

Time apportionment relief for offshore policies

Introduction

Those who spend some time resident outside of the UK may be able to benefit from an important tax relief available to holders of offshore life assurance policies and offshore capital redemption policies.

Where a UK income tax liability arises for an offshore policy, HM Revenue & Customs makes allowance for certain periods of non-UK residence, potentially reducing any chargeable gain. This is called time apportionment relief (TAR).

The rules

The rules on TAR changed in 2013. As such there are:

1. Pre-6th April 2013 rules, and
2. Post-5th April 2013 rules

Which rules apply?

The post-5th April 2013 rules will apply to offshore policies issued after that date. The rules will also apply to offshore policies issued before 6th April if varied so as to increase the benefits (for example, if 'topped up'), if assigned (including to or from a trust), or if the policy was used as security for a debt after 5th April 2013. Simply continuing to pay premiums under a regular premium policy will not constitute a variation.

The pre-6th April 2013 rules will apply to other offshore policies (i.e. those issued before 6th April 2013 which have not since been brought into the post-5th April 2013 rules). Under these rules, the gain from an offshore policy can be reduced for the period before the chargeable event in which the policyholder was not UK resident. TAR is not available if the policy has ever been owned by non-UK resident trustees or a foreign institution (unless the trustees held the policy on 19th March 1985 or the institution held it on 16th March 1998).

The post-5th April 2013 rules

The post-5th April 2013 rules focus on the residence history of the individual who is liable to income tax when the chargeable event takes place.

The 2013 rules introduced the concept of the 'material interest period'. In order for TAR to be available, the individual liable to tax must have been non-UK resident for at least part of this material interest period.

The material interest period is the number of days the policy has been in force prior to the chargeable event in which the individual:

1. Beneficially owns the policy
2. Is the settlor of a non-charitable trust which owns the policy
3. Has used the policy as security for his or her debt

If the individual's spouse or civil partner assigned the policy to that individual while they were living together it may be possible to increase the material interest period. In such a case, the material interest period can be increased by the period to which any of the three conditions above applied to the assignor. It is not possible to add any period which has already been taken into account in the assignee's material interest period – this avoids any overlap, or 'double-counting'.

It is possible for the legal personal representatives of a deceased individual's estate to benefit from TAR, if for example, they surrender a policy following the deceased's death.

Example one

Barry (a UK 'expat') applied for an offshore bond which started on 6th April 2014. At the time he lived in the United Arab Emirates with his wife, Hannah. He assigned the policy to Hannah on 1st December 2014. If Hannah were to surrender the bond in the future after becoming UK resident, the prior material interest period for Barry will be added to that of Hannah.

Calculations under the post-5th April 2013 rules

In order to establish the amount of the TAR the following formula is used:

$$\text{Full gain} \times \frac{\text{No. of days during the material interest period on which the individual is not UK resident}}{\text{The number of days in the material interest period}}$$

Example two (Based on the same facts as Example one)

Hannah (because of unforeseen circumstances) returns to the UK, becomes UK resident on 6th April 2015 and surrenders her policy on 1st September 2015. The material interest period is calculated as follows:

	Dates	Number of days
Barry's material interest period	6 April 2014 to 30 November 2014	239
Hannah's material interest period	1 December 2014 to 1 September 2015	275
Hannah's days of non-residence in her MIP	1 December 2014 to 6 April 2015	127

The TAR, therefore, is:

$$\frac{239 \text{ days} + 127 \text{ days}}{239 \text{ days} + 275 \text{ days}} = \frac{366 \text{ days}}{514 \text{ days}} = \text{reduction in gain of 71.2\%}$$

As mentioned above, where a policy subject to the post-5th April 2013 rules is held in a non-charitable trust, the settlor may be able to benefit from time apportionment relief in the event of a chargeable gain.

Example three

Cedric is the settlor of a discretionary trust which he created on 6th April 2013. The trustees invested into an offshore bond the same day. The trustees surrender the bond after 10 years giving rise to a chargeable gain. At the time of the surrender Cedric is UK resident, however during the interim he spent seven years resident abroad. As a UK resident settlor, Cedric is liable to income tax on the gain however, he will be eligible for time apportionment relief for the seven years he was not UK resident.

Calculations under the post-5th April 2013 rules

The concept of the material interest period does not apply to the pre-April 2013 rules.

In order to establish the amount of the TAR the following formula is used:

$$\text{Full gain} \times \frac{\text{Number of days policyholder not resident in the UK}}{\text{Number of days the policy is in force until the chargeable event occurs}}$$

Applying TAR to reduce the gain

Once the TAR has been calculated under either of the sets of rules, the amount of the relief can be deducted from the full gain, to arrive at amount of the reduced gain.

Example four

If Hannah (from Example two) makes a chargeable gain on her bond of GBP 20,000 and has TAR of 366 days/ 514 days, her reduced gain will be:

$$\text{GBP } 20,000 - (\text{GBP } 20,000 \times 366/514) = \text{GBP } 5,758.75$$

Chargeable event certificates

The amount of any TAR is not shown on chargeable event certificates. As such, it will be up to the person liable for any income tax (with the help of their professional advisers, if necessary) to calculate the amount of the reduced gain.

Top slicing relief

Once the gain has been reduced by any TAR, there is still the potential to benefit from top slicing relief.

Top slicing under the pre-6th April 2013 rules

Where the pre-6th April 2013 rules apply, the number of complete years the policyholder was non-UK resident is deducted from the complete number of years the policy has been in force. This gives the number of years by which the reduced gain may be divided for top slicing.

Example five

Tom surrenders his offshore bond in the tax year 2015/16. He makes a gain of GBP 200,000. Having been non-UK resident for the first **six years** of the 10 years he held the policy, his reduced gain after TAR is GBP 80,000.

Tom is a UK resident at the time of the surrender. His other taxable income (after allowances) leaves him with GBP 3,785 of basic rate band available. Tom is eligible to benefit from top-slicing relief as follows:

Number of years the policy was in force	10 years
LESS the number of years Tom was Non-UK resident	(6 years)
Number of years available for top slicing	4 years

Divide the reduced gain by the number of years available:

GBP 80,000 / 4 years = GBP 20,000

Then calculate the amount subject to higher rate tax:	GBP
Amount of top sliced gain	20,000
LESS Amount of basic rate band available	(3,785)
Amount liable to higher rate tax	16,215

Therefore the amount of tax is calculated as follows:

The tax on the slice is:	GBP 16,215 @ 40%	6,486
Plus	GBP 3,785 @ 20%	757
Total tax on slice		7,243
Therefore the total tax on gain is		28,972
(GBP 7,243 x 4 years)		

This represents approximately 14% of Tom's original gain of **GBP 200,000**

Top slicing under the post-5th April 2013 rules

Where the post-5th April 2013 rules apply, it is the number of complete years consisting of days during which the individual was non-UK resident AND had a material interest in the policy which may be deducted from the complete number of years the policy has been in force. (See above for details of the material interest period.) The reduced gain may be divided by this number of years.

In addition, for the post-5th April 2013 rules, where the policy has been assigned between spouses or civil partners who live together, both of their material interest periods may be added together for the top slicing calculation.

When the post-5 April 2013 rules apply the number of years available for top slicing is reduced by the number of complete policy years made up of the days in the individual's material interest period whilst they were non-UK resident.

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