A guide to Offshore Investment Bonds

What is an Offshore Investment Bond

Offshore bonds and protection products are 'foreign policies of life insurance and foreign capital redemption policies' for UK tax purposes (Section 476 of the Income Tax (Trading & other Income) Act 2005). From 17 November 1983, a policy issued by a non-UK life office will be 'non-qualifying' for tax purposes, meaning all gains are potentially taxable. Similarly, UK investment bonds are also non-qualifying. Indeed, the same tax legislation determines the tax treatment of these respective policies.

Taxation benefits

Individuals liable for tax on a gain on a UK onshore bond are treated as having paid tax on the gain at basic rate (currently 20%). The reason for this is that the underlying fund is taxed. As a result, tax is only payable by those individuals with a marginal rate of 40% or 45%. In contrast, offshore policies can be issued by life companies based in jurisdictions which impose no tax on the income and gains of the underlying funds (such as Isle of Man Ireland and The Channel Islands) – this is known as 'gross roll-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 by the fund.

The rules of a bond are identical to an onshore Investment Bond apart from the way in which tax applies on what is known as a chargeable event (see further down)

Taxation benefits

Any gains from offshore bonds are treated as 'savings income'. Therefore, non-taxpayers can offset their personal allowance, the annual savings allowance and personal savings allowance against any gains made. (Under current legislation). This means that if the total gain is within all these allowances, there would be no further income tax liability and therefore it could be an ideal investment for non-taxpayers.

Tax deferred withdrawals

A client can take up to 5% of the original investment annually where tax is deferred until the bond is ultimately surrendered or 100% of the original investment has been withdrawn. Therefore, someone with £300,000, to invest, could take an annual withdrawal of £15,000 for 20 years without having to pay any income tax, at the time of withdrawal.

If a client has not taken all or any of their withdrawal entitlement in one year, then they can use the accumulated unused withdrawals in another year. i.e., A client does not need any withdrawals until year 10, they could withdraw 50% of the original investment, without any immediate tax liability.

An investment bond is normally split into several segments and the client has the option to fully surrender either individual segments or partially surrender several segments depending on their tax position.

Chargeable Gains

Gains arising on a non-qualifying single premium whole of life assurance policy – such as an Investment Bond issued by either a UK or offshore life office - will be taxed in accordance with legislation contained within Chapter 9 of Part 4 of Income Tax (Trading and Other Income) Act 2005.

Under the relevant provisions of the above Act – an Investment Bond that produces a gain will be subject to income tax rather than capital gains tax.

- A chargeable event can occur on the following:
- Death of the last life assured under the policy.
- Full surrender of the policy
- Certain part surrenders of the policy
- Assignment or part assignment of the policy for money or money's worth
- Maturity of the policy

If the gain when added to an individual's income, exceeds the personal allowance, then a calculation needs to be made to ascertain the rate at which the gain needs to be taxed. It is calculated in the following way:

- Calculate the overall gain, i.e., fund value less initial investment.
- Add back in any previous withdrawals, which then provides the overall gain.
- The total gain is then divided by the number of complete policy years the bond has been held (known as top slicing)
- This provides us with the average gain.

The average gain is then added to all other income to determine the rate of income tax you will pay on the whole gain. i.e., a basic rate taxpayer will pay 20% on the whole gain.

Time Apportionment Relief

Time apportionment relief can be used where the client has been non-UK resident for a period whilst holding the offshore bond. This allows the gain to be proportioned between the days spent as a UK resident and non-UK resident, therefore reducing the ultimate tax payable.

An offshore bond offers simple administration. There is no income tax reporting requirement until there is a chargeable event – and normal chargeable event rules apply.
Funding options – with open architecture and access to platforms and Discretionary Fund Managers (DFM), you can invest in virtually any collective fund – so there will be something to suit any client's risk profile and preferences.

For clients who like to switch funds, there is no liability to capital gains tax (CGT) every time a switch is made – which means that a client cannot utilise their CGT annual exemption to reduce gains on offshore bonds.

Other features

Some products also offer the following features:

- The ability to assign the whole policy or policy segments to other individuals without incurring an immediate tax charge. Any tax charge by assignment would fall on the new policy owner when they fully or partially encash the bond. Therefore, this can be ideal for higher taxpaying spouses to assign across to a lower taxed spouse. Segments can also be assigned to a trust for the benefit of children under the age of 18.

- Some providers allow their bonds to be placed into trust at a later date, this allows individuals that originally needed control and access to their bond to place the bond into trust at a later date when the money is no longer needed.

- Some companies offer a capital redemption bond, which means there is no life assured, so the bond can be continued for up to 99 years (the life of this type of bond). The individual(s) who set the bond up are the policy owners and can decide when the bond is encashed or transfer it or segments to other individuals. This is particularly useful to Trustees.

Notes

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