

Unlocking the *tax advantages* of offshore bonds

With the October UK budget changes shaking things up, the landscape for financial planning has become increasingly complex. Investors are on the lookout for smart ways to help boost their finances, and offshore bonds have emerged as a crucial tool in this environment. They could offer significant tax advantages and flexibility, making them an attractive option for a diverse range of investors, from high-net-worth individuals to retirees.





Understanding offshore bonds

Offshore bonds are investment vehicles issued by insurance companies outside the investor's home country. These bonds offer a tax-efficient wrapper, allowing investments to grow without immediate taxation.

This feature, known as gross roll-up, means that income and gains within the bond are not taxed until they are withdrawn, providing a significant advantage for potential long-term growth.

Key benefits of offshore bonds

- **Tax efficiency:** Offshore bonds allow investors to defer taxes on the bond's growth until withdrawals are made. This can be particularly advantageous for those who expect to be in a lower tax bracket in the future, such as during retirement. By deferring taxes, investors can help maximise the compound growth of their investments, leading to potentially higher returns over time.
- **Flexible withdrawals:** Investors can withdraw up to 5% of their initial investment each year without an immediate tax charge. This allowance can be carried forward, providing a steady stream of tax-efficient income. This flexibility is especially beneficial for those who need to supplement their income periodically without incurring significant tax liabilities.

- **Estate planning and wealth transfer:** Offshore bonds are valuable tools for estate planning. They can be assigned as gifts without incurring capital gains tax or placed in trusts to manage inheritance tax liabilities. This makes them ideal for transferring wealth to future generations in a tax-efficient manner. By using offshore bonds in estate planning, investors can help ensure that their assets are passed on with minimal tax impact, preserving more wealth for their heirs.

Who should consider offshore bonds?

Offshore bonds are not a one-size-fits-all solution, but they offer unique benefits for specific types of investors:

- **High-net-worth individuals:** For those with significant wealth, offshore bonds provide a means to diversify investments and help optimise tax planning. They can access a broader range of investment opportunities and benefit from the tax deferral features of offshore bonds.
- **Retirement savers:** Individuals planning for retirement can use offshore bonds to help grow their savings in a tax-efficient manner, aligning withdrawals with periods of lower income. This strategy could enable retirees to manage their tax liabilities more effectively and ensure a steady income stream during retirement.

Strategic tax planning with offshore bonds

Several strategies can help enhance the tax benefits of offshore bonds:

- **Tax deferral:** Offshore bonds allow you to defer taxes on the bond's growth until you make withdrawals. This can be particularly advantageous if you expect to be in a lower tax bracket in the future. By deferring taxes, you can take advantage of compounding growth without the drag of annual tax payments.
- **5% withdrawal allowance:** Investors can withdraw up to 5% of the initial investment annually without immediate tax implications, deferring tax until the total withdrawals exceed the initial investment. This feature provides a flexible and tax-efficient way to access funds when needed.
- **Assignment:** A unique advantage of investment bonds is the ability to move the tax point away from the original owner to another individual without creating a tax liability, and this is not restricted to spouse/civil partner. When the bond is cashed in, any gains will be assessed on the new owner. This strategic planning benefit can be used with investment bonds held individually or within a trust and, coupled with an effective exit strategy, can help reduce the tax payable on a gain.
- **Trusts:** Investment bonds are an excellent investment vehicle for certain types of trusts. They are deemed to be a non-income producing asset, which can make trust administration much simpler as well as more tax efficient.

Practical tips for maximising benefits

- **Tax planning:** With the capital gains tax (CGT) allowance reduced, investors with unwrapped portfolios might face higher taxes sooner. Offshore bonds can help mitigate this by deferring tax until withdrawals are made. This allows investors to manage their tax liabilities more effectively and potentially reduce the overall tax burden.
- **Income tax efficiency:** Offshore bonds can help manage income tax liabilities, especially with the reduction in dividend allowances. By wrapping investments in offshore bonds, clients can avoid annual tax returns and benefit from tax deferral. This can simplify tax reporting and provide greater control over when taxes are paid.
- **Trusts for estate planning:** Offshore bonds can be placed in trusts to manage inheritance tax liabilities and provide flexible access to funds. This can be particularly useful for clients looking to pass wealth to future generations. Trusts can offer additional benefits such as asset protection and control over the distribution of assets.



Case studies: real-world applications

Grandparents paying school fees

Grandparents Steve and Jane are looking to fund their grandchild's school fees in a tax-efficient manner. Using an offshore bond within a discretionary trust to take advantage of tax allowances.

- **Initial setup:** Steve and Jane set up an offshore bond in a discretionary trust with an investment of £300,000, divided into 1,000 segments.
- **Funding school fees:** When £30,000 is needed for school fees, they make an absolute appointment of capital for 100 segments (assuming no investment growth).
- **Tax efficiency:** The gains from these segments are assessed on the child, who has £18,750 of allowances, ensuring minimal tax impact.
- **Outcome:** This approach allows the grandparents to tax efficiently fund their grandchild's education, while retaining control of the investment in terms of who receives how much, and when.

Income withdrawals

Consider Mark, he falls into the additional rate taxpayer (as his income is over £125,140) who invests £700,000 in an offshore bond and requires £35,000 annually. Using the 5% withdrawal allowance, Mark can receive his desired income without paying any tax on the withdrawals from the bond irrespective of his income tax rate.

- **Flexible withdrawals:** He uses the 5% withdrawal allowance to receive £35,000 annually without triggering an immediate tax charge.
- **Outcome:** By integrating the offshore bond into his financial plan, Mark optimises his tax position and secures a flexible income stream.

Retirement planning

Similarly, Sarah, a higher-rate taxpayer, invests £500,000 and plans to retire in 10 years. Her investment grows significantly due to the gross roll-up feature, and she withdraws funds when her income drops in retirement, minimising her tax liability.

- **Flexible withdrawals:** She withdraws funds during retirement when her income is lower, reducing her overall tax liability.
- **Outcome:** By integrating the offshore bond into her retirement plan, Sarah optimises her tax position and secures a flexible income stream.

Gifts and junior ISA comparison

James invested £1,000,000 in an offshore bond, which he divided into 1,000 segments of £1000 each. He decided to gift £100,000 to his daughter by assigning 100 segments to her. This transfer did not require selling any investments or incurring a tax charge at that point.

- **Flexible withdrawals:** His daughter benefits from the carried-over 5% withdrawals, providing her with tax-efficient income.
- **Control over access:** Unlike a Junior ISA, James can control when his daughter has access to the money. This is in stark contrast to the Junior ISA, which would give his daughter, at age 18, full access to all the money regardless of James' wishes, using the offshore bond for gifting.
- **Tax benefits:** If his daughter is a non-taxpayer, she may not have to pay any tax when money is withdrawn.
- **Outcome:** By using the offshore bond for gifting, James optimises his tax position and retains control over the timing of his daughter's access to the funds.

Estate planning

Consider Jane, a high-net-worth individual with a diversified investment portfolio that includes stocks, bonds, and property. Jane decides to invest £500,000 in an offshore bond to enhance her tax efficiency and estate planning strategy.

- **Flexible withdrawals:** Jane uses the 5% withdrawal allowance to supplement her income during retirement. This allows her to withdraw £25,000 annually without triggering an immediate tax charge, providing a steady stream of tax-efficient income.
- **Estate planning:** Jane places the offshore bond in a trust, ensuring that her wealth can be transferred to her beneficiaries with minimal inheritance tax liabilities. This strategic move helps her manage her estate planning effectively.
- **Outcome:** By integrating the offshore bond into her existing portfolio, Jane optimises her tax position, secures a flexible income stream, and enhances her estate planning strategy.



Understanding the potential drawbacks

The costs associated with financial advice can reduce the overall benefits of offshore bonds. While the 5% tax-deferred withdrawal allowance offers flexibility, it has its limits, and exceeding it can lead to tax liabilities. Some offshore bonds may also have restrictions on the types of investments they can hold, which might limit your choices.

The future of wealth management using offshore bonds

Offshore bonds might just be the secret ingredient to a robust and flexible financial plan. Whether you are a high-net-worth individual or someone planning for retirement, offshore bonds can help you achieve your financial goals while optimising tax liabilities. With the right strategies and careful planning, offshore bonds can be a cornerstone of a robust financial plan, providing growth, flexibility, and security in an increasingly complex financial world.

Important information

Investors should be aware that the price of investments and the income from them can go down as well as up and that neither is guaranteed. Investors may not get back the amount invested. Past performance is not a reliable indicator of future results. Changes in rates of exchange may have an adverse effect on the value, price or income of an investment.

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