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Clerical Medical International (CMI), based on the Isle of Man, is a life assurer specialising in offshore bonds, pensions and investments.

The offshore bond market in the UK has proved extremely resilient over the last year. This is despite the twin challenges of extremely difficult investment conditions and changes to Capital Gains Tax on open-ended investment companies (OEICs) in the 2008 Budget. Many investors have shown that they understand that offshore bonds are still a highly appropriate investment vehicle for a wide variety of circumstances, and this article explains the attractions of offshore bonds for four specific types of investor.

Private investors

Higher-rate taxpayers directly invested in OEIC funds such as fixed-interest, property, cash or hedge funds suffer 40% taxation on income payments, and an effective rate of 32.5% on dividends. In recent times most of the investment return from OEICs has come from income payments. The cut in Capital Gains Tax to 18% is therefore only relevant where there is growth in capital.
Tax on OEIC income payments has to be paid in the year in which it arises. In contrast any income payments from OEICs within an offshore bond are rolled-up on a gross basis, so giving an investor complete control over when tax is payable. However it isn't just about product taxation. An investor, in conjunction with their adviser, has to take into account a huge number of other factors before choosing the most appropriate investment vehicle:

Factors to take into account when choosing the most appropriate investment vehicle:

- Investment amount
- Likely investment term
- Likely inflation rate over term
- Likely personal tax rate during term of investment and on full encashment
- Geographical location of the investor during investment and on full encashment
- Likely growth in tax allowances over term
- Likely frequency of switching funds
- Product and fund charges
- Breadth of investment choice likely to be needed
- Proportion of fund invested in equities and other asset classes
- Likely growth and income yield on those assets

In addition, the likelihood of investors benefiting from the features contained within each investment vehicle need to be assessed. The financial planning benefits offered by the flexibility of offshore bonds are numerous, including:

• A wide choice of investments, including thousands of OEIC funds from recognised jurisdictions, guaranteed funds and fixed term deposits

• Switching between funds within a bond does not incur any tax liability

• Selecting from a variety of product charging options

• Income tax deferral on investment growth, whether from capital or income, with potential to avoid higher rate tax on full encashment

• Because income from fixed-interest payments, dividends and rental income from OEICs held within an offshore bond roll up within the bond, these don't need to be declared on tax returns

• Using policy segmentation to realise gains tax efficiently over a number of years

• Using top slicing relief to extend the basic rate threshold in proportion to the number of years the policy has been in force

• The right to withdraw up to 5% of the initial investment each year for 20 years without an immediate charge to tax

• The bond can be assigned to individuals who are in a lower tax bracket – for example a non working spouse, and a child or grandchild at university

• The bond can be assigned into or out of trust without incurring an Income Tax or Capital Gains tax charge

• For the purposes of Long Term Care planning, offshore bonds may be a disregarded asset

• Withdrawals within the annual 5% tax-deferred limit do not impact on Age Allowance

• Investors benefit from time apportionment relief after just one year of being non-resident for UK tax purposes

And it is not just private investors who are still investing in offshore bonds. Increasing volumes of business are emanating from trustee investments and pension schemes as the attractions of flexibility, investment choice and tax-efficiency in offshore bonds become more widely understood.

Trust business

Offshore bonds can be easily packaged with suitable trusts to be effective for Inheritance Tax planning. Trust solutions combined with an offshore bond as the underlying asset remain as compelling as ever because:

• An income tax charge will not arise unless there is a chargeable event, such as death of a life assured, or withdrawal of more than 5% of the initial investment in any year

• Multiple lives assured provide trustees with greater control over when a chargeable event gain arises

• Trustees maintain tax efficient access to the invested funds via the annual 5% tax deferred withdrawal facility

• The assignment of bond segments does not give rise to a chargeable event

• Bond segmentation provides the trustees with flexibility and planning opportunities when distributing funds to beneficiaries

• Wide investment powers allowing trustees to choose the most appropriate investment, for example, onshore or offshore OEICs

• The wide range of investments available within an offshore bond ensures trustees can meet Trustee Act 2000 requirements, and satisfy beneficiaries' expectations

• Reduced trust administration in respect of self assessment tax returns, as a bond is a non-income producing asset.

• Simplicity and cost efficiency of creating the trust

• Offshore providers offer a broad range of trust solutions which offer settlors flexibility in how they mitigate their Inheritance Tax liability. The three most common types of plan are Gift Trust, Loan Trust and Discounted Gift and Income Plans – usually available on either a discretionary or absolute trust basis

• It is important to ensure trust arrangements permit maximum flexibility for trustees and beneficiaries. For example, a discretionary Discounted Gift and Income Plan can:
- offer a choice of underwriting options – in advance, concurrent or no underwriting – in order to ascertain the amount of discount
- be trust-based which means trustees are not locked into one type of investment vehicle or product provider
- appoint a protector, if the settlor has concerns about control of the investment and distribution of the funds
- be set up on a joint basis as well as on a single life basis, so in the event of a spouse dying, the surviving spouse can continue to receive income.

Pension investments

Increasingly trustees of SIPP and SSAS schemes are looking to benefit from a wider, and more competitively priced, range of investment options than the restrictive ones on the platform that their provider offers. For example, in current volatile markets many pension trustees are looking for steady growth and security, and offshore bonds offer them access to a broader range of fixed term deposits with better rates than many specialist SIPP providers.

When investment conditions become more favourable for investments beyond deposits, offshore bonds also offer access to an expert fund administration system. This can offer a wider range of mutual funds - in the UK, EU, and offshore - than many specialist providers, and usually with better rates on initial and ongoing charges.

Non-domiciled UK residents

Offshore bonds can also be used in conjunction with an Excluded Property Trust as a way of allowing a high net worth individual who is not UK domiciled to protect their overseas assets from becoming liable to Inheritance Tax should they later become UK domiciled.

This arrangement may also be attractive to non-UK domiciled investors who do not intend changing their domicile status, but have UK domiciled beneficiaries. Assets situated outside the UK and held within the trust will not be treated as part of the beneficiary's estate and will not therefore be subject to Inheritance Tax until the trustees distribute the trust property to them.

The term “excluded property” describes assets that are excluded from the Inheritance Tax legislation, and includes the following:

- Property situated outside the UK, owned by a non-UK domiciled individual
- Certain government securities owned by individuals who are non-UK domiciled or not ordinarily resident in the UK
- Holdings in an authorised unit trust or shares in an OEIC where the beneficial owner is not UK domiciled
- Property situated outside the UK owned by trustees (wherever resident) of a settlement created by an individual domiciled outside the UK

Offshore bonds can also offer a solution for non-domiciled UK residents in relation to the new £30,000 remittance charge introduced on 6 April 2008. Under the remittance basis they avoid paying UK income tax and capital gains tax on offshore income and gains which are not remitted to the UK. Offshore bonds are subject to income tax under the chargeable events regime but bond gains are not “relevant foreign income” for the remittance basis of taxation. This means a non-domiciled UK resident can normally defer paying any UK taxes until a chargeable event arises.

So to summarise, the flexibility, investment choice and tax-efficiency of offshore bonds continue to be highly attractive to a broad range of potential investors. It is vital that all the benefits of these bonds are considered when investors are discussing their investment and financial planning objectives with their financial advisers.