Why Offshore Bonds Should be Part of Your Financial Planning Strategy

The topic of family wealth and intergenerational planning has come to prominence in recent years, driven by rising asset prices and frozen Inheritance Tax (IHT) thresholds in the UK. The IHT exemption amount of £325,000 (£650,000 for a couple) has been frozen since 2009 and, under current government rules, is expected to remain at this level until at least 2028.

Whilst the introduction of the residence nil rate band (£175,000 each for a couple) has meant that your main property can be passed on to your direct descendants, this generally means that a maximum of £1 million in assets can be passed on without any IHT liability.

Anything more than this will be taxed at 40%.

Nonetheless, if you plan wisely with enough time, you can invest in a range of accounts that could help you create a tax-efficient strategy to minimise the amount of tax you or your loved ones will have to pay.

Offshore Bonds:

One way of ensuring your assets are passed on tax-efficiently to following generations is through an offshore bond. Offshore bonds tend to get a bad reputation due to the word 'offshore' – however, they have been a key part of the UK investing landscape in some format since the 1980s. Furthermore, an offshore bond is a tax-deferred product – meaning tax is potentially payable upon the eventual encashment of the bond – and is not a means to avoid or evade tax, which can be the popular view of a product with the name 'offshore' in it.

Offshore bonds, due to their tax-deferred nature, allow an individual (or a couple) to put in a theoretically unlimited amount of money without paying any immediate tax on any gains accrued or income paid; therefore, this is known as 'gross roll-up', which is a key advantage to the bondholder.

Coupled with this, the bondholder is also entitled to take up to 5% per year of the initial capital invested without any immediate tax liability. This 5% withdrawal ability is cumulative and any unused allowance can be carried forward to future years indefinitely. Therefore, the bondholder could decide to take the 5% withdrawal annually for 20 years, or 4% for 25 years etc.

The tax-deferred nature of the product, and the ability to take 5% cumulative withdrawals offers distinct advantages to bondholders who:

1

Will have lower taxable income in the future upon encashment and therefore, will be subject to lower rates of tax.

2

Will likely re-locate to a different country in the future where the profit from the bond will be taxed at lower rates or not at all.

3

Want to gift part of/all of the bond to an individual (e.g. children) who may have lower income tax rates.

Why not get in touch? Give us a call on 0203 143 6100 and speak to one of our Wealth Managers or send an email to info@tidewayinvestment.co.uk

Tideway
Wealth & Retirement

Case Study 1

John is in his late 50s, single with no children and is now approaching retirement. He anticipates that he will need around £60,000 p.a. in retirement to enjoy a good standard of living.

Over his lifetime, he has accrued a pension of £1.2 million. He is planning on taking the maximum tax-free cash of £268,275 and this, combined with other cash he holds, means he has around £700,000 to invest outside of the pension and c.£930,000 pension available for drawdown.

As he does not have an ISA at present, from the £700,000 cash holding, £200,000 could be kept aside to fund ISA contributions over the next 10 years, leaving him with £500,000 of excess cash which would incur Income Tax if kept in a cash/savings account.

Investing the remaining £500,000 in an offshore bond could provide the most tax-efficient way for John to receive the desired income:

- He can take up to £50,000 gross p.a. from his pension, only paying basic rate of Income Tax;
- He can take up to £25,000 p.a. from his offshore bond with no immediate tax liability;
- This would save John around £200,000 in tax over the course of 20 years, as that £25,000 withdrawal would have incurred higher rate tax of £10,000 p.a. otherwise;
- The bond will last John, assuming he takes the full 5% annual allowance, until his late 70s – at this point, he can drop his pension withdrawals, thus giving him his basic rate tax band back, encash the bond using the favourable top-slice tax relief if applicable and pay only basic rate tax on the profit

Case Study 2

Mary & Clive are married and have two young children, aged 12 and 9. Following the recent death of a relative, they have received £600,000 in inheritance.

Both Mary & Clive are still working and earn well enough to cover their expenditure and therefore, they want to designate that inheritance for their children for the future, for their education and deposits for property purchases in the future. They can contribute to pensions for their children and/or Junior/adult ISAs, but the amounts are limited and access is restricted to these accounts

They could use an offshore bond to help them achieve their goals:

- They can invest with a truly long-term mindset and for growth and benefit from gross roll-up along the way.
- They can use the 5% annual withdrawal limit to help fund their children's expenditure whilst they are at school and/or university.
- Mary & Clive can retain control over the assets until they deem their children old and responsible enough, at which point they can designate part of or all of the bond to their children to encash in their own names and before the children are earning enough to be high rate tax payers

This allows Mary & Clive to continue working and earning well without having to worry about any eventual tax liability falling on themselves at their highest marginal rate from the encashment of the bonds.

Therefore, as demonstrated above, an offshore bond can certainly be a valuable addition to not just an individual's financial planning, but can also help transfer wealth from one generation to the next tax-efficiently.

- The content of this document is for information purposes only and should not be construed as financial advice
- Please be aware that the value of investments, and the income you may receive from them, cannot be guaranteed and may fall as well as rise
- We always recommend that you seek professional regulated financial advice before investing
- Any withdrawal amounts or rates of tax referred to are correct as of the date of this document and may be subject to change in the future.

Tideway

Tideway Wealth Management Limited (TWM) is an appointed representative of Tideway Investment Partners LLP (TIP) who are authorised and regulated by the Financial Conduct authority (FRN: 496214). TIP and TWM are part of the Tideway Investment Group and all companies are registered in England with their registered address at: 107 Leadenhall Street, London EC3A 4AF

Registered address: 107 Leadenhall Street, London EC3A 4AF. +44 (0)20 3143 6100.