

Top slicing relief

(Lecture P1098 – 13.51 minutes)

Profits made on the surrender of certain life insurance policies are taxed as income. Such policy gains are savings income and are taxed as the 'top slice' of income after dividends.

As the policy gain forms part of taxable income for the year, it will result in a withdrawal of personal allowances if it takes total income above £100,000. [Editor note: there are top slicing relief calculators on the websites of many product providers that you can use to check your calculations. On more than one occasion I have found that these give the wrong tax figure as they do not restrict personal allowances where the policy gain takes income over £100,000. This is because some online calculators take the 'short cut' method of just taxing a 'slice' of the gain rather than treating the full gain as income. These glitches may have been rectified but you are advised to use these calculators with care.]

As the policy gain is savings income, it will qualify for the savings nil band (if this has not already been used against interest).

Policy gains carry a notional 20% tax credit that means that basic rate taxpayers making such gains will have no further liability.

However, it is unfair to tax the full amount of the policy gain in one tax year when, in reality, the profit accrues over the life of the policy. Relief for this inequity is given in the form of "top slicing relief".

Top slicing relief applies when the policy gain takes a taxpayer from one tax band into another. For example, it will apply when:

- (a) Other taxable income falls under the basic rate threshold, but the addition of the policy gain takes the taxpayer into the higher rates; or
- (b) Other taxable income falls to be taxed at the higher rates, but the addition of the policy gain takes the taxpayer into the additional rates.

Top slicing relief is not available where the policy-holder would still be a higher rate or an additional rate taxpayer even if the policy gain was ignored.

Tax software should calculate the top slicing relief. However it is important to check that the calculation is correct. The relief is automatic and a formal claim is not necessary.

Where there is only one policy gain, the process for calculating top slicing relief is as follows:

1. Calculate the policy gain. This is normally notified to the taxpayer by the life insurance company.
2. Calculate the extra tax payable on the policy gain by treating it as the top slice of income.

3. Deduct the 20% deemed tax credit.
4. Divide the policy gain by the number of complete years that the policy has been held. This gives the 'annual equivalent'. [The completed years should be shown on the chargeable event certificate provided by the product provider.]
5. Calculate the extra tax payable on the annual equivalent and deduct the deemed 20% tax credit on that annual equivalent. This gives the 'relieved liability'.
6. Multiply the relieved liability by the number of completed policy years.
7. The top slicing relief is the figure at step 2) less the result of step 6).

The top slicing relief is given by way of a deduction from the total tax liability for the tax year (before tax credits such as PAYE). All other tax reducers (e.g., EIS, VCT etc) are deducted before top slicing relief.

Example 1

Mr Robertson is employed on a salary of £40,000. On 1 July 2014, he invested £35,000 in a non-qualifying life insurance policy. On 15 September 2018, he surrendered it and received proceeds of £60,000. His other income for 2018/19 is bank interest of £3,000.

Tax liability 2018/19:

	Non-savings £	Savings £	Policy gain £
Earnings	40,000		
Interest		3,000	
Policy gain			25,000
Less: PA	<u>(11,850)</u>	<u> </u>	<u> </u>
Taxable	<u>28,150</u>	<u>3,000</u>	<u>25,000</u>
<u>Tax:</u>			
28,150	@ 20%		5,630
500	@ 0%		0
2,500	@ 20%		500
31,150			
3,350	@ 20%		670
34,500			
21,650	@ 40%		<u>8,660</u>
			15,460
Less: Top slicing relief (W)			<u>(2,010)</u>
Tax liability			13,450
Less: Tax credit on policy gain	£25,000 @ 20%		<u>(5,000)</u>
Tax due before PAYE			<u>8,450</u>

The policy gain is taxed as the top slice of total income, so the extra tax due on the gain is:

	£
Tax on policy gain £(670 + 8,660)	9,330
Less: Notional tax credit (£25,000 @ 20%)	<u>(5,000)</u>
Extra tax on policy gain	4,330
Annual equivalent of policy gain: £25,000 / 4	6,250
Extra tax on annual equivalent:	
£3,350 @ 20%	670
£2,900 @ 40%	<u>1,160</u>
	1,830
Less: Notional tax credit (£6,250 @ 20%)	<u>(1,250)</u>
Relieved liability	<u>580</u>
Relieved liability x policy years: £580 x 4	2,320
Top slicing relief:	
Extra tax on policy gain	4,330
Less: Relieved liability x policy years	<u>(2,320)</u>
Top slicing relief	<u>2,010</u>

Scottish Taxpayers

Scottish rates of income tax are paid by “Scottish Taxpayers” (broadly individuals whose main place of residence is in Scotland).

The Scottish rates apply to non-savings income only – i.e., employment income, rental income, certain trust income and pension income. They do not apply to savings and dividend income. Chargeable event gains made by individuals resident in Scotland are therefore taxed at the normal UK savings rates.

When calculating tax on savings income of Scottish taxpayers, we use the UK basic rate threshold of £34,500 (not the lower Scottish non-savings threshold).

This will mean that any top slicing relief computations will be the same for a Scottish taxpayer as they are for taxpayers living in the rest of the UK.

Example 2

Assume that in Example 1 above, Mr Robertson lived in Scotland. His tax liability for 2018/19 would be:

	Non-savings £	Savings £	Policy gain £
Earnings	40,000		
Interest		3,000	
Policy gain			25,000
Less: PA	<u>(11,850)</u>	—	—
Taxable	<u>28,150</u>	<u>3,000</u>	<u>25,000</u>
Tax:			
2,000 @ 19%			380
10,150 @ 20%			2,030
16,000 @ 21%			3,360
500 @ 0%			0
2,500 @ 20%			500
31,150			
3,350 @ 20%			670
34,500			
21,650 @ 40%			<u>8,660</u>
			15,600
Less: Top slicing relief (as above)			<u>(2,010)</u>
Tax liability			13,590
Less: Tax credit on policy gain £25,000 @ 20%			<u>(5,000)</u>
Tax due before PAYE			<u>8,590</u>

Contributed by Steve Sanders