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INDEPENDENT FINANCIAL ADVISERS

Baker Davies Product Guide

Offshore investment bond

2025/26 Tax Year

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Offshore investment bond

What is it?

Offshore Bonds are collective investments in which the investments of many individual investors are pooled. They are technically single premium life assurance contracts and therefore normally have nominal life cover attaching, however they can also be written on a capital redemption basis without a life assured. A wide choice of funds is available ranging from managed to specialist funds. A number of companies market offshore life policies, particularly single premium bonds. The most popular are those issued by subsidiaries of well-known UK life offices in countries such as Luxembourg, the Republic of Ireland, the Channel Islands and the Isle of Man.

The income and gains of an offshore bond fund will normally be free of tax in the relevant jurisdiction. Hence, they are often referred to as benefiting from 'gross roll-up'.

Whilst there will normally be no tax in the particular tax haven that the insurer is based, the fund is likely to suffer some withholding taxes on its underlying investments. There may be scope to reclaim some of the tax under double taxation agreements but it is unlikely that an offshore fund with equity content will ever be truly gross.

The ability to defer tax is greater under an offshore bond than an onshore bond, therefore the longer it is held the greater the compounding effect of the tax deferment. All things being equal an offshore fund will create a greater return than an onshore one over the longer term. However, the greater the level of withholding tax and management expenses (an offshore fund has no tax from which it is able to deduct management expenses) the less an individual will benefit from gross roll up.

Eligibility

To be eligible to invest in an investment bond, an individual investor must be 18 years of age or over. The investment can also be made on a joint basis, or by a company or trustee(s).

The nominated life (lives) assured is usually the applicant / investor but could also be an individual aged under 18.

Contribution limits

The minimum lump sum is usually around £20,000 but this may be higher or lower depending on the provider. The maximum limit will be set by the provider.

Taxation

Offshore bond gains are liable to tax and the rate will depend on the policyholder's personal tax position. The personal allowance, the starting rate band for savings income and the personal savings allowance can all potentially be offset against offshore bond gains to receive some or all of the gains tax free. If earned income falls below the total of the personal allowance and

starting rate band for savings (£12,570 plus £5,000 currently) gains up to that level can be taken tax free. In addition, if the personal savings allowance is available this can also be offset to achieve tax free gains of up to £1,000 (basic rate taxpayers) or £500 (higher rate taxpayers). Otherwise gains will be taxed at the basic rate of 20%, higher rate of 40% or additional rate of 45%. If the policyholder has been UK resident throughout the life of the offshore bond then the whole gain will be taxed in this way. However, if the policyholder has been non-resident for part of the term then the chargeable gain is reduced.

Top-slicing relief is available on offshore bonds but can only be used to reduce (or eliminate) higher rate tax liability – it cannot be used to reduce basic rate liability. It is also available to higher rate taxpayers where the total gain is not covered by the higher rate band, in order to assess whether any additional rate tax is due. The number of years used for top-slicing is reduced by the number of complete years for which the policyholder was non-resident. Where the policyholder has been UK resident throughout the life of the bond, the top-slicing period on a chargeable event resulting from a partial encashment only runs from the date of the last chargeable event if there has been more than one – this is the case for offshore bonds taken out from 6 April 2013 onwards (or those added to or assigned on or after that date).

Changes to top-slicing relief calculations were made from 11 March 2020 and backdated to apply to gains made in tax year 2018/19 onwards:

- Allowances and reliefs have to be set as far as possible against other income in preference to the gain
- The personal allowance is reinstated within the top-slicing relief calculation where it has been reduced by reason of including a gain in their income for the year i.e. in the step of the calculation where the tax on the slice is worked out, the personal allowance used is that available based on income plus the 'slice' (Note: This doesn't change the fact that the full gain forms part of Adjusted Net Income as described further below)
- From 2021/22 onwards, in the step of the top-slicing relief calculation where the tax on the slice is worked out, the amount of personal savings allowance and starting rate band for savings is assessed using the slice and not the full gain. However, the full gain is added to income to work out whether there is loss of these allowances to use against income generally.

All statements concerning the tax treatment of products and their benefits are based on our understanding of current tax law and HM Revenue and Customs' practice. Levels and bases of tax relief are subject to change.

Withdrawals

You can withdraw some or all of your money whenever you need to.

You can benefit from the '5% rule' which allows you to withdraw up to 5% of the initial premium in each policy year (until such time as all of the original investment has been withdrawn, for example 20 years if 5% is withdrawn each year) with no immediate tax liability. At the start of each policy year, a tax deferred allowance is accrued of 5% of the premiums paid. If this allowance is not used it can be carried forward to use in future policy years (the cumulative allowance).

Should you need to make withdrawals in excess of the cumulative 5% entitlement in order to achieve the necessary 'income' level in the future, any such excess would be added to your taxable income in the tax year and charged to income tax. Top slicing relief is available to those who are not already higher or additional rate taxpayers when assessing whether any higher or additional rate tax is payable on the policy gain. Some gains may not incur a tax liability at all if, when added to other income, the total gain falls within the personal allowance (and starting rate band if available).

On death of the last life assured a lump sum will be paid out based on the surrender value of the investment, this will be taxed in the same way as a surrender. Where the capital redemption option has been selected, the bond will continue for a term of 99 years unless it is surrendered before then.

You should also be aware that if a chargeable gain occurs, the full gain is added to your other income in the tax year for the following purposes:

- In order to assess whether 'adjusted net income' exceeds £100,000 and the Personal Allowance is reduced or lost (lost completely once total income reaches £125,140 currently)
- In order to assess whether 'adjusted net income' exceeds £60,000 and the High Income Child Benefit Tax Charge is applied (the child benefit is clawed back completely by way of the tax charge once adjusted net income reaches £80,000)
- In order to assess whether Married Couple's Allowance is reduced (i.e. where at least one of the couple was born before 6/4/ 1935) - This allowance is reduced if 'adjusted net income' including the full gain exceeds £37,700 (2025/26)
- To calculate 'adjusted income' (a different figure to the above) and 'threshold income' when assessing whether the pensions annual allowance needs to be tapered – If adjusted income exceeds £260,000 and threshold income exceeds £200,000 the annual allowance is reduced (to a minimum of £10,000 if adjusted income reaches £360,000 plus)

The Provider may apply penalties to your investment in the event of partial or full surrender of the Bond within the first few years of investment.

These are applied on a sliding scale basis, over the period.

Trust Registration Service (TRS)

The Trust Registration Service (TRS) is a government register of the beneficial ownership of trusts. From 6 October 2020, the scope of the TRS was extended. The new rules are to ensure that the UK has an anti-money laundering and counter terrorist financing regime that is up to date, effective, and proportionate. The rules will improve transparency about the ownership of assets held in trust.

If the investment bond is written under trust, it will need to be registered on the TRS. The deadline for registration is 90 days from trust creation.

Where the offshore bond is with a life office based in Ireland, the trust also needs to be registered on the Irish Central Register of Beneficial Ownership of Trusts (CRBOT).

NB: The Irish Revenue are simplifying the process for UK resident trustees so our understanding, at time of writing, is that the Irish Revenue is writing to trustees on a phased

basis with details of how to register. The CRBOT 'FAQs and troubleshooting for UK trustees and advisors' document gives the latest information.

The trustees can designate a 'lead trustee' to register the trust or an 'agent'. The 'agent' would need to be a business which operates as an accountancy service provider.

Risk considerations

There are a number of risk considerations that need to be taken into account. It is important that you are aware of these.

- Past performance is no guarantee of future returns.
- If growth is low, charges may eat into the capital invested.
- Any ad-hoc or ongoing adviser charges being paid from an investment bond will count towards the 5% tax deferred allowance.
- The value of this investment is not guaranteed and on encashment you may not get back the full amount invested.
- If withdrawals are made at a rate which exceeds the net growth of the fund, capital will be eroded.
- Before making any withdrawals in excess of the cumulative 5% allowance, you should seek advice in respect of the most appropriate and tax efficient method of achieving this.
- The price of units and the income from them can fall as well as rise.
- A surrender penalty may apply if you encash this investment in the early years.
- An early withdrawal charge may apply.
- The government may change the tax rules that currently apply to offshore bonds.
- Please be aware that there may be occasions when an individual fund or funds may have a higher risk rating than your overall stated attitude to risk. If this is the case, then the overall risk rating applied to all of the combined funds being recommended will still be designed to meet your stated tolerance.
- The illustration uses certain assumed rates of growth, as prescribed by the Financial Conduct Authority, these rates are not guaranteed.



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