UTMOST WEALTH SOLUTIONS

PARAPLANNERS ASSEMBLY

OCTOBER 2020

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A WEALTH *of* DIFFERENCE

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AGENDA

- AIM OF SESSION IS TO GIVE AN OVERVIEW ON THE STRUCTURE OF OFFSHORE BONDS AND THEIR USES IN THE UK TAX PLANNING ENVIRONMENT

INTRODUCTON (UK TAXATION)

STRUCTURING OF BONDS/

SEGMENTATON

TAXATION BASICS

USE OF BONDS IN TAX PLANNING

QUESTIONS

1

INTRO – UK TAXATION BASICS

WHERE OUR PRODUCTS FIT IN

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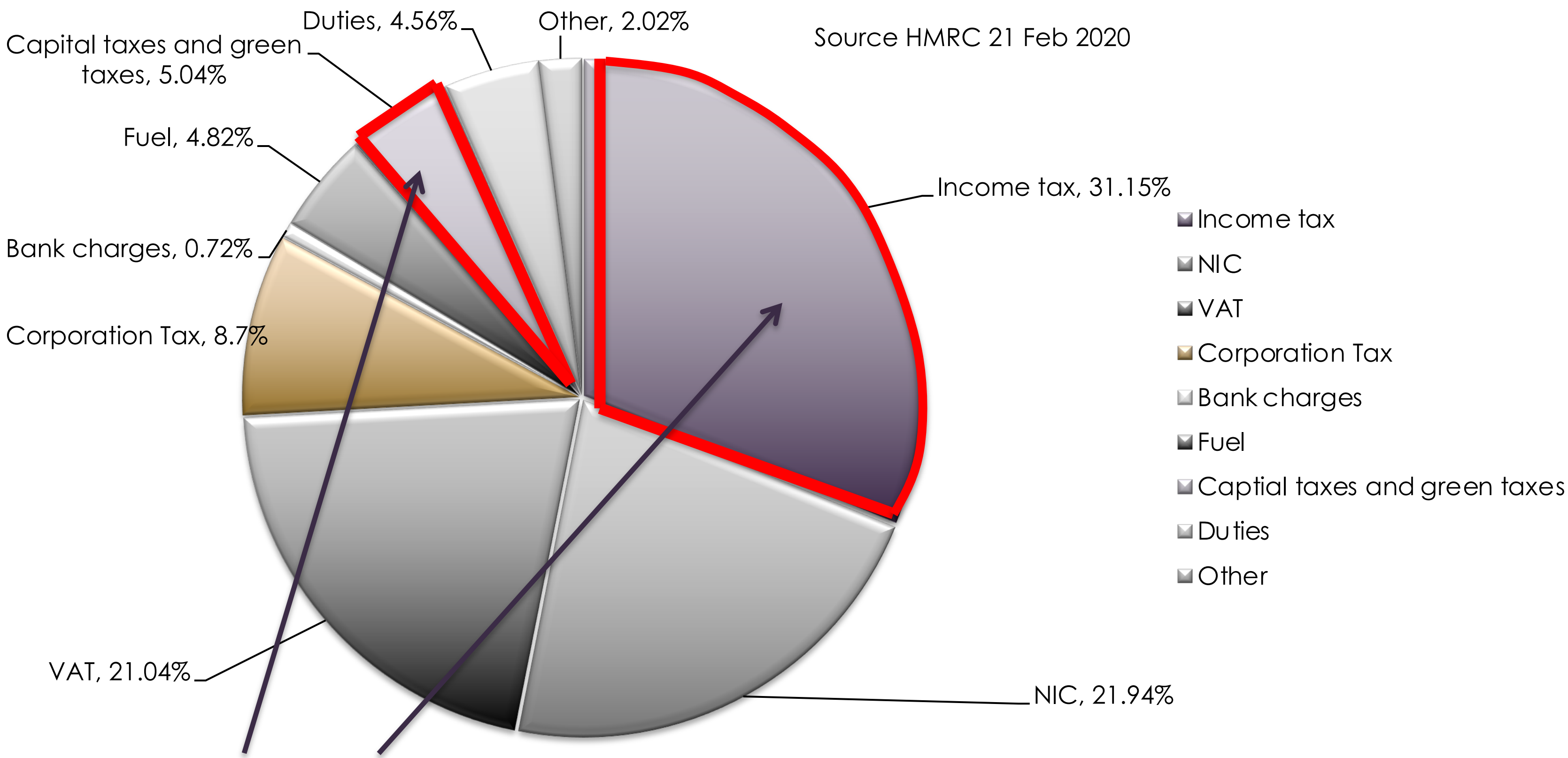
THE DIFFERENT UK TAXES

WHAT ARE THEY?

- **Income Tax**
- **NIC**
- **VAT**
- **Corporation Tax**
- **Capital Taxes:**
  Capital Gains Tax (CGT)
  Inheritance Tax (IHT)
  Stamp Duty and Stamp Duty Land Tax (SDLT)
- **Green taxes**
  Inc. Aggregates Levy, Air Passenger Duty, Fuel Duty

HOW MUCH DOES EACH BRING IN?

2018/19 FIGURES – PERHAPS NOT WHAT YOU THOUGHT?



- Offshore bonds help to mitigate exposure to income tax, CGT (not liable)
- Bonds in Trust can reduce exposure to Inheritance tax.

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WHAT IS AN OFFSHORE PORTFOLIO BOND?

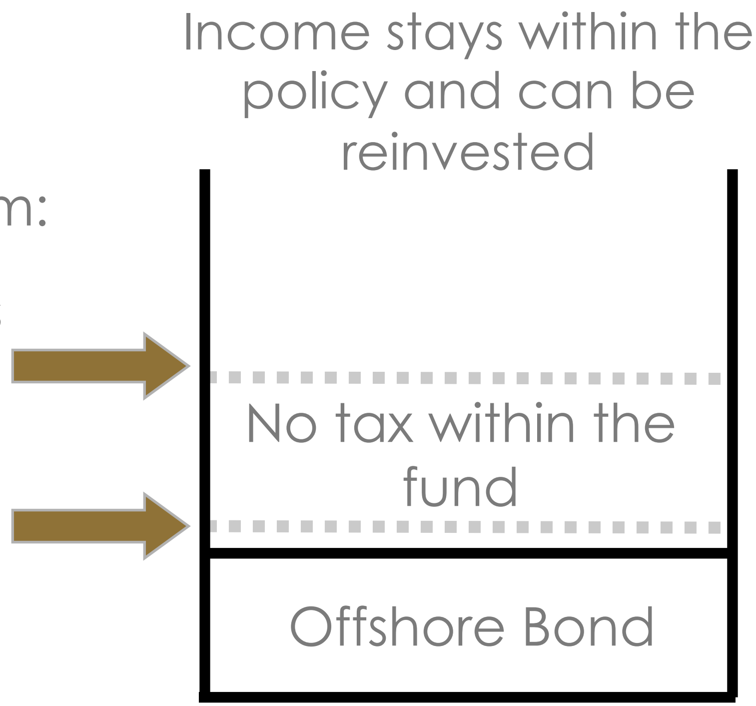
- A taxation and administration wrapper

- Similar to an onshore bond, plus
  - Greater investment flexibility
  - Capital redemption option
  - Third party custody and management.

OFFSHORE SINGLE PREMIUM BOND

Income from:

1. Dividends
2. Coupon
3. Interest
4. Rent



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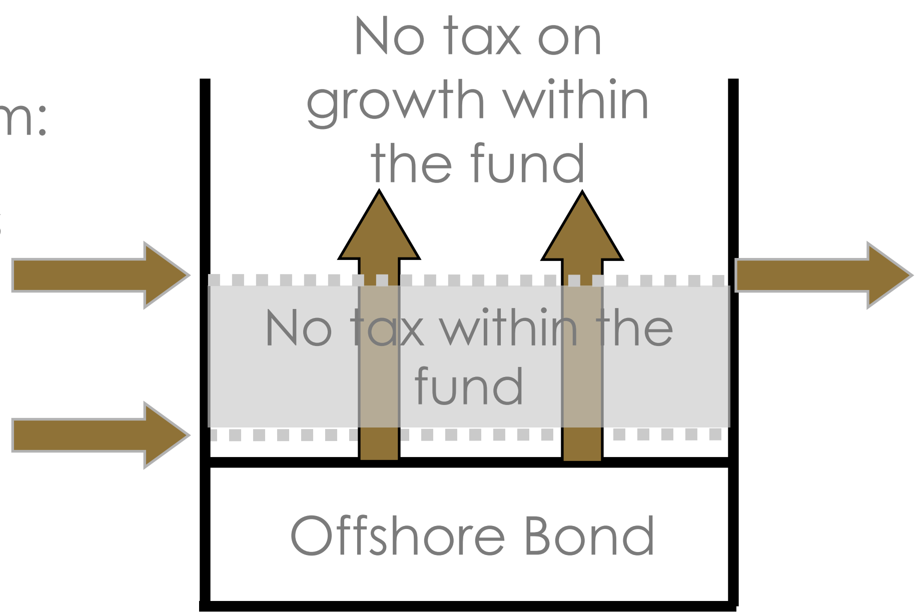

5% per annum withdrawals.
Any excess is a chargeable event

OFFSHORE SINGLE PREMIUM BOND

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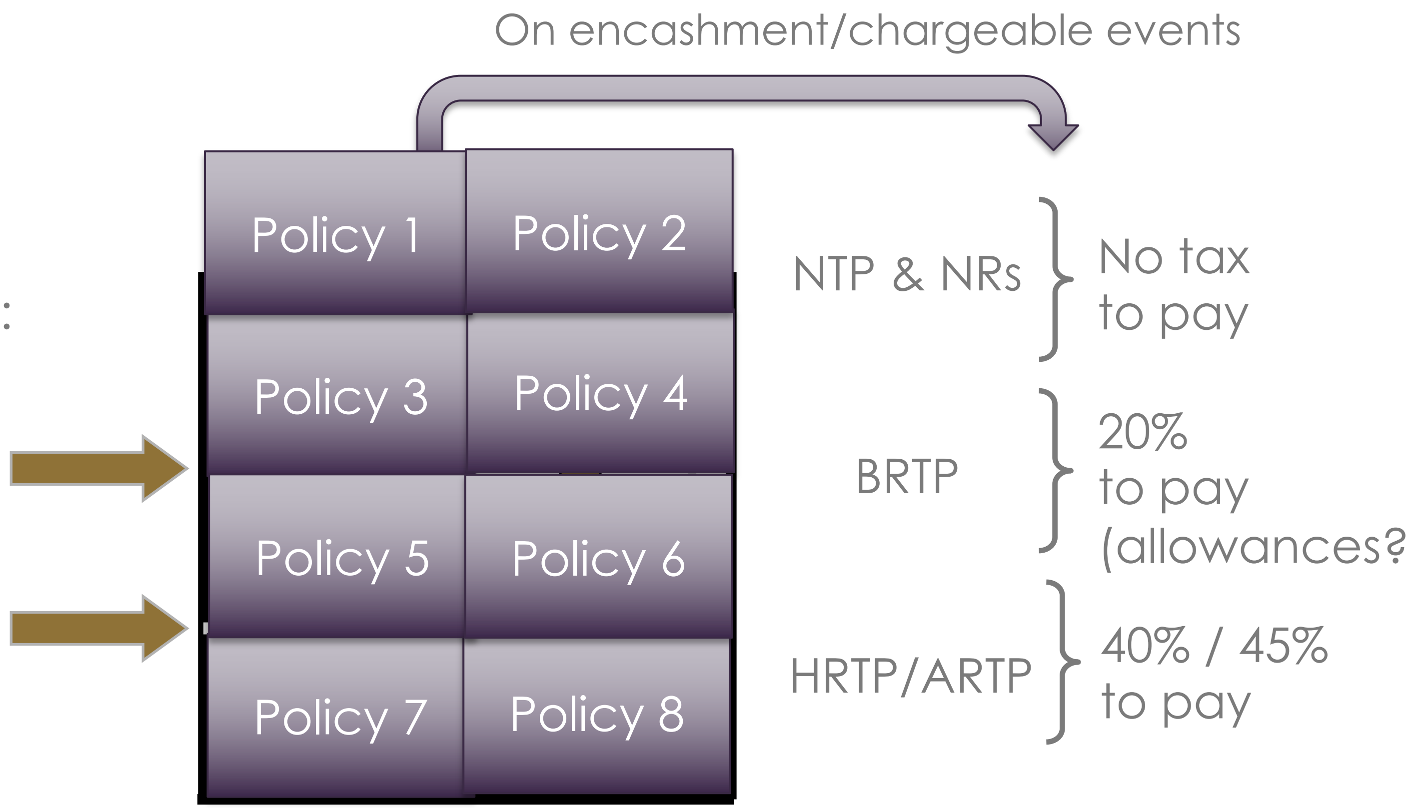

WHAT TAXES CAN OFFSHORE BONDS HELP MITIGATE AND PLAN AROUND?

INCOME TAX
INHERITANCE TAX
CAPITAL GAINS TAX (DOESN'T APPLY!)

THE UK SAVINGS REGIME

IT'S QUITE COMPLICATED!

- Three broad types of 'income' when considering taxation
- **Non-savings income** – which includes employment income, trading income (from the self-employed) and property income
- **Savings income** – which includes interest from banks/building societies and gains from offshore life insurance policies
- **Dividend income** – which covers UK dividends.

A basic tax Proforma looks something like this:

Example Source	**Non Savings**	**Savings**	**Dividends**
Earnings/Property income	X		
Interest/Bond gains		X	
Dividends			X
Total income	£x	£y	£z
Less available P.A	£12,500 (applied to non-savings first)		
Net **taxable** income	£NI	£NI	£NI

TAX RATES 2020/21 CONTINUED

7 RATES OF TAX IN THE UK

	INCOME TYPE	NON-SAVINGS	SAVINGS	(PSA/SRBS)	DIVIDEND	(DIVIDEND ALLOWANCE)
PA	**Less P.A.** £12,500[4] Allocated in most efficient way	(£X)	(£X)		(£X)	
TAXABLE INCOME		(£X)	(£X)		(£X)	
TAXPAYER	**Basic rate** First £37,500 taxable (different rates and bands apply in Scotland for non-savings income only)	20% 1	20% 1	0% within SRBS[1] 0% within PSA (£1,000)[2] 7	**7.5%** 4	0% within dividend allowance[3] 7
	Higher rate £37,501-£150,000 taxable	40% 2	40% 2	0% within PSA (£500)[2] Then – 40%	**32.5%** 5	0% within dividend allowance[3]
	Additional rate Over £150,000 taxable	45% 3	45% 3	No PSA	**38.1%** 6	0% within dividend allowance[3]

[1] Applies where non-savings taxable income is less than £5,000. Note, the savings income within this band still counts towards the basic or higher rate thresholds.

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[3] Applies to all types of dividend income despite taxpayer status. As per SRBS and PSA, dividend income falling within this allowance still counts towards the basic rate or higher rate thresholds.

[4] Where an individual's "adjusted net income" is above the income limit of £100,000 p.a., the amount of the personal allowance will be reduced by £1 for every £2 of income above the limit until it is eliminated.

LIFE ASSURANCE AND CRB

So what is a Single Premium bond?

Two broad types:

- **Life Assurance Bond** – ends on death of the 'life assured'. Can be first death or last death. Ours are all last death
- **Capital Redemption Bond** - Not strictly a life policy but still taxed under same tax legislation. Doesn't require human life but simply actuarial calculation – here's the definition of CRB from s56(3) FA 2012:

LIFE ASSURANCE AND CRB

- Offshore **life assurance bonds and capital redemption** bonds are taxed under **same tax legislation** as onshore bonds – specifically chapter 9 part 4 Income Tax (Trading and Other Income) Act 2005. ("ITTOIA")
- *"Business is capital redemption business if it consists of the effecting on the basis of actuarial calculations, and the carrying out, of contracts under which, in return for one or more fixed payments, a sum of a specified amount (or a series of sums of a specified amount) become payable at a future time or over a period"*

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STRUCTURE OF BONDS

SEGMENTATION AND LINKED ASSETS

LINKED ASSETS – CLASS 1 BUSINESS

HOW OFFSHORE BONDS ARE STRUCTURED (CLASS 1 LINKED LONG-TERM)

POLICYHOLDER SELECTS ASSETS

MATCHED LIABILITY

LONG TERM BUSINESS FUND

Policyholder selects assets they want the performance of their bond to be linked to.

If policyholder is UK resident then the assets **that can be selected by policyholder (or any connected person) under the policy** must meet the permitted assets rules – broadly collective investments and "cash". Rules provided for in chapter 9 part 4 ITTOIA 05.

If client asks to surrender we would pull back monies from LTBF and then use these to pay surrender proceeds…

Insurer purchases same assets in LTBF – matches policyholder linked-asset selection**.**

Liability to policyholder is said to be "matched".

Other aspects such as life cover (on death) would need to be met by insurer.

STRUCTURING AND TAX

If assets held directly client would pay CGT and income tax – no deferral

- Policyholder only holds a life policy or CRB – not the underlying assets
- Policyholder is taxed under chargeable event rules
- Tax deferral is achieved under these rules (we will look at this later).
- Matching mechanism, regulations and local investor protection regime are available to help ensure our liabilities to policyholders are met.

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POLICY SEGMENTATION EXPLAINED

EACH BOND CONTAINS A SERIES OF POLICY SEGMENTS

P1	P2	P3	P4	P5
P6	P7	P8	P9	P10

- The bond is simply a charging function and **each policy must legally stand alone**
- When we calculate tax we look at each policy separately. We can often shortcut the calculations by using the full bond values but this can sometimes lead to misunderstandings.

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POLICY SCHEDULE

All POLICIES SCHEDULED ON ONE DOCUMENT – THE POLICY SCHEDULE

One policy document is issued for all the sub-policies, this is referred to using different terms:

- **“Bond”**
- **“Wrapper”**
- **“Cluster Policy” (HMRC Terminology)**
- The use of one schedule saves paper but in the past insurers used to issue and print the separate policies.
- Remember that despite one schedule there are still separate policies!

WHAT HAVE WE LEARNT SO FAR?

- Our products are subject to **savings rates** of income tax and when **combined with trusts can help clients reduce exposure to IHT**. **They are not subject to UK capital gains tax**

- The structure explained previously means the policyholder **only holds a life policy** or CRB **not the underlying assets**

- Each Bond contains a series of **policy segments** that are **subject to savings rate income tax** – PSA and SRBS can be utilised (if applicable)

- There are then specific tax rules associated with bonds which are contained in Chapter 9 Part 4 Income Tax Trading and Other Income Act 2005 ("ITTOIA")

- These rules can be really beneficial for UK investment planning and that's where we fit in…

- **IT'S ALL ABOUT TAX DEFERRAL!**

(3)

TAXATION BASICS

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TAXATION OF EACH POLICY SEGMENT

P1

- Here we will focus on one policy segment
- What can happen to this segment?

TAXATION OF EACH POLICY SEGMENT

CHARGEABLE EVENTS

P1

chargeable events

- The policy can be surrendered at a gain
- The policy can be partially-surrendered (above 5% entitlement)
- The policy can mature – CRB etc.
- The life assured can die causing the policy to end
- The policy can be sold for consideration (value) - rare

not chargeable events

Two key main benefits

- The policy can be surrendered at a loss
- The policy can be gifted (trust, another person)
- The policy can be partially surrendered (below 5% entitlement)
- The policy can lapse.

THE TWO MAIN CALCULATIONS

THESE BOTH ALLOW FOR TAX DEFERRAL

- **Surrender (A+B) – (C+D)**

  A = Surrender Value

  B = Withdrawals

  C = Premium Paid

  D = Previous excess events

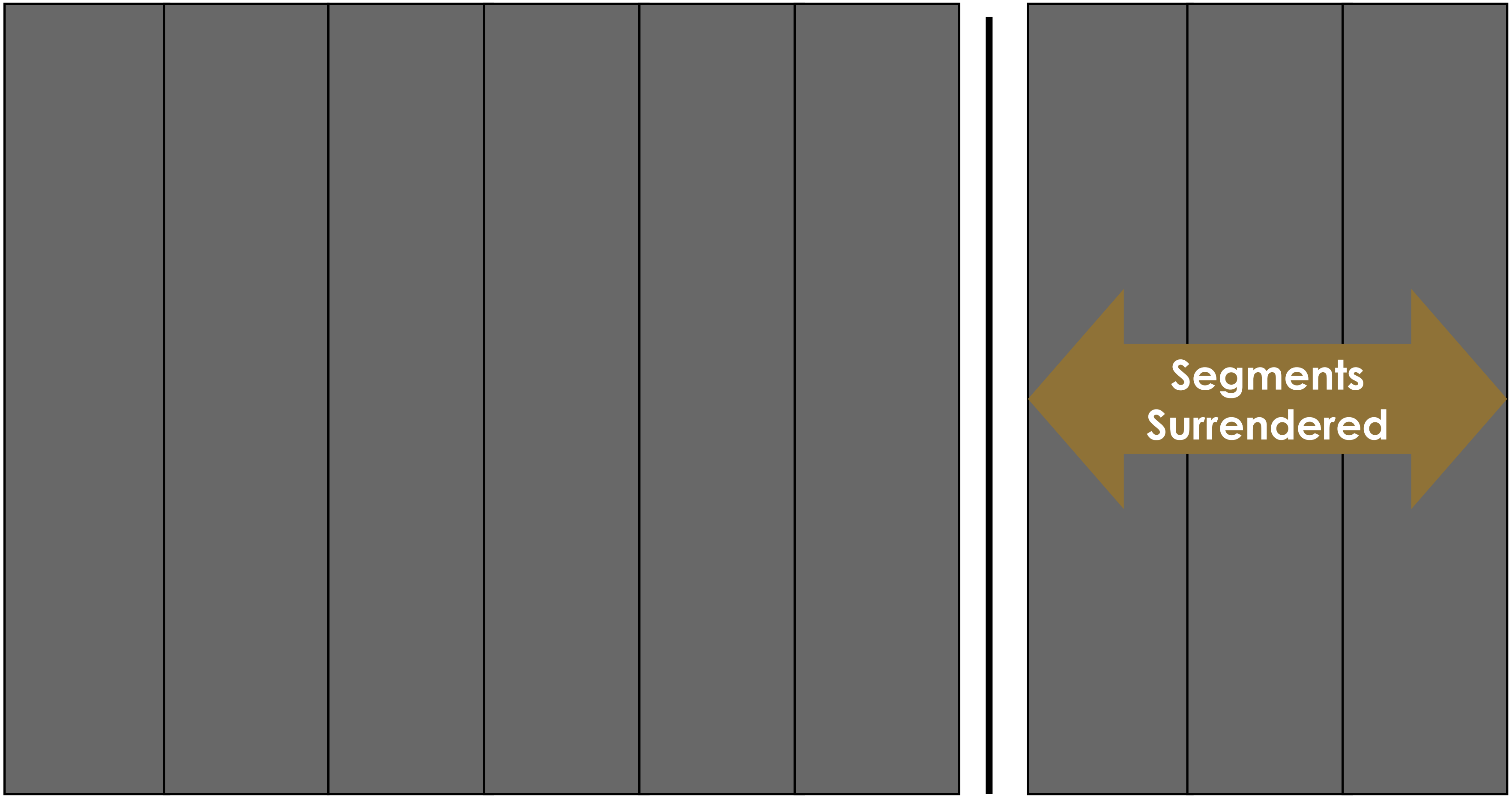
- **Partial-Surrender = 5% of premium(s) paid (across policies)**
- Added back in on surrender (B in formula) but allows for tax deferral

PARTIAL-SURRENDER

ACROSS ALL SEGMENTS

FULL SEGMENT SURRENDER

SURRENDER OF SOME POLICY SEGMENTS



RECAP ON TAX RATES

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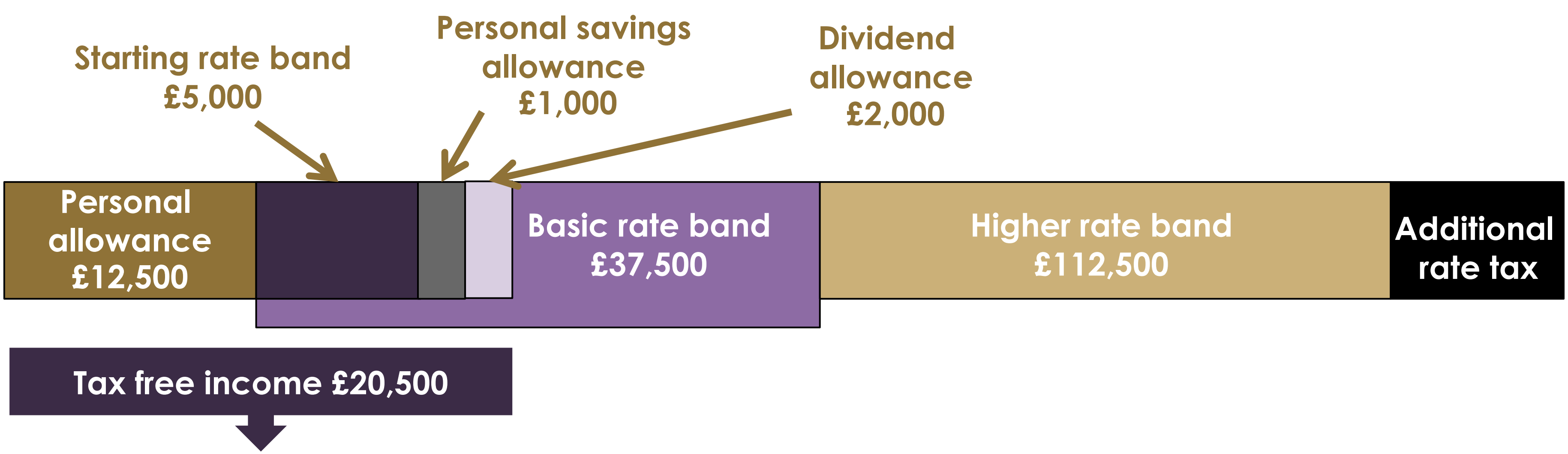
BACK TO THE TAX BANDS

- Bands are as shown below with the PSA for a basic rate taxpayer
- The starting rate band and personal savings allowance (PSA) are not mutually exclusive – they sit within the bands as illustrated below
- Someone could have tax free 'income' of up to £20,500…



2020/21 – TAXATION OF BOND GAINS

- Chargeable Event Gains on life insurance policies are taxed as **savings income**
- They can benefit from both the Starting Rate Band for savings and the PSA (where applicable) prior to any potential top-slicing relief
- Can also benefit from top-slicing relief which can be used to reduce liability to higher or additional rates of tax…Silver case!
- A non-tax payer could have gains of £18,500 before they pay tax.

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OFFSHORE MYTHS AND USES

LOOKING AT SOME MYTHS AND USES FOR OFFSHORE BONDS

OFFSHORE MYTHS

LOOKING AT SOME COMMON OFFSHORE MYTHS

Myths explored….

STATEMENT	RESPONSE
Offshore is agressive tax planning	• Uses same legislation as onshore bonds • We report to HMRC and policyholder chargeable event gains for UK residents • We report under the CRS and FATCA • Not covered under DOTAS and potentially not under DAC6 either (EU DOTAS!)
The Products are complicated and expensive	• Coventional offshore bonds are not necessarily complicated • Planning regarding trusts can be complex due to the breadth of the UK IHT rules • Costs are very competitive nowadays
Surely UK residents can't invest offshore?	• They can and they do!

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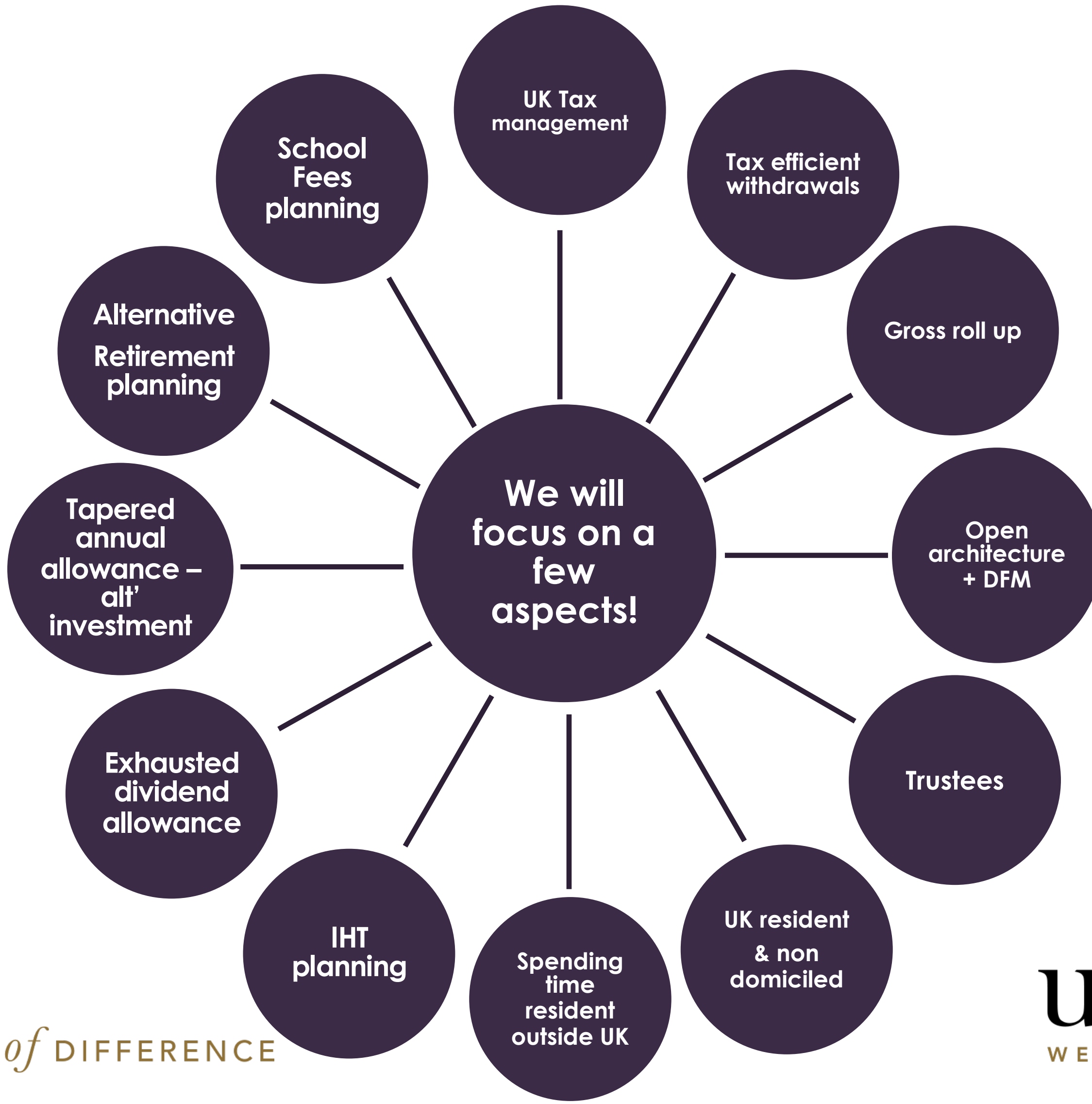
REASONS TO CONSIDER OFFSHORE BONDS



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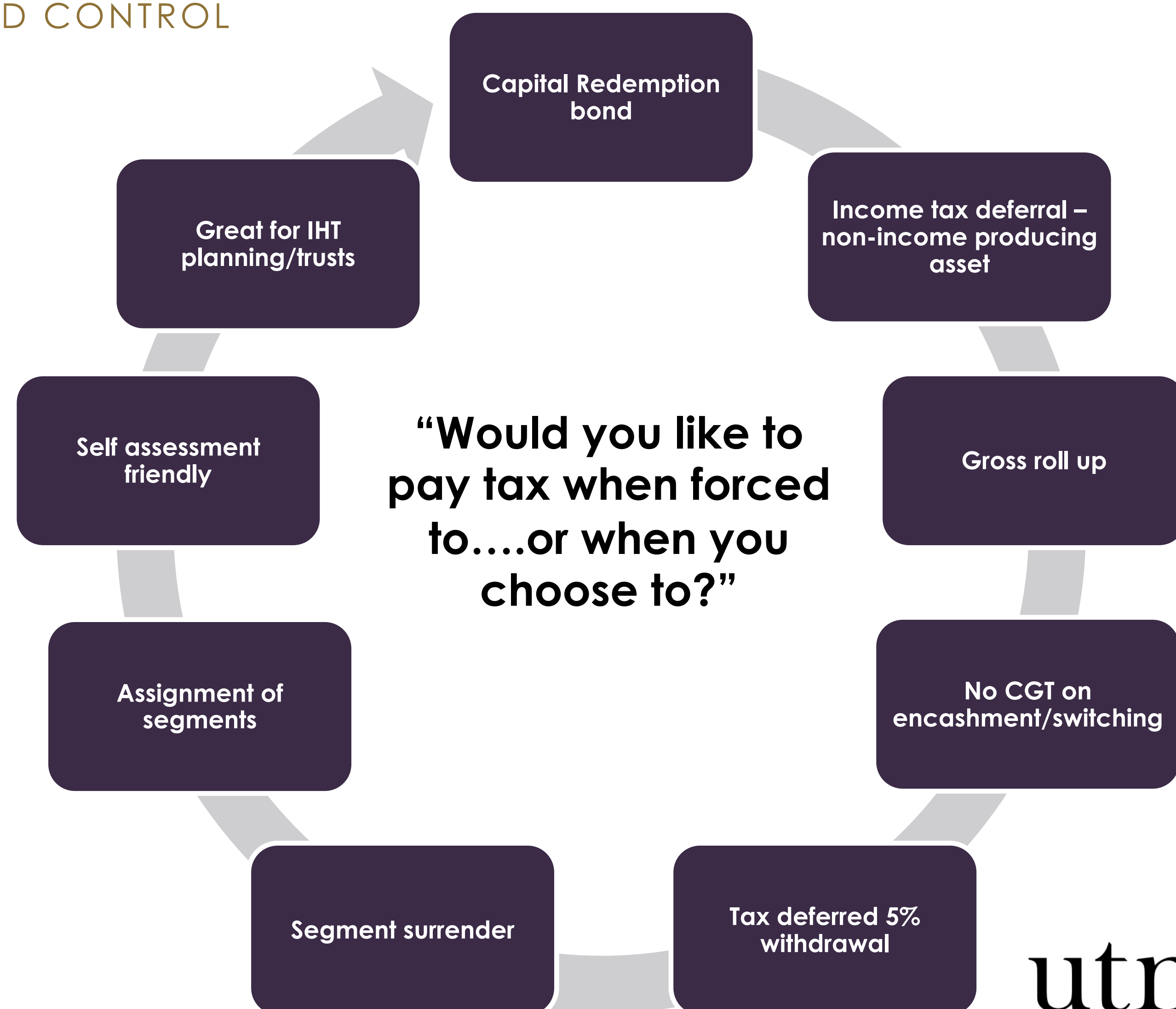
TAX MANAGEMENT

CHOICE AND CONTROL



WIDE INVESTMENT OPPORTUNITY

TWO DIFFERENT ROUTES

Open Architecture (selection rights)	Open Discretionary (no selection rights)
External **collective funds** and **cash deposits**	Investment managed by experts who are free to invest into a wider range of assets including assets normally excluded from conventional bonds, which are usually constrained by the personalised portfolio bond rules to purchase collective funds and cash deposits only
Option to appoint external discretionary manager with custody	Therefore reduces administrative burden and responsibility on investor
More competitive than buying funds directly?	Chosen EMC manages investment in line with client's appetite for risk and their standard portfolio management practices (which often includes investing in assets not normally allowable under a conventional bond)
Access to thousands of collective funds v onshore where usually restricted (due to I-E)	This can potentially result in cheaper portfolio management costs

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TRUSTEES

DISCRETIONARY TRUST AND BONDS

FEATURE/ASPECT	BENEFIT
Capital redemption bond	Timing of tax management – no surprises
Dividends and income taxable at 38.1% and 45% above standard rate band	Tax deferred within bond – improved accumulation?
Assignment	Tax management - Over 18 - utilise beneficiary's income tax allowances. Below 18 – assign to bare trust for non-parental settlements?
Non income producing	Eases administrative burden in terms of self assessment and tax management i.e. tax pool! Improve income position for beneficiaries where dividends distributed.
Open architecture	Helps to meet TA 2000 standard investment criteria

- How often do the trustees use their CGT exemption? (£6,150 at best or £1,230 at worst!)
- How much of portfolio will be turned over every year?
- What is the cost of rebalancing?

IHT PLANNING

COVERING THE BASES

CLIENT TYPE/FEATURE	REASON
UK resident, non domiciled	May want to use an excluded property trust in future and cannot use UK based assets – an offshore bond is obviously a non-UK asset.
Possibility of future settlement into trusts – using life policy drafts	Can do so with no CGT complications on assignment of a bond.
Potential tax efficiency	Offshore bonds sit very well within discretionary trusts, especially if longevity and legacy planning are important. No complex tax regime…
Capital redemption bonds	Good fit with trusts – do not end on any life matching trustee perpetuity period (125 years) Can potentially be converted to Discounted Gift Trust with no chargeable event, therefore saving income tax on unnecessary encashment….. in order to save IHT!
Risk Averse	Investment Bonds allow linked investments to a wide range OEICs, Investment Trusts and, provided there is no policyholder influence, equities. Portfolios can be constructed to be low(er) risk investments unlike investments needed to qualify for business relief

ANY QUESTIONS?

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Information regarding tax and practise is based on our interpretation of current legislation and HM Revenue & Customs policy/practice in the UK, Isle of Man and Ireland as at 1 October 2020. Tax treatment is subject to change and individual circumstances. There is therefore a risk that the value of the tax treatment provided by a bond may change.

International bonds are intended to be a medium (at least 5 years old) to long term (over 10 years) investment. The value of investments may fall as well as rise and is not guaranteed. Your client or their trustees may get back less than originally invested.

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