

OFFSHORE BONDS TAX PLANNING FOR PRIVATE INDIVIDUALS

The tax treatment of an Offshore Bond offers significant scope for tax planning and, in many circumstances, legitimate tax mitigation.

What is an Offshore Bond?

An Offshore Bond is an investment wrapper, which facilitates investment in a wide range of investment funds.

Offshore Bonds benefit from 'gross roll-up', which means that investment gains and income are able to accrue within the Bond free of tax (apart from an element of withholding tax). Over the longer term this has a compounding effect on returns, as additional growth can be gained on the untaxed income and gains within the Bond.

Any personal tax liability is deferred until the Bond is encashed (or partially encashed), at which point any gain is taxed at the investor's marginal rate of income tax. This tax deferral allows scope to plan for how and when any such tax liability may be incurred, so that the most tax-efficient result can be achieved.

For example, a higher rate taxpayer may defer the encashment until such a time as they become a basic rate taxpayer. Alternatively, they may assign the Bond to a non-working spouse or children prior to encashment.

A further benefit of an Offshore Bond is that investors are permitted to draw up to 5% of the original investment each year until such time as all their original investment has been returned (e.g. 5% per annum could be taken for 20 years) without incurring an immediate tax liability. Indeed, this allowance is cumulative, so if no withdrawals are made in the first 4 years, for example, 25% of the amount invested can be taken in year 5 without triggering a tax charge. This can provide a highly tax-efficient source of income to supplement a pension in retirement, for example.



Finally, individuals may benefit from time apportionment relief in respect of any time spent resident outside the UK.

For example, if an individual has been non-resident in the UK for half the time that the Bond is held for, the amount of gain that is chargeable to tax will be reduced by half.

What will my money be invested in?

An Offshore Bond permits investment in a wide range of collective investment funds, from fixed interest and property to UK and overseas equities.

Cash savings accounts can be accessed through an Offshore Bond. Again this has the benefit that

interest accrues tax-free and the investor is able to control the timing of any personal tax liability.

Example

Clive has £100,000 in a savings account but is reviewing his finances, as he falls under the new 50% tax regime.

He transfers his £100,000 to a 3 year fixed rate savings account with ABC Bank at an interest rate of 4.15% p.a. He invests through an Offshore Bond.

After 3 years, Clive's Bond is worth £113,000. He decides to withdraw the gain he has made to date in order to fund the purchase of a new car. As he is permitted to take up to 5% of the amount invested for every year the Bond is in force, he has no tax to pay at the time of this withdrawal. Clive transfers the residual £100,000 into investment funds within his Offshore Bond.

Further down the line, Clive's Bond is worth £125,000. He now wants to use these monies to fund his twins' university education. Clive can encash the Bond, in which case he will pay tax at his marginal rate on the £25,000 gain plus the previous withdrawal of £13,000.

Alternatively, Clive can assign segments of the Bond to the twins. The twins can then encash these segments and, as they have no other income of note, they can each realise a gain equal to the amount of their unused Personal Allowance free of tax with any gain above this amount being subject to tax at 10% (if earned income is

sufficiently low) and 20% (based on 2010/11 rates).

Next steps

For further information or to discuss whether this option may be appropriate for you, please contact us so we may refer you to our independent financial adviser.

Creaseys LLP
12 Lonsdale Gardens
Tunbridge Wells Kent TN1 1PA
01892 546546
www.creaseys.co.uk