Technical

Taxation of offshore bonds

For financial advisers only

The purpose of this guide is to provide you with information around the use of offshore bonds as an investment vehicle for investors who may be UK resident in the future.

Offshore bonds are designed to accumulate income and gains without any immediate tax liability for a UK tax resident. This is because RL360° is not subject to tax in the Isle of Man on policyholder funds. Consequently, the owners of such bonds do not have an ongoing liability to tax if benefits are not taken. There is no capital gains tax liability on switching between the underlying funds, should investment conditions and/or individual circumstances change. The policy allows for gross roll-up of investment income and capital gains.

Tax efficiency

Tax events on offshore bonds are called chargeable events. These most commonly arise where there has been an excessive withdrawal or one or more policies has been surrendered. Examples and scenarios related to these types of events are detailed in this guide.

There are, however, a number of reliefs/options available which could reduce or even remove a tax liability altogether.

There are other events which may give rise to a tax liability being incurred by an investor such as death of the last life assured, assignments for money or money's worth and maturity of a capital redemption bond (no lives assured). If you require further information on these type of events or a more detailed overview of any of the subjects below please view our *Guide to offshore bonds*.

Partial withdrawal or segment surrender

Most offshore bonds can be issued as multiple policies (normally up to 100 individual segments), each segment represents a policy in its own right. This affords greater flexibility especially when it comes to Income Tax and estate planning.

It is possible to withdraw up to 5% of the total premiums paid into a bond each policy year for 20 years, without incurring an immediate liability to income tax. If the 5% allowance is not fully used in a given policy year, the unused allowance carries forward to the next policy year on a cumulative basis. There is no need to detail these withdrawals on a self-assessment tax return until the bond is surrendered or withdrawals in excess of the 5% allowance are taken.

Where the cumulative 5%'s have been fully utilised, the surrendering of segments can sometimes result in a lower Income Tax liability. This is because only the gain on each segment is liable to Income Tax as opposed to a partial encashment where the entire excess over the cumulative 5% allowance is subject to tax.

Example:

Diana invested £100,000 into an offshore bond just over three years ago. Since the policy was opened no withdrawals have been taken and the policy value is now, in the 4th policy year, worth £120,000. Diana needs £30,700 from the policy to help her son towards the purchase his first home. She decides to take the money from her offshore bond:

As a withdrawal:

- 4 years x 5% (of £100,000) = allowance of £20,000
- £30,700 - £20,000 = excess amount of £10,700

As a segment surrender (assuming issued with standard 100 segments)

- £100,000 (Original premium) / 100 segments = One segment original value of £1,000
- £120,000 (current value) / 100 segments = One segments current value of £1,200
- 30,700 / £1,200 (round up) = 26 whole segments must be surrendered to raise enough for payment.
- £1,200 - £1,000 = £200 gain on each segment
- £200 x 26 segments = £5,200 gain on surrender of 26 segments

The withdrawal creates a chargeable excess of £10,700 and the segment surrender creates a chargeable gain of £5,200

Another example of where it may be more prudent to take capital via segment surrender is where the client is non-UK resident and needs to take a large withdrawal just prior to returning to the UK.

Any tax liability on a segment surrender is immediate, whereas the liability on a withdrawal in excess of the cumulative 5% allowance is deemed to occur at the end of the policy year in which it is taken (by which time the client could be resident for Income Tax purposes in the UK and be left with an unexpected and unnecessary tax bill).

You can count on us

Time apportionment relief

This relief applies where an offshore bond is held by a chargeable person who is UK resident for only a part of the period between the policy's inception and the chargeable event.

Where this happens, any chargeable gain is proportionately reduced based on the number of days absent from the UK divided by the number of days since the policy commenced.

Example:

James is a non-UK resident when he makes a £100,000 single premium investment. He returns to live in the UK in 5 years' time

$$\frac{\text{Total number of days policyholder is UK resident x GAIN}}{\text{Total number of days policy in force}}$$

The investment

- £100,000

The surrender

- Policy is fully surrendered in year 10 with a total surrender value of £210,000

The gain subject to tax

- Gain is £110,000

less

- Non-residents relief 5/10 years (50%)
- Chargeable gain is £55,000 (or 50% of original gain)

Top slicing

Top slicing can be applied where the gain pushes a basic rate taxpayer into the higher rate bracket. If, after adding the slice to the other taxable income, they remain within the basic rate tier, then the whole gain would be subject to income tax at 20% (for the 2016/2017 tax year).

If they are already a higher rate taxpayer, then top slicing will have no effect as higher rate tax would be paid on the whole of the gain.

Onshore bonds can also benefit from top slicing, however, it is only available going back to the date of the last chargeable event and not back to the start of the bond. This highlights another potential benefit of an offshore bond.

Example:

John has £29,000 of taxable income and has made a gain of £15,000 on his offshore bond, which he has held for 3 complete policy years.

The top sliced gain equals £15,000 divided by 3, resulting in a £5,000 slice.

John's total taxable income is £29,000, and the higher rate threshold for 2016/2017 is £32,000. Effectively, part of the slice is within the basic rate and part is within the higher rate. Top slicing allows tax to be applied proportionately at different rates on each slice.

As a result £3,000 is within the basic rate of tax and £2,000 within the higher rate.

- £3,000 x 20% = £600
- £2,000 x 40% = £800

The total tax on the slice is £1,400 (£600 + £800) which is effectively a tax rate of 28% ((£1,400/ £5,000) x 100). As the bond has been in force for 3 policy years, £1,400 is multiplied by 3 to arrive at the final tax payable on the gain of £4,200.

Important notes

For financial advisers only. Not to be distributed to, nor relied on by, retail clients.

Please note that every care has been taken to ensure that the information provided is current and in accordance with our understanding of current law and Her Majesty's Revenue and Customs' (HMRC) practice as at April 2016. You should note however, that we cannot take upon the role of an individual taxation adviser and independent confirmation should be obtained before acting or refraining from acting upon the information given. The law and HMRC practice are subject to change.

Issued by RL360 Insurance Company Limited. Registered Office: RL360 House, Cooil Road, Douglas, Isle of Man, IM2 2SP, British Isles. Telephone: +44 (0)1624 681681. Telephone calls may be recorded. Website: www.rl360.com. RL360 Insurance Company Limited is authorised by the Isle of Man Financial Services Authority. Registered in the Isle of Man number 053002C.