

Top-slicing relief for basic rate taxpayers (Lecture P1407 – 12.42 minutes)

Profits made on the surrender of certain life insurance policies are taxed as income. It is taxed as the top slice of income after taxing all other income.

But the profit often arises after holding the policy for many years, so the legislation recognises that it is unfair to tax it as one amount as a large profit could mean crossing a tax band.

Top slicing relief makes adjustment for this by calculating an annual equivalent profit, calculating the tax on this, then multiplying the tax by the number of years the profit was made over.

Life assurance gains are taxed like interest income and can utilise the PSA and starting rate band for interest if available. The gains carry 20% tax credit if the bonds are UK located.

If the investment is in offshore bonds there is no tax credit.

You will need to check calculations produced by your software to ensure it is correct – especially if the client is not a higher-rate taxpayer.

HMRC has claimed that TSR cannot be claimed by basic-rate taxpayers and that it effectively gives them multiple use of the personal savings allowance but there is nothing in the legislation to prevent this.

The legislation is contained at s535 and s536 ITTOIA 2005.

“535 Top slicing relief

- 1) An individual is entitled to relief under this section for a tax year if—
 - a) the individual's liability for the tax year, as calculated under subsection (3), exceeds
 - b) the individual's relieved liability for the tax year, as calculated under—
 - s.536 (top slicing relieved liability: one chargeable event), or
 - s.537 (top slicing relieved liability: two or more chargeable events).
- 2) The relief is given by a reduction in or repayment of income tax equal to the excess
 - 2A) If the relief is given by a reduction in income tax, it is given effect at Step 6 of the calculation in section 23 of ITA 2007.
- 3) An individual's liability for a tax year for the purposes of subsection (1)(a) equals $TL - BRL$, where—
 - TL is the amount of the individual's total liability to income tax on income charged to tax under this Chapter for the tax year, calculated on the basis that relief is available under this section and the highest part assumptions apply, and
 - BRL is the amount of income tax at the basic rate that the individual is treated as having paid under section 530(1) for the tax year.

- 4) For the purposes of subsection (3) and sections 536 and 537, the highest part assumptions, in calculating liability to income tax on an amount, are that—
 - a) the amount is the highest part of the individual's total income for the tax year, and
 - b) any provision directing any other amount to be treated as the highest part is ignored.
- 5) For the purposes of this section and sections 536 and 537, an individual's total income is treated as not including any amount which—
 - a) is charged to tax under Chapter 4 of Part 3 (profits of property businesses: lease premiums etc.) as the profits of a UK property business, or
 - b) counts as employment income under section 403 of ITEPA 2003 (payments and benefits on termination of employment etc.).
- 6) For the purposes of this section and sections 536 and 537—
 - a) any chargeable event under section 525(2) (chargeable events where annual personal portfolio bond calculations show gains),
 - b) any gain treated as arising on the occurrence of such an event, and
 - c) the amount of any liability to income tax arising on such a gain, are ignored.
- 7) For the purposes of the calculations mentioned in subsection (1) any relief under Chapter 2 or 3 of Part 8 of ITA 2007 (which relate to gift aid and other gifts to charities) is ignored.]
- 8) For the purposes of the calculations mentioned in subsection (1)—
 - a) section 25(2) of ITA 2007 (deductions of reliefs and allowances in most beneficial way for taxpayer) does not apply, and
 - b) reliefs and allowances are available for deduction from an amount that, for the purposes of those calculations, is the highest part of the individual's total income for the tax year only so far as they cannot be deducted from other amounts."

S.536 ITTOIA then sets out the calculation of the relief, and again, makes no mention of the relief only applying to higher-rate taxpayers.

Example

A client has general income of £35,000 and dividend income of £800 in 2023/24. They encash a single-premium offshore investment bond.

The certificate from the investment company shows a chargeable event gain of £9,080 and it was held by the client for 2 complete years.

Calculate the income tax payable by the client for 2023/24

Analysis

Tax liability ignoring top-slicing relief:

			<i>General</i>	<i>Interest</i>	<i>Dividends</i>
Income			35,000	9,080	800
PA			<u>(12,570)</u>	—	—
			<u>22,430</u>	<u>9,080</u>	<u>800</u>
Tax:	22,430	20%	4,486		
	1,000	0%	-		
	8,080	20%	1,616		
	<u>800</u>	0%	—		
	<u>32,310</u>		<u>6,102</u>		

Tax liability with top-slicing relief:

			General	Interest	Dividends
Income			35,000	4,540	800
PA			<u>(12,570)</u>	—	—
			<u>22,430</u>	<u>4,540</u>	<u>800</u>
Tax:	22,430	20%	4,486		
	1,000	0%	-		
	3,540	20%	708		
	4,540*		708*		
	<u>800</u>	0%	—		
	<u>32,310</u>		<u>5,902</u>		

* Divide the gain of £9,080 by 2 years – tax the result (£4,540) then multiply the tax by the 2 years again

By claiming TSR, the tax liability is £200 smaller. HMRC and 3rd party software do not calculate TSR where the taxpayer is a basic-rate taxpayer - this is incorrect.

Contributed by Malcolm Greenbaum