TECHNICAL SALES BRIEFING

TAX PLANNING USING BONDS
DEFICIENCY RELIEF

- This technical briefing is part of a series intended to shine a light on various areas of overseas single premium bond taxation from the point of view of a UK resident investor
- It looks at deficiency relief, when it is applicable and how it is calculated.

WHAT IS DEFICIENCY RELIEF?

Deficiency relief may reduce the higher rate tax liability of an individual if a chargeable event brings the policy to an end and there have been excess gains on part surrenders in earlier years of assessment.

Trustees, personal representatives, companies, and beneficiaries of overseas trusts are not eligible for the relief.

The relief cannot exceed the excess gains on part surrenders in earlier years of assessment, so it is important to recognise that the relief does not apply in respect of any economic loss under the bond, (i.e. reductions in the value of the bond arising as a result of stock market fluctuations).

CALCULATING THE AMOUNT OF RELIEF

The usual chargeable event formula is applied in order to ascertain if a gain has been made (obviously if the result is positive, no deficiency relief is available). The formula making reference to chargeable gains which have arisen on previous events, and the amount of deficiency relief available, will be the lower of these two figures. The relief is given by extending the individual's basic rate tax band but only to the extent that the total income figure exceeds the basic rate threshold (£33,500 for 2017/2018).

utmost™
WEALTH SOLUTIONS

AN EXAMPLE TO HELP

This can be shown by the following example using the case of Horace who took out an overseas single premium bond in April 2011 for £80,000. In the third policy year he withdrew £25,000, which triggered a chargeable event gain of £13,000 (i.e. £25,000 less 3x5%x£80,000 = £12,000).

The bond was fully surrendered in July 2017 for £50,000. Horace has taxable income (i.e. after deduction of his personal allowance) for 2017/2018 of £37,500 and so £4,000 of his income would normally be liable to higher rate tax.

THE FORMULA USED ON FINAL SURRENDER IS: (A+B)-(C+D), WHERE

A = surrender proceeds	£50,000
B = plus previous withdrawals	£25,000
C = less original investment	£80,000
D = less previous chargeable gain	£13,000
(£50,000+£25,000) - (£80,000+£13,000) = loss of £18,000	

The amount of deficiency relief in this case is therefore the previous chargeable event gain of £13,000 as this is lower than the loss (£18,000).

This figure can be added to Horace's income and easily eclipses the £4,000 of income which is subject to higher rate tax. The liability to higher rate tax is therefore eliminated, so saving Horace £800 (i.e. £4,000 x 20%).

The fact that all or part of the previous chargeable gains may have suffered little or no UK tax charge does not diminish the amount of deficiency relief available when the bond terminates.

LEVEL OF AVAILABLE RELIEF

Rules were introduced by Finance Act 2004 and 2012 to counter what HM Revenue & Customs perceived as tax avoidance schemes utilising deficiency relief. These rules

› restrict the deficiency relief on final encashment of a single premium bond to an amount not exceeding the total of any earlier gains which formed part of the same individual's income.

› mean that gains made when the individual was non-UK resident can no longer be included as previous chargeable gains for the purposes of deficiency relief. Under these circumstances, relief will be restricted to the lower of the chargeable event gain and the previous chargeable events made whilst UK resident (if applicable).

UL PR 0040 | 11/22

CONCLUSION

A working knowledge of deficiency relief and the circumstances in which it can apply will offer the chance to add real value for your clients.

Some final points to note:

› Since 1 April 2008 deficiency relief is not available to companies or trustees.

› It is not possible for an individual to claim relief for any economic loss suffered on a bond.

› Nor can losses on one bond be set against a gain on another bond.

› Events that occurred whilst the policyholder was not UK tax resident (and thus subject to tax) are ignored

› Deficiency relief is only available for the tax year in which the bond is terminated.

TECHNICAL SERVICES
APRIL 2017

A WEALTH *of* DIFFERENCE