Factsheet – Offshore Bond

What is an Investment Bond?

An investment bond is non-qualifying single premium whole of life policy providing an element of life cover and the potential for capital growth. The life cover is provided in the form of an enhanced death benefit usually 101% of the value of the bond.

The investment bond is effectively a 'tax wrapper'. Within this 'wrapper' you can select individual funds to invest into and switch between funds without any tax consequences. The actual range of funds available will depend on the investment bond provider.

An insurance bond is a 'non-incoming producing asset'. This simply means that, as far as HMRC are concerned, the investment bond does not produce any income but only capital growth.

An Offshore Bond is essentially an investment bond written outside of the UK.

A chargeable event

Investments are subject to income tax and a tax liability may arise whenever there is a chargeable event. A chargeable event is triggered on:

- Death of the life assured (or last to die of lives assured) where benefits are payable
- Assignment (full or in part) for money or money's worth
- Maturity of the policy
- Partial or regular withdrawals across a whole bond, in Excess of the 5% tax deferred allowance
- Surrender of the bond, whether in full or surrender of clusters

The amount of tax you pay will depend upon your income tax rate.

There are 2 types of investment bonds:

1. Life Assured Bond – a life assurance bond must have a life assured or lives assured. It can be set up with:

    a. single or joint owners - with a single life assured or with joint lives assured on either a first death or last survivor basis
    b. on an own life or life of another basis - with a single life assured or with joint lives assured on either a first death or last survivor basis
    c. or with multiple lives assured.

    The bond will have to come to an end when the last of the lives assured dies. The lives assured does not necessarily need to include the policyholder.

2. Capital redemption bond – with a capital redemption bond, there are no lives assured and therefore, the bond does not need to come to an end due to death. They do however have a maximum term of 99 years.

Most investment bonds are written as a series of identical policies or segments and each segment is treated as a separate policy in its own right. This allows flexibility when withdrawing lump sums.

Withdrawals and the 5% tax deferred allowance

All investment bonds have a '5% tax deferred allowances'. The 5% tax deferred allowance means that you can take an 'income' of up to 5% of the original investment each year without any immediate liability to tax, or having to declare anything on your tax return. This can be done for up to 20 years and the logic behind this rule is that the HMRC considers the 5% tax deferred allowance to be the repayment of your original capital rather than any income or gain as such.

You can also carry forward these 5% tax deferred allowances each year. For example, you can leave the bond untouched for 5 years and then take 25% of the original investment without any immediate tax charge at that time. Please note the 5% tax deferred allowances refer to 5% of the *original* investment, not 5% of the value of the bond at the time.

Withdrawals in excess of 5% per year will trigger a chargeable gain event and there is an immediate potential tax liability.

Any ongoing adviser fees will utilise part of this 5% allowance.

Withdrawals

There are three ways of withdrawing lump sums from an investment bond:

1. Partial surrender across all of the segments held within the bond – if the amounts withdrawn are within the 5% tax deferred allowance, then there is no immediate liability to tax.
2. Full encashment of whole segments held within the bond – this gives rise to a chargeable event and a potential liability to tax. This also reduces the 5% tax deferred allowance available in future as the number of segments will be reduced.
3. Combining both methods

Assignment

An investment bond, or any of its segments, can be assigned. An assignment is a change of ownership of an investment bond (or its segments); the change of ownership has to be supported by a legal document – a deed of assignment.

The assignment has to be outright and unconditional. Provided it is not for money or money's worth, it does not trigger a chargeable event and does not give rise to an income tax charge. Subsequent chargeable event gains are assessed on the assignee (new owner).

How Gains are taxed

Income tax is only potentially payable when a chargeable event has occurred. Capital Gains Tax does not apply to policy holders.

A key feature of an investment bond is that when investments are changed within the bond wrapper, there is no liability to tax for the policy holder.

With an offshore bond, these are usually established in jurisdictions which impose no tax on the income and gains of the underlying funds – this is known as gross role up. Growth may not be entirely tax free however, due to the impact of irrecoverable withholding tax which may be deducted from interest and dividends received within the fund.

When an offshore policy is surrendered an individual can be charged income tax at nil if the personal allowance is available; starting rate 0%; basic rate 20%, higher rate 40% and additional rate 45%. Top slicing relief is available for the higher rate and additional rate calculations which may assist in reducing the rate of tax charged.

Effective from 6 April 2016, a new personal savings allowance was introduced. Each individual has an annual savings allowance of £1,000 unless he/she has any higher rate income for the year (in which case the allowance will be £500) or any additional rate income (in which case the allowance will be nil). 'Savings income' includes gains on offshore bonds.

Top Slicing

Top slicing relief is generally available where the taxpayer would be liable to tax at a lower rate were it not for the inclusion of the chargeable event gain in their income for the year.

When the chargeable event gain does not move a taxpayer into a higher tax rate, there may be still be some top slicing relief available due to the effect of the personal savings allowance nil rate and the starting rate for savings.

The gain is essentially sliced by the number of complete years the bond has been in force, unless the event is triggered by an excess event in which case you go back to the last excess event if the policy was set up or amended after 6th April 2013 (policy holder being a UK resident throughout). The slice is then added to other income to determine the split between 20/40/45% tax.

If, when the slice is added, income **remains** within the 20% or 40% tax band, then 20% or 40% will be due on the whole gain. If however the slices pushes you into the 40% or 45% bracket, a full top slicing calculation will need to be performed to determine the effective rate of tax that will be applied to the whole gain.

The calculation essentially follows a 5 step process and takes into account your income from all sources, the outcome of which will determine the level of tax due and whether top slicing relief has been successful in bringing the gain taxable at a lower rate.

Whilst top slicing relief is available to mitigate a higher rate or additional rate income tax liability arising as a result of a chargeable event gain being added to the taxpayer's total income. It does not:

- Reduce income for the purposes of child or working tax credits (instead the full amount of the gain is included).
- Reduce income below £100,000 to preserve full entitlement to the personal allowance.
- Apply to personal representatives, corporate's or trustees. However, for the avoidance of doubt where a gain arises on a trust held policy and the creator is chargeable then that person would be eligible for top slicing relief. In contrast, where the creator is deceased or non resident and the trustees are non resident then a UK beneficiary receiving a benefit from the trust is taxable on that amount - if so, top slicing relief is not available.
- Apply to annual gains that arise on 'personal portfolio bond events.'