TECHNICAL SALES BRIEFING

TIME APPORTIONED REDUCTIONS
DECEMBER 2024

KEY POINTS

- Time Apportioned Reductions (TAR) can be a particularly useful relief for returning expatriates or those planning to spend a significant time working abroad whilst holding their bond. TAR can reduce the amount of tax payable if a chargeable event occurs whilst the bondholder is UK resident
- The application of TAR can differ depending on whether the bond was taken out on or after 6 April 2013 or whether the bond has been altered since this date.

This technical briefing considers when TAR is available, how TAR is calculated and contains various examples to assist understanding.

TAR - THE BASICS

TAR can be used by individuals who have been, or will become, non-UK resident, to reduce the gain calculated on any chargeable event should they return to the UK. It is not available to trustees and care needs to be taken if there have been any previous assignments.

The rules for TAR are different depending on if the bond has been issued or altered on or after 6 April 2013.

PRE-6 APRIL 2013 BONDS

For bonds which commenced prior to 6 April 2013, TAR can be claimed for the period where the legal owner of the bond at the time of the chargeable event was resident outside of the UK during the time the bond has been in force.

The reduction applied to the gain for pre-2013 bonds is as follows:

$$\text{Gain x } \frac{\text{The policyholder's overseas days whilst the bond was in force}}{\text{The total period in days the bond was in force}}$$

All examples use approximations for day counting. In reality the true number of days should be used, always accounting for factors such as leap years when day counting.

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EXAMPLE 1 – A PRE-2013 BOND WHICH HAS NOT BEEN ALTERED AFTER 6 APRIL 2013

Sally, who is UK resident, invested £500,000 in a bond in early 2000 and assigned this for no consideration to her son Bob exactly two years later in early 2002. At this time, Bob was working in Bahrain on a contract and had been non-resident for just over three years. Bob then returned to become UK tax resident in early 2012 and surrendered the bond exactly eight years later in early 2020 when it was worth £1,000,000. For simplicity we will assume no withdrawals have been taken.

Here, Bob had held the bond for 18 years prior to surrender but the bond had been in force for 20 years (7,300 days). During the time the bond had been in force, Bob had been overseas resident for 12 years (4,380 days) and UK resident for only eight years (2,920 days).

It is our understanding that the calculation under the pre-2013 rules simply looks at Bob's non-residence (as policyholder and legal owner) throughout the whole period the bond was in force and the gain would be reduced as follows:

$$£500{,}000 \times \frac{\text{4,380 (the policyholder's overseas days whilst the bond was in force)}}{\text{7,300 (the total period in days the bond was in force)}} = £300{,}000$$

The gain would therefore be £500,000 - £300,000 = £200,000

We can see here that Bob gets relief for all the 12 years he was abroad, despite the fact his mother owned the bond for the first two years and was UK resident.

However, under the pre-2013 rules TAR was not available if the bond was ever held by a non-UK resident trustee or non-UK resident trustees, even if it was subsequently assigned out of trust prior to 6 April 2013.

EXAMPLE 2 – A PRE-2013 BOND WHICH WAS PREVIOUSLY HELD BY NON-UK RESIDENT TRUSTEES AND HAS NOT BEEN ALTERED POST 6 APRIL 2013

Stan and Wendy take out a bond in 2004 when resident in Hong Kong, place it into trust and appoint themselves as trustees. In 2010 they then assign the bond to their son Charlie (a beneficiary) who is also resident in Hong Kong. In 2012 Charlie subsequently moves back to the UK. TAR would not be available on this bond as it was previously held by non-UK resident trustees and has not been altered on or after 6 April 2013. The rules for TAR would follow the pre-2013 rules which didn't provide for TAR if the bond had ever been held by a non-UK resident trust.

BONDS ISSUED ON OR AFTER 6 APRIL 2013 (OR THOSE WHICH HAVE BEEN ALTERED AFTER THAT DATE)

For bonds which commenced on or after 6 April 2013, TAR is based on the material interest period which is aligned to the residence history of the person liable for income tax on the gain.

The material interest period is defined in s528 Income Tax (Trading and Other Income) Act 2005 ("ITTOIA") as the time the individual meets one of the following conditions which align to the taxation of individuals under s465 ITTOIA:

a) Beneficially owns the rights under the bond

b) Created a non-charitable trust to hold the rights under the bond

c) Transferred the rights under the bond as security for debt.

HMRC have also issued guidance, available on their website, which gives numerous examples on how the new rules work with the Statutory Residence Test (SRT). If you wish to understand in detail how the new rules may impact your client you should refer to this guidance.

Importantly, these rules also apply to bonds that commenced before the 6 April 2013 if the following changes have been made on or after 6 April 2013:

- Bond is altered to increase the benefits payable (i.e. it is topped up)
- Bond is assigned to another individual* or into a trust – whether this is for consideration is irrelevant
- Bond rights are held as security for a debt of the individual.

The reduction applied to a gain for a post 2013 bond is as follows:

$$\text{Gain} \times \frac{\text{Overseas days in material interest period}}{\text{Total days in material interest period}}$$

*Where a policy is assigned to a spouse or civil partner living together post 6 April 2013, the material interest period is then combined as covered in example 5.

EXAMPLE 3 – A PRE-2013 BOND WHICH HAS BEEN ALTERED POST-6 APRIL 2013

Let's look at Example 1 again and assume in 2015 Bob topped the bond up with a further £200,000 and therefore the bond is now caught under the post - 6 April 2013 rules. The bond was worth £1,400,000 when he came to surrender in early 2020. However under the new post 6 - April rules the ownership period doesn't include the two years his mother held the bond and instead the material interest period only includes the 18 years (6,570 days) he beneficially owned the rights under the bond. The calculation would be changed to the following - noting the difference in the fraction of TAR applicable:

$$£700{,}000 \times \frac{\substack{3{,}650 \\ \text{(overseas days in material interest period)}}}{\substack{6{,}570 \\ \text{(Total days in material interest period)}}} = £388{,}888$$

The gain would therefore be £700,000 - £388,888 = £311,112

Whilst the top up was made five years before encashment, Bob's TAR fraction gets reduced for 730 days (two years) in both parts of the equation to account for the fact he didn't have a material interest in the bond throughout its life, i.e. his mother held the beneficial rights for the first two years.

BOND ASSIGNMENTS AND TAR

One of the benefits of an offshore bond is that it can be assigned by way of a gift which doesn't constitute a chargeable event, providing that this is not for money or money's worth (consideration).

This means when a bond is purchased by someone resident abroad, it can be assigned to another non-UK resident individual who will be able to claim TAR if they subsequently return to the UK and surrender the bond.

EXAMPLE 4 – A PRE 6 APRIL 2013 BOND WHICH HAS BEEN ASSIGNED POST 6 APRIL 2013

Richard invests £200,000 into an offshore bond in the spring of 2012 whilst resident in Portugal. He subsequently gifts it to his friend Rebecca exactly two years later in spring 2014 whilst she is also resident in Portugal. She moves back to the UK five years later in the spring of 2019. She then surrenders the bond two years later in the spring of 2021 when it is worth £500,000.

Whilst the bond commenced in 2012, as it has been assigned on or after 6 April 2013, it will be dealt with under the post-6 April 2013 rules.

Again we will assume there have been no withdrawals taken from the bond and the gain before TAR is therefore £300,000.

Here Rebecca's material interest period is seven years (2,555) days of which she has been UK resident two years (730 days) and thus non-resident 1,825 days.

The reduction due to TAR is therefore:

$$£300{,}000 \times \frac{\substack{1{,}825 \\ \text{(overseas days in Rebecca's material interest period)}}}{\substack{2{,}555 \\ \text{(total days in Rebecca's material interest period)}}} = £214{,}285$$

The gain would therefore be £300,000 - £214,285 = £85,715

Just like Bob in Example 3, Rebecca only benefits from TAR for the period she was the owner of the bond (her material interest period).

THE MATERIAL INTEREST PERIOD AND MARRIED COUPLES OR CIVIL PARTNERS

If a person is married, or in civil partnership, the material interest period following assignments are combined.

EXAMPLE 5 – ASSIGNMENT BETWEEN SPOUSES

Simon and Rachel are married and currently live and work in Dubai. Simon takes out an offshore bond for £1,000,000 in autumn of 2015 that is held in his name. Two years later Rachel subsequently moves back to the UK to be nearer to her family as her mother is quite unwell. Simon then stays overseas for a further two years to complete a work contract and returns to the UK to live with Rachel in the autumn of 2019. On returning to the UK Simon decides to immediately assign the bond to Rachel as she is a non-tax payer and therefore this will help reduce the UK tax liability on surrender. Rachel surrenders the bond two years later for £1,500,000 in autumn 2021.

Here the material interest period is based on **both** their periods of UK residence and non-UK residence and the foreign days are then applied in relation to each period of ownership, thus the time Simon was overseas (1,460) when holding the beneficial rights can still be brought into account and be used to reduce gains.

As before, there have been no withdrawals so the gain would be calculated as £500,000 and the reduction due to TAR would be as follows:

$$£500{,}000 \times \frac{\underset{\text{(overseas days in their combined material interest period)}}{1{,}460}}{\underset{\text{(total days in the combined material interest period)}}{2{,}190}} = £333{,}333$$

The gain would therefore be £500,000 - £333,333 = £166,667

ALTERATION OF A PRE-2013 BOND PREVIOUSLY HELD BY OVERSEAS TRUSTEES

If we turn back to Example 2, we can see that, where a bond has ever been held by overseas trustees, the previous rules would not permit TAR. Conversely, the current (post - 6 April 2013) rules will allow TAR based on the person liable to tax in the material interest period.

The new rules therefore allow for beneficiaries to claim TAR where assignments are made out of the overseas trust **on or after 6 April 2013** and Charlie is still overseas resident.

EXAMPLE 6 – POST 6 APRIL 2013 ALTERATION OF A PRE-2013 BOND PREVIOUSLY HELD BY OFFSHORE TRUSTEES

Stan and Wendy take out a bond in 2004 when resident in Hong Kong and appoint themselves as trustees. However, instead of assigning the benefits to their son Charlie in 2012, as per the previous example, the assignment is made in 2019.

TAR would now be available on this bond for the beneficiary Charlie, as the bond has been altered post - 6 April 2013. This will allow for TAR for the period Charlie holds the bond prior to moving to the UK.

TOP-SLICING RELIEF (TSR) AND THE INTERACTION WITH TAR

Another benefit of an offshore bond is the ability to utilise top-slicing relief (TSR) on the happening of any chargeable event.

We have separate guides available on top-slicing relief on our uTech site and therefore these should be read for full details of how this relief operates.

In simple terms top-slicing relief provides a relief to higher, or additional, rates of tax based on a spreading mechanism. Here the gain prior to top-slicing relief is tested against the gain had the gain instead been spread over a number of years (known the top-slicing divisor "n"). For surrender events the number of years for divisor "n" always goes back to inception. However, where TAR is claimed (based on day count) then the divisor "n" is also rounded down to the nearest year.

EXAMPLE 7 - HOW TAR INTERACTS WITH TSR

Sophia invested £500,000 into an offshore bond in autumn 2001 following an inheritance received on the death of both her parents who were living in Spain at the time. She decided to move to the UK approximately five and a half years (2,000 days) later in the summer of 2007 to live with her boyfriend. In autumn of 2025, 18 and a half years later she decided to surrender the bond to fund the purchase of their first house. At the time of surrender the bond was worth £1,200,000. Again, there have been no withdrawals taken and therefore gain before TAR is £700,000.

As the bond commenced in 2001, and is unaltered after 2013, it will be dealt with under the pre-6 April 2013 rules. The reduction due to TAR is

$$\text{£}700{,}000 \times \frac{\underset{\text{(overseas days since inception as pre-2013 unaltered bond)}}{2{,}000}}{\underset{\text{(days policy in force since inception as pre-2013 unaltered bond)}}{8{,}760}} = \text{£}159{,}817$$

The gain would therefore be £700,000 - £159,817 = £540,037

Here she would still benefit from a **19** year top-slicing divisor despite being out of the UK for five and a half years and UK resident for only 18 and a half years. This is because the top-slicing divisor "n" is rounded down to the nearest year when gains are reduced by TAR. Sophie has held the bond for 24 years and has spent five and a half years overseas, however, the divisor "'n" is only reduced by five years to 19 years. Whilst the divisor is rounded down for top-slicing relief purposes, and the half year is effectively ignored, the actual overseas day count including the half year (2,000 days in this example) still applies for TAR.

If Sophia has no earnings for the tax year 2025/26 when she surrendered the bond, utilising both TAR and TSR, she would only pay £108,037 tax on the bond whilst receiving £1,200,000 – an effective rate of only 9%.

SUMMARY

TAR can play a vital role in reducing the tax payable if a policyholder is planning to be resident outside of the UK for a significant period, or where policyholders take out bonds and subsequently become UK resident.

When considering TAR, it is very important that you establish which set of rules will apply to the bond and whether there has been an alteration which could mean the new rules apply.

Due to the difference in the way TAR interacts with TSR, there can also be further benefits achieved which can help reduce gains for expatriates that return to become UK resident.

More information on TSR and the taxation of bonds can be found by visiting our uTech site.

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