Should you top up an existing bond?
We explore

Key takeaways:

- Learn how to compare the 5% tax deferred withdrawal allowances as they apply to separate investment bonds and to a single policy that has been topped up (incremented)
- Compare how top-slicing relief applies to separate bonds and a single policy that has been incremented

Category:
Investment and tax

We explore some of the key tax-planning issues associated with the decision to either increment an existing investment bond with an additional premium or establish a new policy.

Case study

Albert Smith has had a particularly good year, providing body piercing services to rock stars. He decides to invest some of his profits. He takes out an investment bond with ABC Life, for a premium of £50,000.

Five years later, Albert's mother dies, and his share of the inheritance is £200,000. He wants to invest this money for his retirement. He has enjoyed the simplicity of the investment bond: tax deferral, no tax reporting, ease of administration and being able to switch funds and re-balance his portfolio without tax considerations. So, he decides to invest the £200,000 into an investment bond.

Should Albert take out a new investment bond or top up his existing bond? Let's compare the two scenarios.

1. New bond

5% tax deferred withdrawals:

- Each policy will have its own 5% tax deferred allowance
- 5% of initial premium into each policy
- The cumulative entitlement based upon policy years of each policy

Top-slicing relief:

- On surrender, Albert may benefit from top-slicing relief
- The relief will be calculated separately for gains from the separate bonds
- The top-slice divisor will be the full number of years each policy has been in force (or it may be the number of years since the previous chargeable event gain in respect of part surrenders)

2. Top up the existing bond

5% tax deferred withdrawals:

- Each increment will have its own 5% tax deferred allowance
- 5% of each premium/increment
- Cumulative entitlement based upon policy years of each premium/increment

Top-slicing relief:

- The top-slicing relief calculation will be based upon one policy
- The top-slice divisor will be the full number of years the policy has been in force (or it may be the number of years since the previous chargeable event gain in respect of part surrenders)
- There is no separate top-slice divisor for each premium/increment

Note: the top-slice divisor in respect of offshore bond gains from part surrenders will depend upon whether the policy was taken out pre or post 6 April 2013, or was taken out pre 6 April 2013 but has since been varied. Essentially, for pre 6 April policies that have not been varied, the top slice divisor is the number of complete years the policy has been in force. For post 6 April policies or pre 6 April 2013 policies that have been varied since 6 April 2013, the top slice divisor for part surrenders is the number of complete years since the previous chargeable event.

Case study (continued)

Just over 10 years after Albert invested the £200,000 (and fifteen years since he invested the initial £50,000), he retires and wants to supplement his retirement income with withdrawals from his investments. The investment bond is now in its sixteenth policy year..

Assuming growth at around 6% pa

£50,000 initial premium value	£120,000
£200,000 additional investment current value	£360,000
Total	**£480,000**

Albert's cumulative 5% tax deferred allowances

£50,000 x 5%x 16 years	£40,000
£200,000 x 5% x 11 years	£110,000
Total	**£150,000**

This outcome is the same, whether Albert has two policies or has one policy that he has incremented. But what about top slicing?

Let's assume Albert fully surrenders the polices:

Top-slicing relief:

Separate policies

Policy 1	
£120,000 – £50,000	£70,000 gain
Divided by 15 years top-sliced gain	£4,667
Policy 2	
£360,000 – £200,000	£160,000 gain
Divided by 10 years top-sliced gain	£16,000
Total combined top-sliced gain	**£20,667**

One policy

£480,000 – £250,000	£230,000 gain
Divided by 15 years top-sliced gain	**£15,333**

The top-sliced gain on the single policy is **£5,334 less** than the total combined top-sliced gains from two policies.

It is likely to be advantageous to increment an existing policy due to the way the top-sliced gain is calculated.

Of course, there may be reasons to establish separate policies. These might include:

- The existing policy having highly restricted investment options
- The existing policy provider being closed to new business and not allowing increments
- In relation to a settlement into trust, if the tax issues associated with incrementing existing trusts outweigh the top-slice advantages discussed above

For more information refer to our article on "Should you choose a new trust or top up?