Technical

Guide to offshore bonds for trustee investments

(this document should be read in conjunction with the *Guide to offshore bonds*)

For financial advisers only

Why should trustees consider offshore bonds as trust investments?

Trustees may find the following features of interest:

- the absence of a tax charge until a chargeable event occurs
- the ability to take part surrenders of the bond within a cumulative 5% of the premium each policy year without triggering an immediate tax charge
- the ability to select the time at which a tax charge arises
- the possibility of assigning (transferring) the bond to a beneficiary without triggering a tax charge
- the ability to have an actively managed portfolio of assets increasing the potential return for trust beneficiaries without a capital gains tax charge
- the ability to assign the bond in part or in full to a beneficiary to take advantage of a beneficiary's lower tax rate

Trust administration costs

The administrative costs associated with trusts such as the preparation of annual tax returns and annual accounts can be substantial. Using an underlying investment vehicle which can reduce these costs is therefore clearly beneficial to the trust beneficiaries.

An offshore bond used as the trust investment can significantly reduce these costs as the trustees only have to account for the value of the bond and not the individual values of the assets in which it is invested.

Who pays any tax on bonds held in trust?

Where trustees own a bond, the policy gains on a chargeable event are charged to tax;

a) on the settlor whilst UK resident

b) on the trustees where the settlor is dead or non-UK resident

c) on UK resident beneficiaries where neither a) nor b) apply

When the settlor is liable for any tax, they have the right to recover this expense from the trustees. Where the trustees are liable, any tax charge is met from the trust fund.

Where a beneficiary is liable, the tax liability is met from their personal resources.

UK resident trustees are liable for tax under the chargeable event code if, immediately before the chargeable event, they are UK resident and any of the following apply:

- The bond is held on charitable trusts.
- The bond is held on non-charitable trusts created by an "absent settlor".

  An "absent settlor" is one who;

  - is dead, or
  - is non-UK resident, or
  - in the case of a company or foreign institution, has been wound up, dissolved or otherwise ceases to exist.
- The bond is held (by another person) as security for a debt owed by the trustees.
- The bond was established or varied on or after 9 April 2003, the settlor is not an "absent settlor" but there is no individual, company or personal representative liable.

Where the policy is held on **Bare Trust**, an adult beneficiary is absolutely entitled as against the trustee and therefore the trust is effectively ignored. The adult beneficiary is chargeable. Where however the beneficiary is a minor the "normal" rules apply and the settlor is chargeable.

Where a UK resident settlor receives a repayment of tax on trust income due to them being taxed at a lower rate of tax than the trustees, they are required to pay any amount they receive to the trustees. These payments are disregarded for Inheritance Tax purposes. Thankfully, offshore bonds are non-income producing assets and therefore, this situation should not arise.

Personal representatives

Should a gain occur on a chargeable event whilst the bond is owned by a personal representative, they would be liable to income tax at basic rate which is currently 20% for 2016/2017 tax years.

When a chargeable event occurs after the death of a UK resident settlor but before the end of the tax year in which death occurred, the chargeable bond gain is regarded as part of the total income of the settlor for the year of death.

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Direct Ownership

If the trustees held the assets outside of the offshore bond (direct ownership), they have a limited Capital Gains Tax (CGT) exemption of GBP5,550 (for the tax year 2016/2017) and are subject to pay 20% CGT on any gains realised.

Assets held within an Offshore bond

Assets held within an offshore bond are not liable to CGT and may be more tax efficient in the long run.

The Trustee Act 2000 widened trustee powers and allowed trustees to invest as if they were the absolute beneficial owners of the trust fund. However, in order to protect the beneficiary, trustees are required to consider diversification and the overall suitability of the investment. The fund switching facility and investment management of an offshore bond will enable trustees to undertake a more active investment policy, without the adverse tax capital gains tax consequences inherent in other forms of trustee investments

Important notes

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

There are other tax planning opportunities available to trustees using offshore bonds. On final encashment for example, provided the bond is written on multiple lives, a significant degree of control can be exercised as to when the chargeable event happens. Making use of policy segmentation can pass the tax burden from the settlor and trustees to a non-taxpaying beneficiary.

As this process requires the assignment and the surrender of a policy segment, it is only available to beneficiaries aged 18 and over. Another method of making tax effective distributions from the trust fund is to make use of the 5% withdrawal facility. Under current legislation, (ITTOIA 2005, s507(5)), 5% of the original investment can be taken each policy year for 20 years without an immediate liability to income tax. If this 5% notional allowance is not fully used in any year, the unused allowance will be carried forward to the next policy year and so on, on a cumulative basis.

Finally, please note that every care has been taken to ensure that the information provided is correct 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.

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