £1,000)

A – B = £6,000 gain

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