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Onshore or Offshore?

Making Sense of Insurance Bonds



This content is based on our understanding of current taxation, legislation and HM Revenue & Customs practice all of which are liable to change without notice. The impact of any taxation (and any tax reliefs) depends on individual circumstances.

Where content includes case studies or examples these are for illustration purposes and are not recommending a specific course of action.

Past performance is not a reliable indicator of future performance. The value of an investment can go down as well as up and your client may get back less than they've paid in.

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Learning Objectives

By the end of this session, you will be able to:

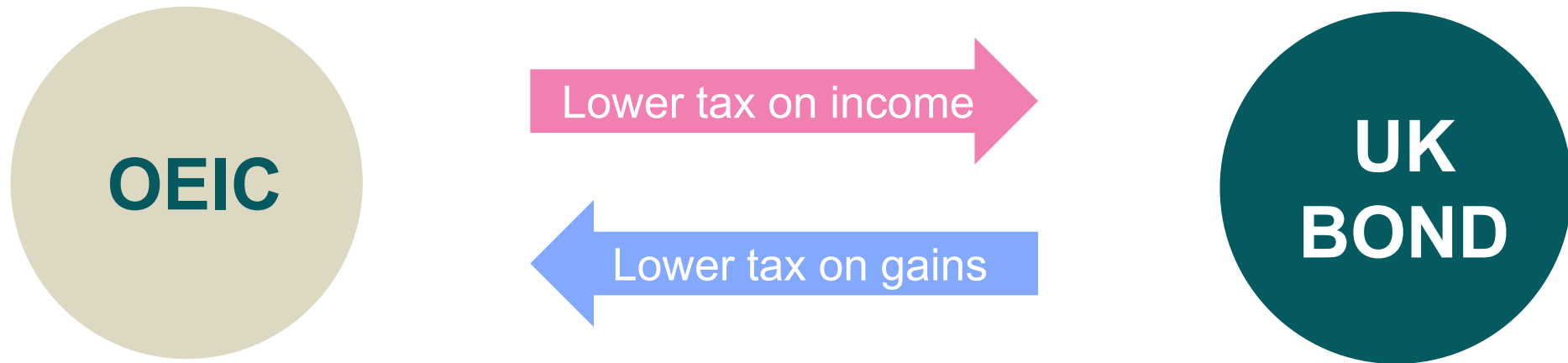
Explain why insurance bond use is on the rise

Explain the specific tax attributes of insurance bonds

Evaluate when onshore or offshore will deliver the best outcome for your clients

Wrapping Matters

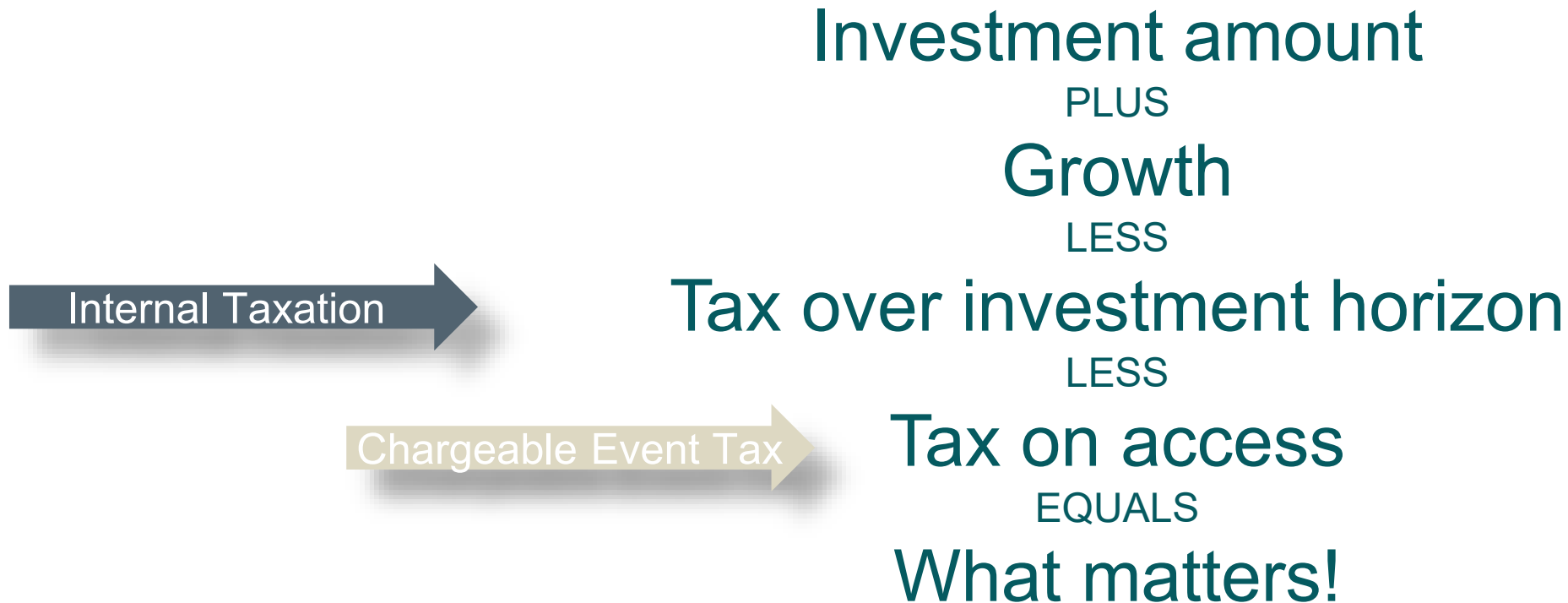
Balancing tax, inter alia



Bond income tax advantages are rising as CGT disadvantage falls

The crux...

...of the matter



The net return at the point it is likely to be needed.

Bonds

Key Tax Considerations

Internal
Rate of Tax

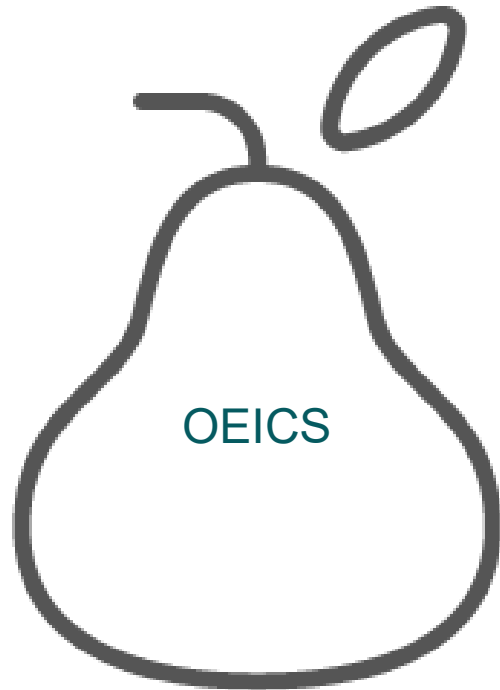
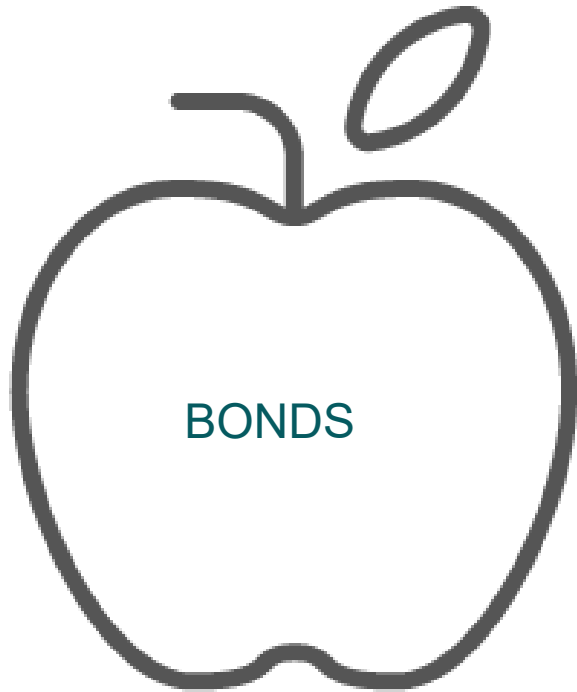
Tax
Deferral

Top Slicing

Savings
Allowances

Two sides

...of the same coin



Other than tax

...telling your apples apart



FSCS protection (inhouse insured funds)

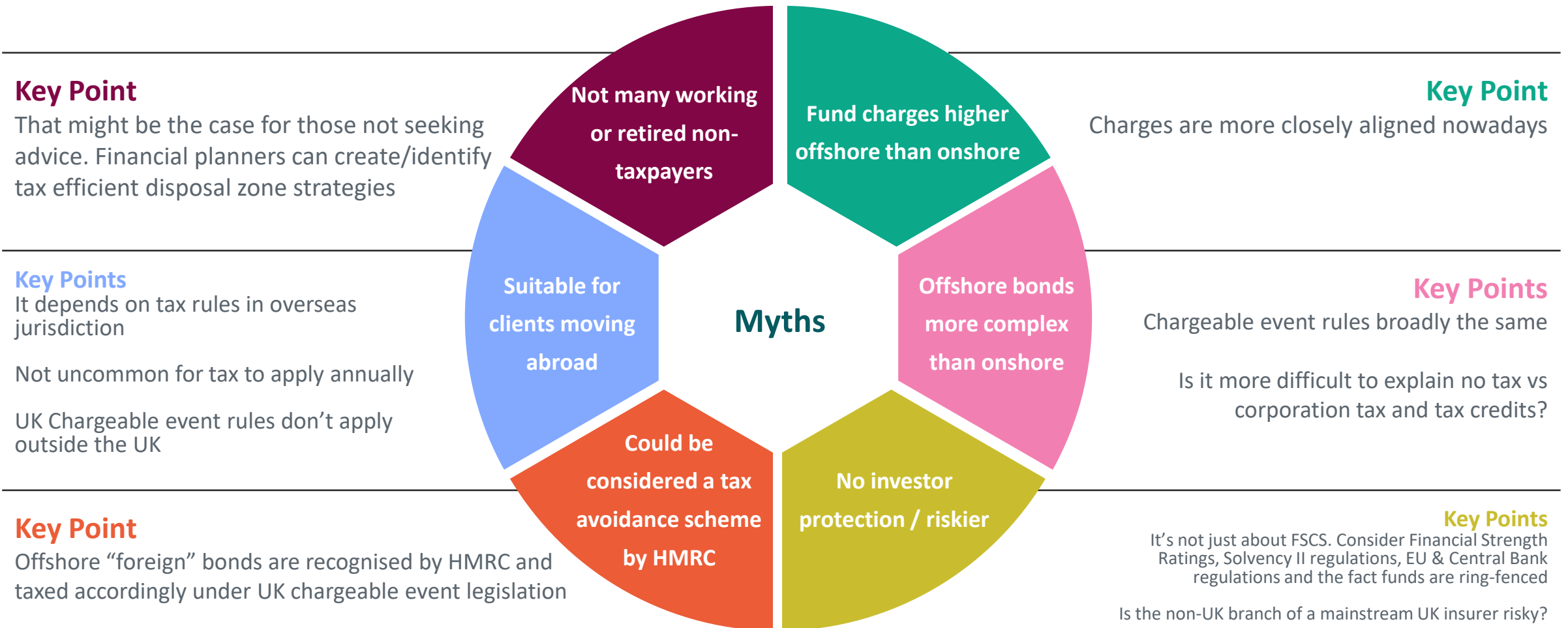
Non-FSCS protections

Life Assured only

Capital Redemption also available

Offshore

...mythbusters







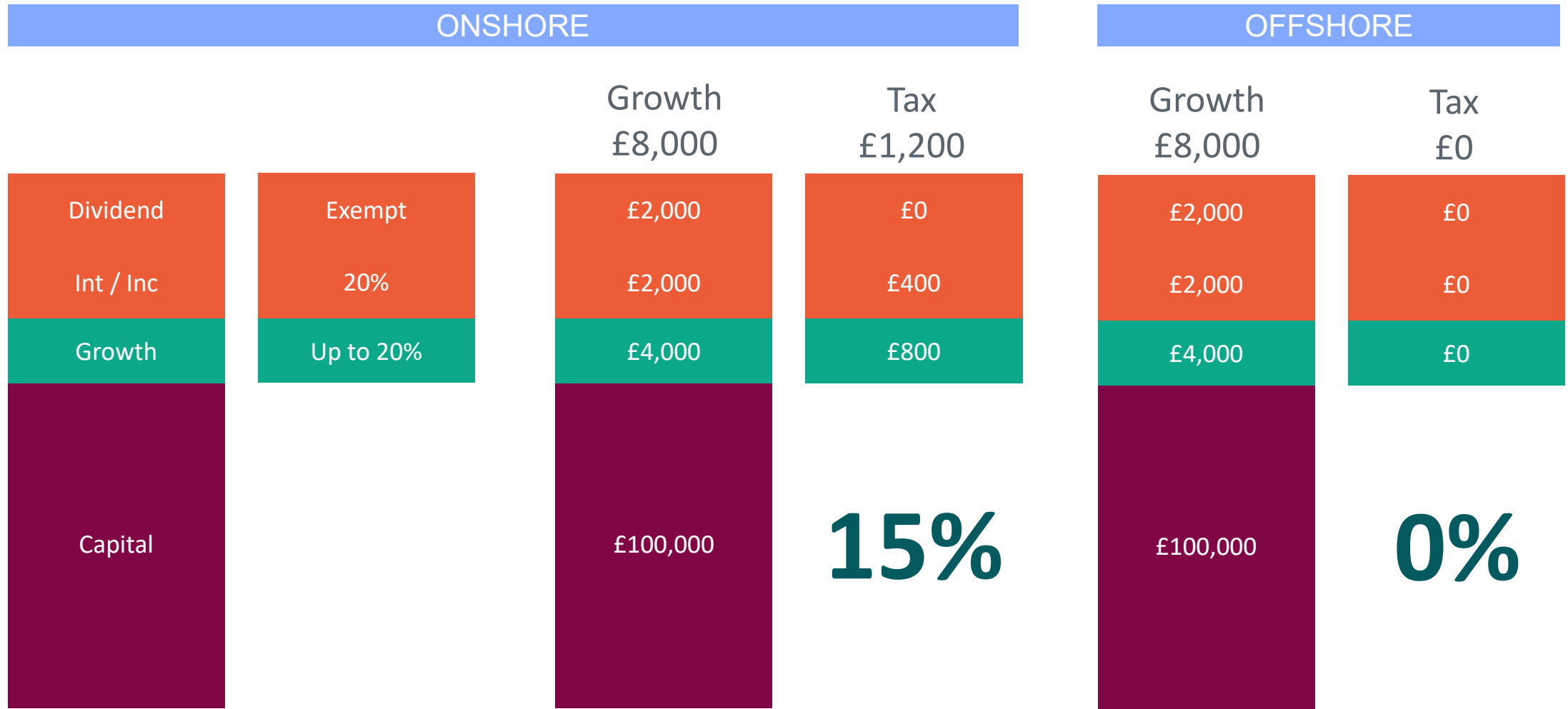
Internal Rate of Tax

Insurance Bonds

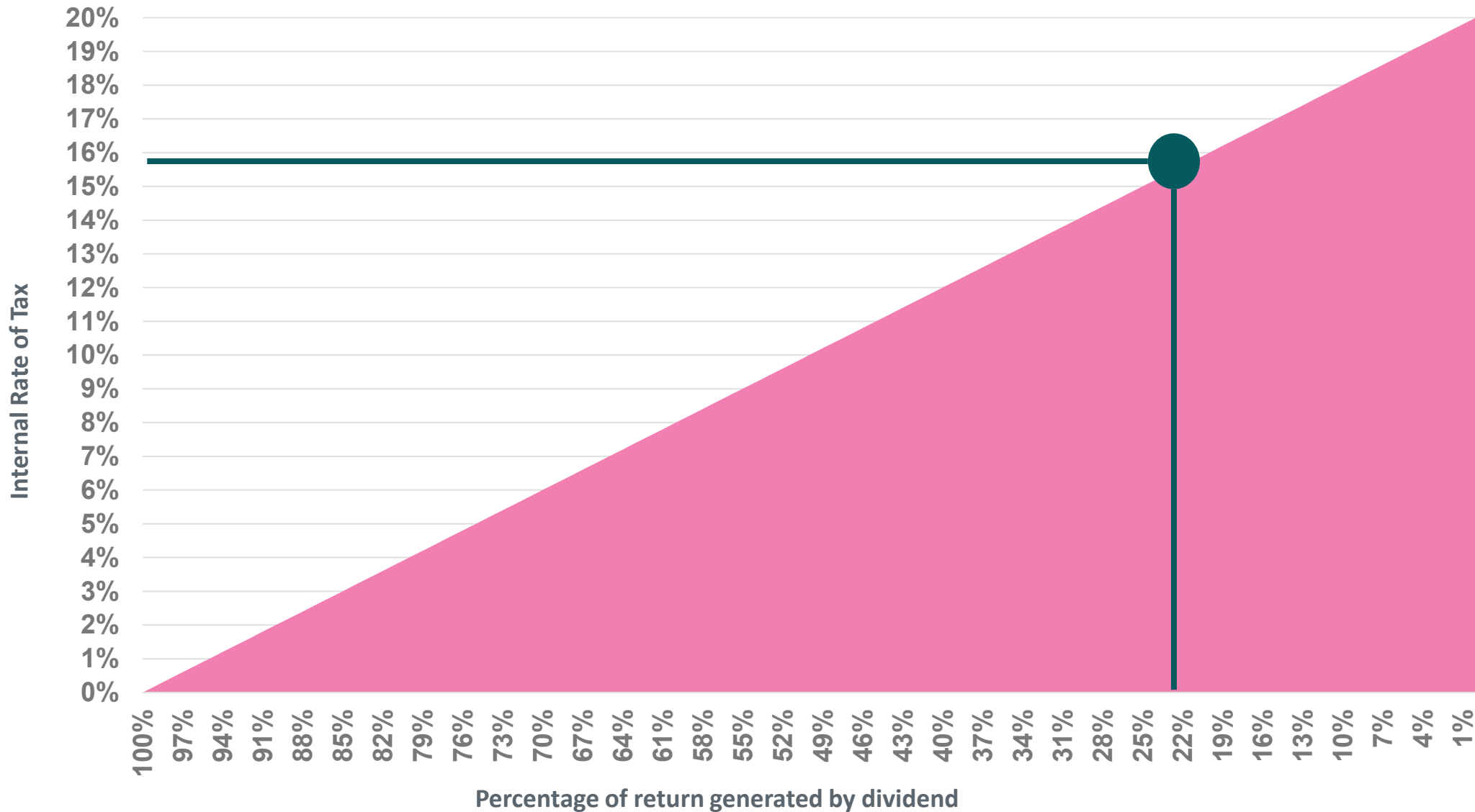
Internal Taxation

	Income	UK Dividends	Overseas Dividends	Capital Gains
 <p>“ONSHORE BOND”</p>	20% (22% from 4/2027)	Exempt	Exempt	20% (22% from 4/2027)
 <p>“OFFSHORE BOND”</p>	Exempt	Exempt	Exempt	Exempt

Internal Bond Taxation



Onshore Internal Tax Rate (by dividend component)



The crux...

...of the matter





Tax Deferral

Tax Deferral

Not tax free

Tax Deferral

No income produced

No CGT events

No tax events or reporting e.g. self assessment, trustee returns

Avoid tax traps (inc bare/IIP trusts)

Choose (or engineer) beneficial tax year for tax events

Tax Deferred Allowance

“Income” within no immediate tax impact

Higher / additional rate taxpayers looking to supplement income

No tax reporting / admin (especially trustees)

Simple way to deliver fixed income amount

Simplicity and tax efficiency – it's equal

Tax Events

Timing

Employment income

Gain Disposal Zone

Fixed pension income

Income controlled by
circumstances e.g. students,
or, adviser e.g. turn off
drawdown income

Who will be liable?

What will their income
position be?

What **could** you make their
income position?

How many tax years after
income stops/reduces
before fixed pension
provision starts?

Mitigates / eliminates chargeable event taxation

Non residence

Thoughts

No UK liability

**Chargeable event rules are UK tax rules
so are irrelevant**

Temporary Non-Residence rules

**Paying internal tax onshore would seem
undesirable**

UK liability

Periods of non residence expected

**Time Apportionment Relief (TAR)
- onshore and offshore**

**If a portion of gain is going to be exempt
paying internal tax onshore would seem
undesirable**



Top Slicing

Top slicing relief

Three easy steps

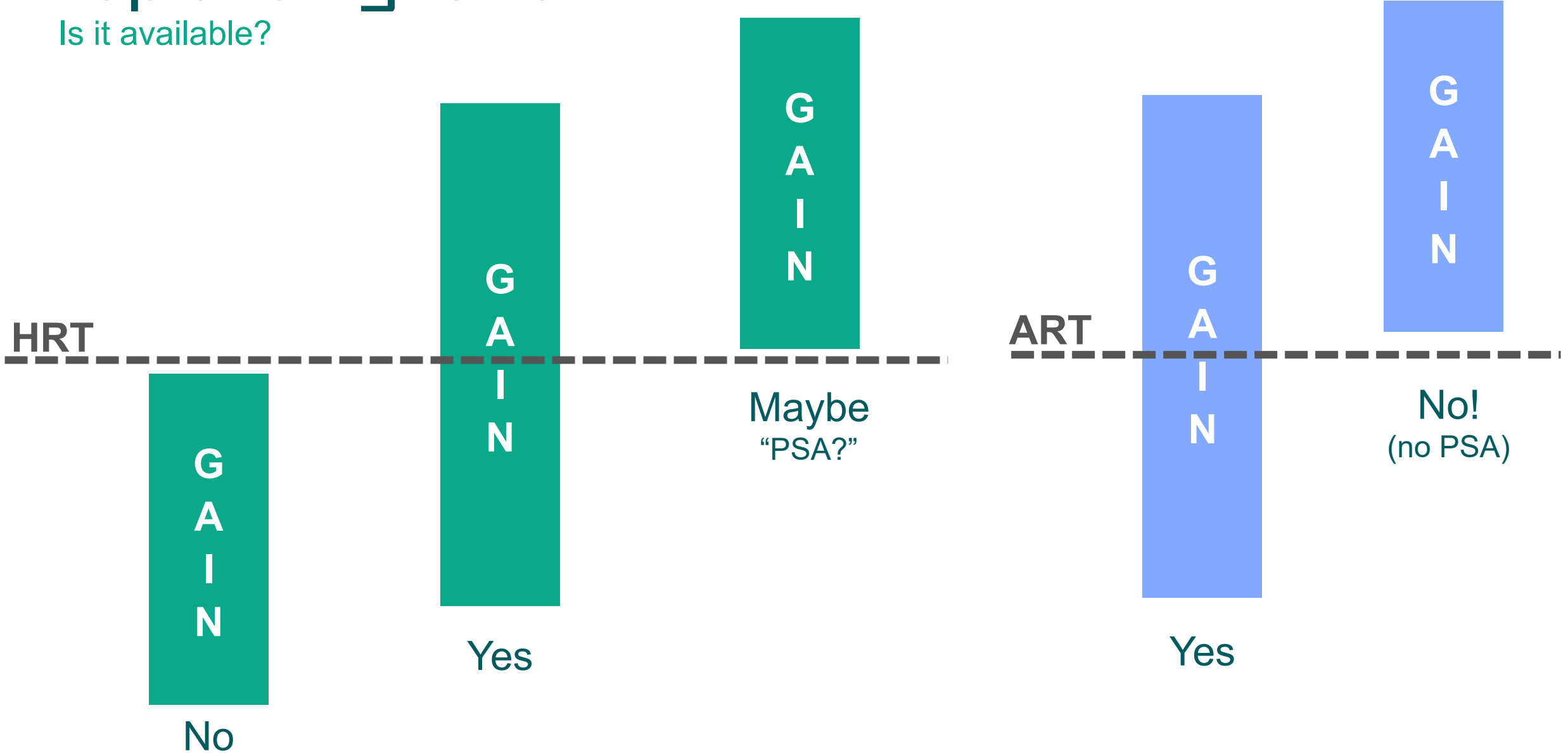


Allowances calculated based on full gain

Allowances calculated based on slice

Top slicing relief

Is it available?



Top slicing relief

Onshore and offshore work the same

Onshore		Offshore	
"Total Income"	£500,000	"Total Income"	£500,000
Adjusted Net Income	£500,000	Adjusted Net Income	£500,000
Personal Allowance	£0	Personal Allowance	£0
Personal Savings Allowance	£0	Personal Savings Allowance	£0
Child Benefit Charge	£0	Child Benefit Charge	£0
Capital Gains Tax	£0	Capital Gains Tax	£0
Tax Liability	£0	Tax Liability	£100,000
Bond Gains Summary		Bond Gains Summary	
Tax on gains	£210,203	Tax on gains	£210,203
Onshore Tax Credit	£100,000	Onshore Tax Credit	£0
Top slicing relief	£110,203	Top slicing relief	£110,203
Liability	£0	Liability	£100,000
"Bank Balance"	£500,000	"Bank Balance"	£400,000

£500,000 gain, no taxable income, accrued over 10 yrs

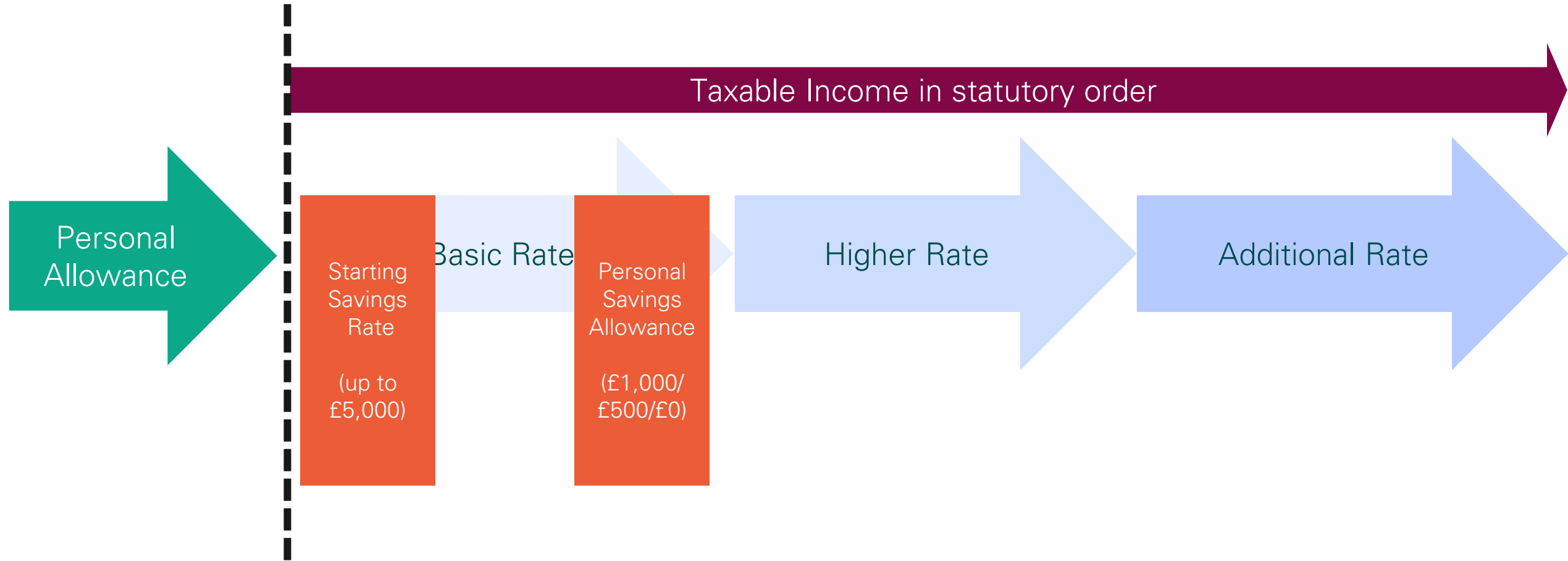
Offshore would need to outperform by c 2.5% per annum to equal net return



Savings Allowances

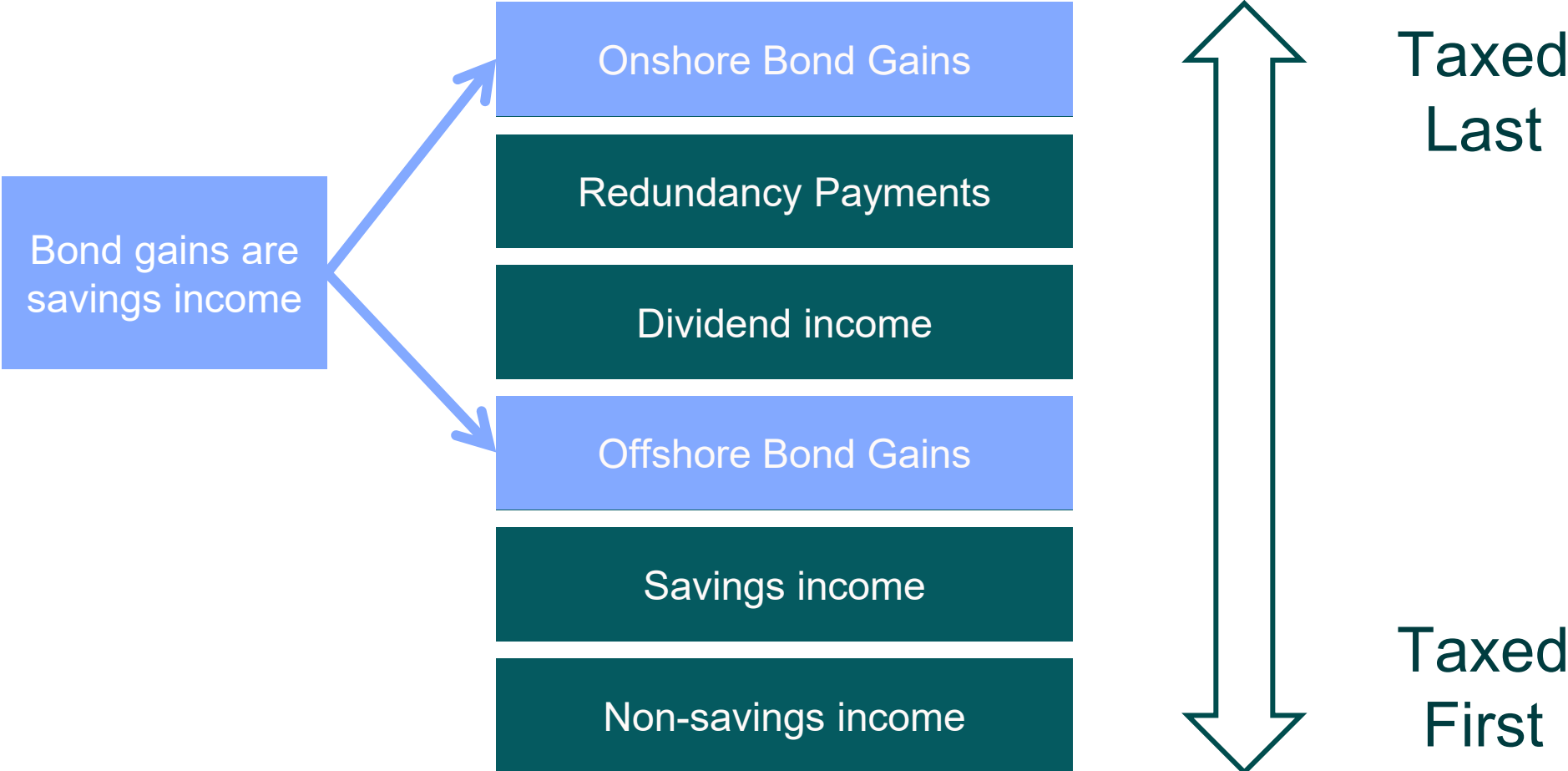
Savings Allowances

Benefit or not?



Order of tax

It's important



Savings Allowances

Benefit or not?



- Starting rate not required as covered by tax credit
- Potential for unused PSA to allow some top slicing relief if whole gain within higher rate band
- Niche tax reduction where:
 - tax credit within a savings allowance, and
 - gain within basic rate band, and
 - there is non bond tax payable
- Can allow tax free gains up to £18,570 (£37,140 joint) **after** gross rollup
- Potential for unused PSA to allow some top slicing relief if whole gain within higher rate band

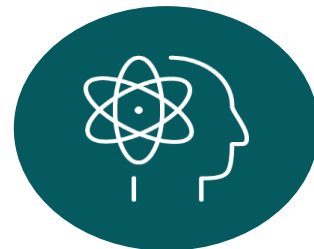
Tax Free Allowances

It's an offshore thing

£1,000 / £500
Personal Savings Allowance
£5,000
Savings Starting Rate

£12,570
Personal Allowance

Bond Gains
£18,570



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So...



Overall effective rate of tax

Onshore and offshore

	Onshore	Offshore	Onshore
Gross Return	£100	£100	£100
Tax within fund	22%	0%	15%
Net Return	£78	£100	£85
Where is slice on exit?			
Basic Rate	£0 / £78	£22 / £78	£0 / £85
Higher Rate	£15.60 / £62.40	£42 / £58	£17 / £68
Additional Rate	£19.50 / £58.50	£47 / £53	£21.25 / £63.75
Overall tax rate			
Basic Rate	22%	22%	15%
Higher Rate	37.6%	42%	32%
Additional Rate	41.56%	47%	36.25%

Overall rate onshore decreases as dividend component of return increases

The crux...

...of the matter

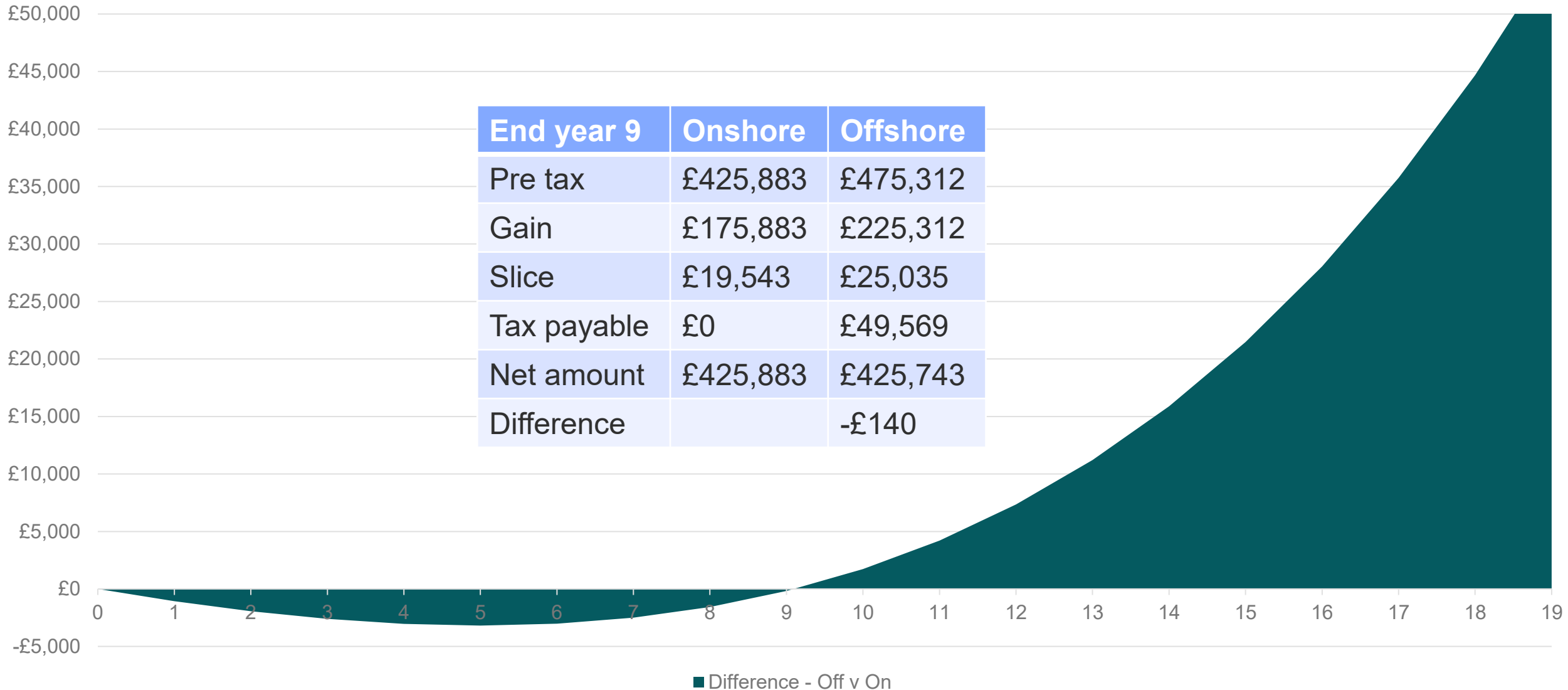


Offshore has to have sufficient additional return to overcome the lower effective overall tax onshore if it is to "win".

Offshore should always win where tax free allowances can be optimized.

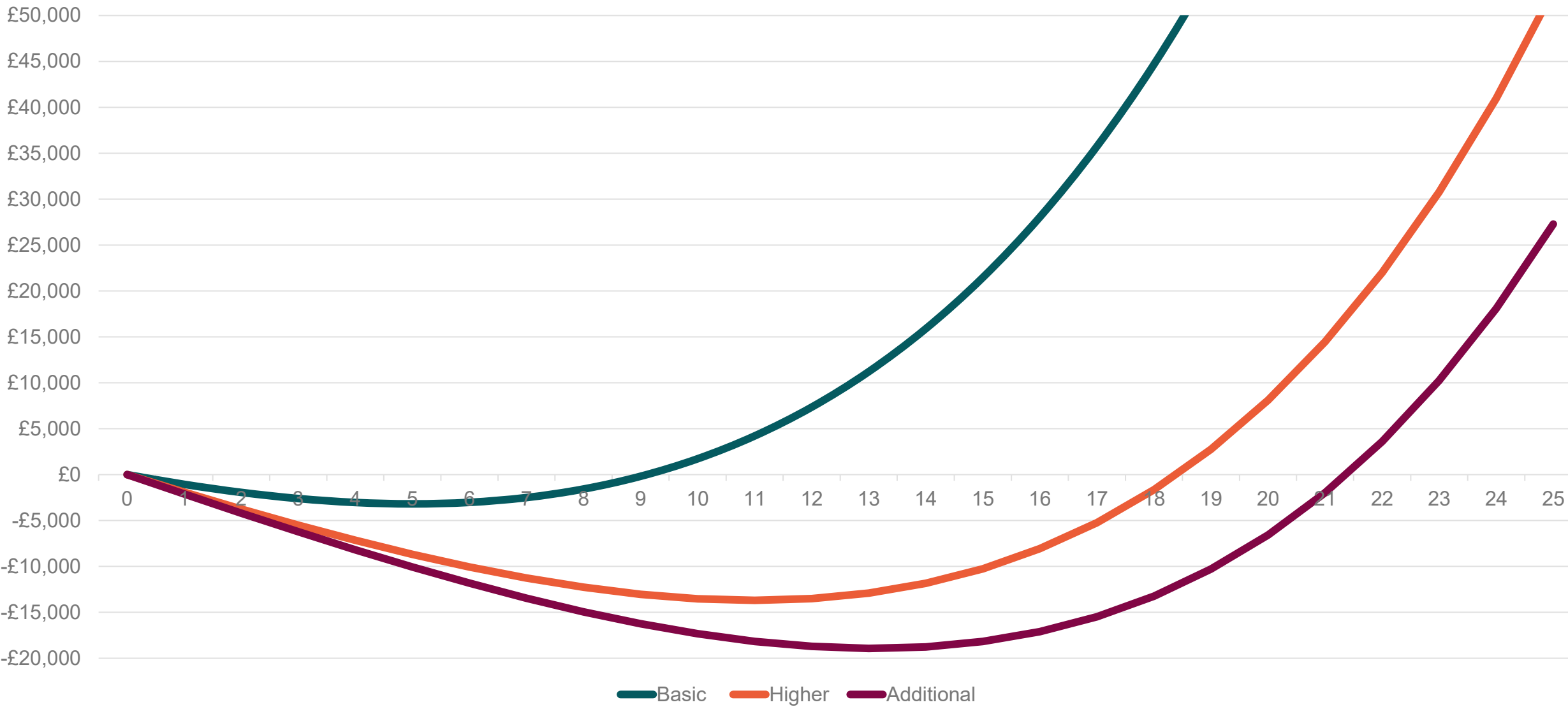
Basic rate on exit

£250,000 invested, gross return 7.4%, internal tax 17.6% (20% div), 22% savings rates used



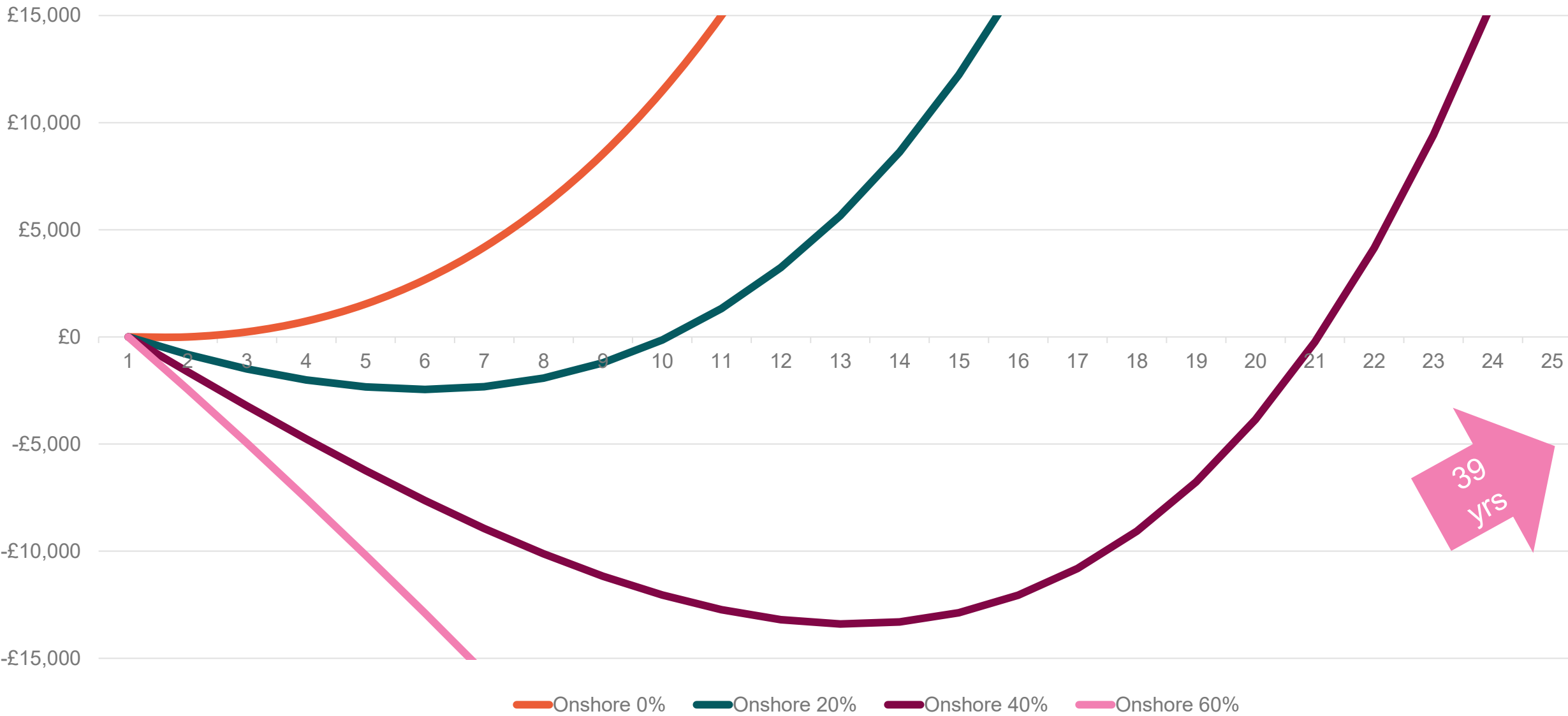
Onshore v offshore differential

22%, 42% and 47% savings rates used on exit



Onshore v offshore differential

Basic rate on exit but differing dividends component



Gross roll up

The story



Offshore takes longer to “win” as dividend component increases



Offshore takes longer to “win” as tax rate on exit increases



Taking withdrawals does not materially impact net return

Case Study

1

Mary



- Mary (75) wants to put aside £300,000 to help fund the education of her grandchildren.
- She wants to reduce her inheritance tax (IHT) liability, but also ensure any planning is effective for income tax purposes.
- She anticipates that withdrawals will need to be made from year 5.

Mary's adviser suggests...



- Gifting £300,000 into a discretionary trust, which will be invested in an offshore bond across 1500 segments.
- The beneficiary class include her two grandchildren.
- After five years, the bond has grown from £300,000 to £450,000.
- Each grandchild requires £30,000 (per annum) for education costs.

What is the gain?

Gain (1500 Segments Combined)	
Initial Premium	£300,000
Surrender Value	£450,000
<u>Chargeable Gain</u>	<u>£150,000</u>

Gain Per Segment	
Initial Premium	£200
Surrender Value	£300
<u>Chargeable Gain</u>	<u>£100</u>

Grandchildren require $£30,000 \times 2 = £60,000$

$£60,000 / £300 = \underline{\mathbf{200 \text{ Segments need to be surrendered}}}$

$200 \text{ Segments} \times £100 = \underline{\mathbf{\text{Chargeable Gain of } £20,000}}$

What is the tax liability?

Settlor (Mary)
is assessed

Mary's total
income is
£25,000

Personal
Savings
allowance is
used by other
savings
income

Tax Liability is Chargeable Gain (£20,000) x 22% = £4,400

Is there a better way?

Use a deed of appointment to create a bare trust for the grandchildren

Appoint the 200 segments into the bare trust

Surrender the 200 segments

Chargeable gain of £20,000 assessed on the grandchildren (*£10,000 each*)

Summary



- Each grandchild has a chargeable gain of £10,000, which they need to report to HMRC.
- No tax is paid as the gain sits within their personal allowance.
- This process is repeated in subsequent tax years, meaning a 0% tax rate is paid on the investment bond gains.



Are Onshore bonds suitable for people with savings allowances?

£1,000
Personal Savings Allowance
£5,000
Savings Starting Rate

£12,570
Personal Allowance

Bond Gains
£18,570

Case Study

2

Stuart



- Stuart (48) is an NHS Consultant earning £140,000 per annum and has recently received a gift of £250,000 from his grandmother.
- He has plans to retire at 58 and wants to use this lump sum towards funding his retirement.
- NHS Pension of £50,000 per annum will begin at age 68.
- Between 58-68, Stuart is projected to have zero taxable income.

Stuart's adviser suggests...



- Stuart (48) invests £250,000 into an offshore bond.
- He retires on his 58th birthday and the bond is now valued at £500,000.
- Stuart has told his adviser that he needs £40,000 per annum from the bond, as a bridge until his NHS pension and state pension commence payment at 68.

What is the gain?

Gain (1250 Segments Combined)	
Initial Premium	£250,000
Surrender Value	£500,000
<u>Chargeable Gain</u>	<u>£250,000</u>

Gain Per Segment	
Initial Premium	£200
Surrender Value	£400
<u>Chargeable Gain</u>	<u>£200</u>

Stuart needs £40,000 per annum.

$£40,000 / £400 = \underline{100 \text{ Segments need to be surrendered}}$

$100 \text{ Segments} \times £200 = \underline{\text{Chargeable Gain of } £20,000}$

How much tax does Stuart pay on his £40,000 bond withdrawal?

	Gain	Tax Rate	Tax Liability
Starting Rate	£5,000	0%	£0
Personal Savings Allowance	£1,000	0%	£0
Personal Allowance	£12,570	0%	£0
Basic Rate	£1,430	22%	£314.60
Total	£20,000		£314.60

Effective tax rate = 1.57%

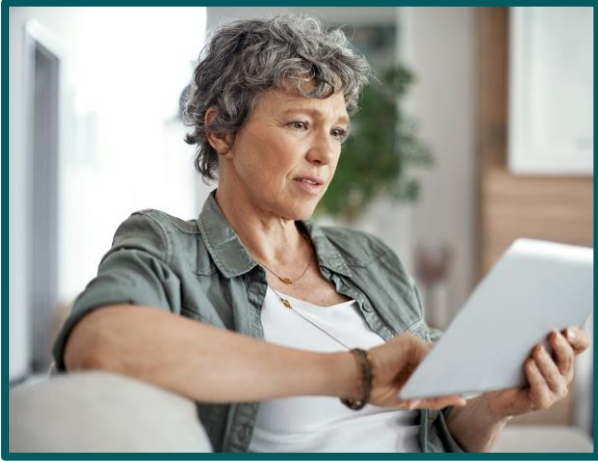


Are Onshore bonds suitable for people with savings allowances?

Case Study

3

Emily



Age 55 and has £300,000 in cash savings that she wants to invest for 5 years.

Intends to purchase a holiday home in France on her 60th birthday.

Currently earns £75,000 per annum but will be working part-time in 2031 and she estimates her earnings will be £35,000.

Emily

	Onshore Bond	Offshore Bond
Starting Value (Year 1)	£500,000	£500,000
% of return generated by dividends	20%	20%
Net Investment Return	5.77% per annum	7.00% per annum
End Value (Year 5)	£661,822	£701,276

Chargeable Gain	£161,822	£201,276
Tax Paid on Bond Gain in Self-Assessment <i>(entire bond surrendered in a single tax year)</i>	£16,594	£64,740
<u>Amount left in bank account</u>	<u>£645,228</u>	<u>£636,536</u>

Onshore or offshore

Rule(s) of thumb

Those who may be able to use tax free allowances should be offshore

Basic rate taxpayers should be considering offshore if investing for 10yrs+ (Higher 18yrs+)

Uncertainty on exit tax position favours offshore

High dividend components in return favour onshore, regardless of tax on exit

Non residence factors favour offshore

Learning Objectives

By the end of this session, you will be able to:

Explain why insurance bond use is on the rise

Explain the specific tax attributes of insurance bonds

Evaluate when onshore or offshore will deliver the best outcome for your clients

Q & A



Thank
you



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