

Taking money from a bond: individual policy surrender or partial surrender?

Briefing Note

Canada Life investment bonds offer the facility to divide the premium into a series of identical policies.

This means that clients wishing to withdraw part of their investment have a choice as to how to take it, either by taking a partial surrender or by surrendering individual policies.

Which way is best will depend on the client's circumstances at the time. Before deciding which option is suitable there are a number of factors to take into consideration.

Points to consider

One of the main benefits of an investment bond is tax deferral. Part surrenders of up to 5% of the total premiums paid, can be withdrawn without any immediate personal liability to tax. Any unused 5% allowance can be carried forward to future years.

Where the cumulative 5% allowance is exceeded a chargeable gain will occur. So, where a client withdraws a significant partial surrender a substantial chargeable gain could occur as there is no correlation between the gain and the growth on the bond.

Any withdrawal will be taken into account on the eventual full surrender or maturity of an investment bond or the death of the last surviving life assured.

The timing of the chargeable event also needs to be considered. Chargeable gains in respect of withdrawals are calculated at the end of the policy year, whereas gains on policy surrenders are calculated on the actual date of the event.

These dates may fall into different tax years, meaning that the tax bill is payable earlier. Also, if the client has fluctuating income the timing of the chargeable event may be crucial.

The entitlement to future 5% withdrawals also needs to be considered. If a full policy surrender is used the encashment of policies means that the 5% withdrawal will not be available on those policies in future.

For example, if a client starts with 100 individual policies of £1,000 each and surrenders 20 individual policies, their 5% tax deferred withdrawal allowance will immediately drop from £5,000 each year to £4,000.

Also, any 5% withdrawal allowance carried forward and not used in respect of previous years for the policies surrendered will be lost.

So which is best, a partial surrender or policy surrender?

It is truly 'horses for courses' and depends on the client's circumstances. As a general rule, if the amount required is less than the 5% withdrawal allowance, use that.

If the amount required is much higher than the 5% withdrawal allowance, or regular withdrawals have used it up, policy surrenders would normally be best.

And whilst not wishing to complicate matters further, in some cases the lowest chargeable gain figure can be achieved by taking a combination of withdrawal and policy surrenders.



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Examples			
a. 5% withdrawal covers the amount required		b. Large partial surrender	
Bond commenced	01/05/2012	Bond commenced	01/05/2020
Premium	£100,000	Premium	£100,000
Policies	100 at £1,000 each	Policies	100 at £1,000 each
Withdrawals to date	nil	Withdrawals to date	nil
Withdrawal required	£40,000 on 01/11/21	Partial surrender required	£72,600 on 01/11/21
Current surrender value	£160,000 (£1,600 each policy)	Current surrender value	£110,000 (£1,100 each policy)
Partial withdrawal		Partial withdrawal	
5% allowance	50% (including current policy year)	5% allowance	10% (including current policy year)
Allowance	£50,000	Allowance	£10,000
Partial surrender	£40,000	Partial surrender	£72,600
Chargeable gain	nil	Chargeable gain	£62,600
Date of chargeable event	not applicable	Date of chargeable event	30/04/22
Individual policy surrender		Individual policy surrender	
Amount required	£40,000	Amount required	£72,600
Number of policies encashed	25	Number of policies encashed	66
Gain for each policy	£600	Gain for each policy	£100
Chargeable gain	£15,000	Chargeable gain	£6,600
Date of chargeable event	01/11/21	Date of chargeable event	01/11/21
Top slice	£1,667	Top slice	£6,600
Tax year	2021/22	Tax year	2021/22
5% allowance now	£3,750 a year	5% allowance reduces from	£5,000 to £1,700 a year

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c. 5% withdrawal used up		Partial withdrawal	
Bond commenced	01/05/2017	5% allowance	0% (fully used)
Premium	£100,000	Allowance	nil
Policies	100 at £1,000 each	Amount required	£38,000
Withdrawals to date	Year 1 & 2 £5,000 (taken in July each year)	Chargeable gain	£38,000
	Year 3 £6,000 taken in July (1,000 chargeable gain 30/04/20)	Date of chargeable event	30/04/22
	Year 4 & 5 £5,000 (taken in July each year)	Top-slice	£19,000
Partial surrender required	£38,000 on 01/11/21	Tax year	2022/23
Current surrender value	£95,000 (£950 each policy)	Individual policy surrender	
		Amount required	£38,000
		Number of policies encashed	40
		Gain per policy	£200*
		Chargeable gain	£8,000
		Date of chargeable event	01/11/21
		Top slice	£2,000
		Tax year	2021/22
		5% allowance reduces from £5,000 to £3,000 per year	

*This gain arises because the calculation on a policy surrender takes into account the previous withdrawals on each policy.

This document is based on Canada Life's understanding of applicable UK tax legislation and current HM Revenue & Custom's practice, as at April 2021 and could be subject to change in the future. It is provided for professional advisers only. Any recommendations are the adviser's sole responsibility.



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