Investment Bonds

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# Introduction

Welcome to Investment Bonds for PFE Online Training.

The Income Tax changes announced by the UK government in 2022 and 2024 have huge implications for the future of UK investment bonds, particularly their tax-efficiency relative to other wrappers. With this in mind, we have created this course to highlight these and bring them into the forefront of the financial planning process.

If investment bonds form part of your advice proposition, it is highly recommended you complete this course.

## Learning Outcomes

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

* Explain the Income Tax changes in the Autumn Statement 2024, including how they impact the taxation of chargeable gains on UK and offshore investment bonds.
* Complete **moderately complex** top-slicing calculations for basic/higher and higher/additional rate taxpayers.
* Explain the tax position in relation to UK and offshore investment bonds for a married couple where one partner is deceased.
* Explain how personal pension contributions minimise tax on chargeable gains for UK and offshore investment bonds.

## Course Structure

This course comprises this PDF document and a case study with short-answer questions into an engaging blended learning experience.It provides the following CPD:

|  |  |  |
| --- | --- | --- |
| **CPD Hours** | **Structured?** | **IDD CPD?** |
| 6 | Yes | Yes |

Realistically, if you digest all learning materials and complete the assessments, this course should take most people approximately six hours.

# The Autumn Statement 2024

A critical understanding of the UK tax system is essential for competent Financial Advisers. Particularly, Income Tax and National Insurance, which must be established and evaluated to inform recommendations for tax wrappers including investment bonds and pensions.

Labour’s Autumn Statement 2022 will have a significant impact on investment and pension planning in 2025 and beyond.

## Income Tax Thresholds

In the UK (excluding Scotland) there are three main tax brackets. These are:

|  |  |  |
| --- | --- | --- |
| **Bracket** | **Rate %** | **2024/25** |
| Basic | 20% | £0 to £37,700 |
| Higher | 40% | £37,701 to £125,140 |
| Additional | 45% | £125,141 and over |

These thresholds have been frozen until 2028/29.

Most UK taxpayers have a personal allowance for Income Tax. This is an amount of otherwise taxable income they can receive without being subject to Income Tax. This amount in 2024/25 is £12,570, and the government has frozen this until 2028/29. In real terms, this is a tax increase, because of inflation.

**Inflation** is the general rise in the cost of goods and services, and the corresponding fall in the purchasing power of money.

If goods and services are costing more each year, and the personal allowance is frozen and wages don’t rise, individuals will be able to purchase fewer goods and services. From a purchasing power perspective, they are paying a greater proportion of their income in tax.

If wages rise (which they tend to do as employees demand more money to combat inflation and maintain their standard of living) and the personal allowance is frozen, a greater proportion of their income falls outside of the personal allowance and will be subject to tax.

**There is therefore an argument that a freeze on the personal allowance is a “stealth tax”.**

## Savings Allowances

The **Personal Savings Allowance** (PSA) is a tax relief that offsets tax on savings income.

As a reminder, savings income for the purpose of the PSA includes interest earned on cash savings, coupons on most fixed interest securities, interest paid by collective investment schemes which are predominantly invested in bonds (generally 60%+), and chargeable gains on investment bonds.

The amount of PSA someone has depends on their highest marginal tax bracket:

|  |  |
| --- | --- |
| **Bracket** | **PSA Available** |
| Basic | £1,000 |
| Higher | £500 |
| Additional | £0 |

The **Starting Savings Rate** (SSR) has not been impacted by the Autumn Statement. As a reminder, it provides an additional 0% band of £5,000 which can be offset against savings income only. However, it’s only available for lower earners because it’s tapered away by £1 for every £1 of non-savings income earned over the £12,570 Personal Allowance.

## Dividends and Capital Gains

The annual dividend allowance is a 0% tax band available to offset tax on dividend income only. This includes dividends received from individual company shares and collective investment funds. It’s reduced as follows:

|  |
| --- |
| **Dividend Allowance** |
| 2022/23 | 2023/24 | 2024/25 |
| £2,000 | £1,000 | £500 |

Capital Gains Tax (CGT) is in a similar position:

|  |
| --- |
| **CGT Annual Exemption** |
| 2022/23 | 2023/24 | 2024/25 |
| £12,300 | £6,000 | £3,000 |

For life offices, this was probably music to their ears because it makes unwrapped collectives (OEICs, unit trusts, and investment trusts) far less tax-efficient than they were. And bonds look much more competitive. It’s worth the reminder that investment bond chargeable gains are not subject to Capital Gains Tax, but Income Tax.

Over the past several years, the standard tax wrapper solution for typical investment planning clients involved a “bed and ISA” strategy facilitated via an online platform. This is where the first £20,000 would be invested into an ISA, with the remainder in a General Investment Account (GIA). For tax purposes, the funds in the GIA were unwrapped, while income and gains in the ISA would not be subject to any Income Tax or Capital Gains Tax.

This worked well. For a £100,000 investment planning client, £20,000 could be immediately wrapped within an ISA. The remaining £80,000 would then be held within a GIA. Each year, the platform would automatically sell down £20,000, move it over to the ISA, and immediately repurchase the same funds within the ISA.

The £80,000 in the GIA could produce a dividend yield of 2.5% before the dividend allowance was exceeded, and with the typical dividend yield on a multi-asset tracker fund being 1-2%, it was unlikely any Income Tax would ever be payable. For advised portfolios of single-sector funds, Advisers could prioritise wrapping higher-yielding funds within the ISA to help minimise the risk of a tax liability. Furthermore, with such a generous CGT annual exemption, it was unlikely that any of the £20,000 bed and ISA transactions would result in gains falling outside it.

However, from 2023/24, this is no longer the case and Advisers are going to have to think much more ‘outside the box’. Possible workarounds include:

* Considering whether to sell down £20,000 each year to fund the ISA in full, or less to part-fund the ISA if it could cause an unacceptable/avoidable liability to CGT. It may well be that a full written and numerical analysis (based on the fund’s income yield, growth, and potential for a future reduction in the ISA allowance) is needed each year to determine the optimal amount to surrender to fund the ISA.
* Using advised portfolios of single-sector funds, which provides Advisers the flexibility to determine which asset classes to wrap in the ISA first. For example, higher-risk assets more likely to yield high dividends or produce strong growth.
* Consider balancing growth and income funds. Growth funds are likely to produce a low dividend yield but strong growth which could quickly use up the lower CGT allowance, whereas income funds are likely to produce a high dividend yield with lower growth, which could quickly use up the lower dividend allowance.
* Consider using alternative tax wrappers, such as pensions and investment bonds.

**The Holborn Cash ISA Cleverness**

The Team at financial planning firm Holborn Assets came up with a clever tax planning strategy for clients with existing cash ISA money that they didn’t want touched, and new money requiring investment advice. It involves replacing the cash ISA with a deposit account, and the effect is to wrap investments within the ISA much more quickly. Again, it’s best explained with an example.

Harriet, a basic-rate taxpayer, has an existing cash ISA of £25,000 and a recent inheritance of £100,000. The cash ISA money is an emergency fund/cash savings account on which she is not requesting investment advice. However, she is requesting investment advice for the £100,000 inheritance.

Her Adviser recommends that she transfer the £25,000 ISA into a stocks and shares ISA. The money is then used to purchase investment funds. The cash ISA is replaced by £25,000 of the inheritance money within an ordinary instant-access savings account with a 3% interest rate. The 3% interest is £750, which is within her PSA.

The Adviser then recommends a further £20,000 contribution into the ISA to use this tax year’s ISA allowance in full, with the remaining £55,000 of the Inheritance being invested into a GIA, into dividend-paying multi-asset collectives.

The result is as follows:

1. Harriet still has her cash savings of £25,000, and she’s still not paying any tax on her income.

2. Harriet has £45,000 of her inheritance immediately wrapped in her stocks and shares ISA, as opposed to just £20,000.

3. The remaining £55,000 in the GIA is potentially low enough to avoid breaching the dividend allowance and CGT annual exemptions over the coming years, especially when combined with the Wicks ISA Strategy.

Had this strategy not been used, it could have taken 2-3 years longer to wrap everything, exposing Harriet to increased risk of a tax liability, particularly given the reducing dividend allowance and CGT annual exemption. This is very efficient use of her available allowances – real financial planning; the kind that retail clients need and for which they are prepared to pay.

## Inheritance Tax

The Inheritance Tax (IHT) Nil-Rate Band (NRB) and Residence Nil-Rate Band (RNRB) will remain frozen at £325,000 and £175,000 respectively until 2028/29.

This is arguably another stealth tax because, over time, peoples’ investments and property are expected to increase in value. More and more of a person’s assets are therefore likely to fall outside the NRB and RNRB, increasing the proportion of assets which are ultimately paid in tax.

IHT is relevant to this course because bonds can very easily be assigned into trust for IHT purposes, whereas ISAs cannot. While GIAs can be held in trust, they also yield income in the form of savings income or dividends, which can create complexity and tax-inefficiency. Bonds continue to be more attractive for many Financial Planners advising settlors and trustees.

# Top-Slicing Relief

The taxation of investment bonds is complex. However, Financial Advisers should be able to complete basic Income Tax calculations for UK and offshore investment bonds. That said, while taught in some professional exams, many Financial Advisers struggle. The main sticking points are as follows:

* Understanding how to correctly apply Top-Slicing Relief (TSR).
* Understanding that the taxation of the investment bond needs to be established in context with the client’s other income for the year. It’s not about the taxation of the investment bond in isolation, it’s about the taxation of the client based on the bond and their other income.

Investment bonds are only subject to Income Tax when a “chargeable event” occurs. There are several, with the most common being upon full encashment of segments, or partial encashment in excess of the 5% cumulative annual withdrawal limit.

|  |  |
| --- | --- |
| **Type of Surrender** | **Chargeable Gain** |
| Full segment | The actual investment gain on the segment(s). |
| Partial (across the top of all segments) in excess of the 5% cumulative annual withdrawal limit | The full amount of the excess over the 5% cumulative annual withdrawal limit, which may mean that the client needs to pay tax on their original capital. |

## Bond Segmentation

Most investment bonds are not single life assurance policies but made up of clusters of smaller individual life assurance policies. Each of these smaller policies within the cluster are called **segments**.

The overall bond (made up of the cluster of segments) is allocated a policy number, e.g., A123456. Then, each segment is identifiable via its own policy number. A simple investment bond consisting of 10 segments would be structured as follows:

A123456-001

A123456-002

A123456-003

A123456-004

A123456-005

A123456-006

A123456-007

A123456-008

A123456-009

A123456-010

Writing investment bonds in segments provides additional flexibility for tax planning, because where a large partial withdrawal is required, and the client has not yet built up an adequate 5% cumulative annual withdrawal limit to facilitate the withdrawal, the client can simply encash full segments and pay tax on the true gain on the surrendered segments rather than the excess over the 5% limit.

In the example above, if the client wanted to take half their money out, they could simply encash segments A123456-001 through to A123456-005.

There aren’t really any tangible disadvantages to segmentation. However, Financial Advisers need to ensure they’re recommending a suitable number of segments which will vary from client to client, based on their objectives.

**Scenario: You have a client who has an objective to mitigate Inheritance Tax, and you have decided to recommend an investment bond in a discretionary trust (for example, a gift trust, loan trust, or discounted gift trust). But how many segments should you have?**

One answer is "as many as possible" but this isn't always (or often!) the optimal number.

Essentially, the number of segments should be divisible by the number of beneficiaries. For example, if you have two beneficiaries, it makes sense for there to be, say, 100 segments. This provides a great deal of flexibility for tax planning and is divisible by two (50 segments for each beneficiary). 100 segments is very common for investment bonds.

However, what if there are three beneficiaries? 100 doesn't go into 3 exactly, so when the time comes to assign the segments to the beneficiaries for them to encash at their marginal rates of tax, there will be a remainder which may need to be encashed within the trust. This creates unnecessary complexity with the plan.

100 divides by two (50 segments each), four (25 segments each), five (20 segments each), and ten (10 segments each) perfectly.

Some bonds allow 1,000 segments. This works even better because we now have more flexibility for tax planning for each beneficiary, and we can now divide by eight (125 segments each).

Yet, this is still not optimal because many trusts have, say, two beneficiaries but there may be a third one born in the future. Where the number of beneficiaries is unknown, it makes sense for the number of segments to be divisible by as many numbers as possible. So, what is the answer?

**Our Answer is 120 (or Multiples Thereof) Such As 1,200**

120 divides into two (60 segments each), three (40 segments each), four (30 segments each), five (24 segments each), six (20 segments each), eight (15 segments each), and ten (12 segments each).

For example, if you have two possible beneficiaries just now, but more grandchildren or even great grandchildren could be born in future, 120 offers a great deal of chance that the number of segments will be divisible by the number of beneficiaries, as it allows for a further FOUR beneficiaries to be born before we hit 7 and the game is up.

Pru / M&G is one provider which offers only up to 100 segments on **some** of its investment bonds. So, 120 cannot be used. What we can do is take the closest multiple of twelve which is 96. 96 total segments divides into two (48 segments each), three (32 segments each), four (24 segments each), six (16 segments each), and eight (12 segments each).

This can be compared with 100 segments, which would give you five (20 segments each) but not three.

## Income Tax Calculation – Basic Rate

Let’s consider a simple example to get us started: Lucius has a salary of £44,770, savings income from his cash savings account of £500, and a UK investment bond chargeable gain of £50,000. Lucius has held the bond for 5.5 years.

The first thing we do in any Income Tax calculation is establish whether we’re over £100,000 of adjusted net income, which determines whether we have any Personal Allowance tapered away. Fortunately, we’re at £95,270, so we’re all good.

**REMEMBER:** IT IS THE GROSS GAIN THAT DETERMINES OUR ADJUSTED NET INCOME, AND OUR LEVEL OF PERSONAL SAVINGS ALLOWANCE - NOT THE SLICE!

|  |  |  |  |
| --- | --- | --- | --- |
| **Income Source** | **Amount** | **Tax Rate** | **Amount of Tax** |
| Salary | £12,570 | 0% Personal Allowance | £0 |
|  | £32,200 | 20% | £6,440 |
|  | £0 | 40% | £0 |
|  | £0 | 45% | £0 |
| Savings Income | £500 | 0% PSA | £0 |
|  | £0 | 20% | £0 |
|  | £0 | 40% | £0 |
|  | £0 | 45% | £0 |
| UK Chargeable Gain | £0 | 0% | £0 |
|  | £5,000 | 20% | £1,000 |
|  | £45,000 | 40% | £18,000 |
|  | £0 | 45% | £0 |
| **Total** | **£95,270** |  | **£25,440** |

This is a straightforward Income Tax calculation. Financial Advisers should be able to complete this without any trouble.

That seems like a lot of tax, but we have two tax reliefs at our disposal:

1. The onshore tax credit.
2. TSR

The onshore tax credit is simply calculated as 20% of the chargeable gain. This represents the theoretical 20% tax paid within the UK life fund by the Fund Manager:

|  |  |  |  |
| --- | --- | --- | --- |
| **Income Source** | **Amount** | **Tax Rate** | **Amount of Tax** |
| Salary | £12,570 | 0% Personal Allowance | £0 |
|  | £32,200 | 20% | £6,440 |
|  | £0 | 40% | £0 |
|  | £0 | 45% | £0 |
| Savings Income | £500 | 0% PSA | £0 |
|  | £0 | 20% | £0 |
|  | £0 | 40% | £0 |
|  | £0 | 45% | £0 |
| UK Chargeable Gain | £0 | 0% | £0 |
|  | £5,000 | 20% | £1,000 |
|  | £45,000 | 40% | £18,000 |
|  | £0 | 45% | £0 |
| **Total** | **£95,270** |  | **£25,440** |
| Onshore Tax Credit | (£50,000) | 20% | (£10,000) |
| Top-Slicing Relief |  |  |  |
| **Actual Tax Due** |  |  |  |

For the TSR, we need to complete some calculations. Contrary to common myth, they’re not very difficult; it just takes time and practice to memorise all the steps.

The point of TSR is to acknowledge that a gain has likely accrued over several years, and it would be unfair to tax it all as if the entire gain was earned in a single year. TSR has the effect of spreading the gain over all the complete years the policy has been in force, resulting in a much more proportionate tax bill. TSR is usually available where a chargeable gain results in the policyholder being brought into a higher tax bracket than they would otherwise be; however, this is not always the case.

Similarly, TSR is unlikely to be available where the gain does not take the policyholder into a higher tax bracket than they would otherwise be. Again, this isn’t always the case.

There is a simple formula for working out TSR:

**TSR = A – B**

### Working Out ‘A’

Dead simple: calculate the total tax on the bond, and deduct the Onshore Tax Credit. Total tax on the bond (according to our table) is £1,000 + £18,000 = £19,000. And the Onshore Tax Credit is £10,000. So £19,000 - £10,000 = £9,000.

**TSR = £9,000 – B**

### Working Out ‘B’

For B, we need to redo our table entirely, but based on the ‘slice’ rather than the full chargeable gain. The slice is *usually* the full chargeable gain divided by the number of **complete** policy years since inception. For clarity, if a bond has been held for five-and-a-half years, there are five years available for TSR. The slice here is £50,000 / 5 years = £10,000. Now let’s redo the table based on the slice:

|  |  |  |  |
| --- | --- | --- | --- |
| **Income Source** | **Amount** | **Tax Rate** | **Amount of Tax** |
| Salary | £12,570 | 0% Personal Allowance | £0 |
|  | £32,200 | 20% | £6,440 |
|  | £0 | 40% | £0 |
|  | £0 | 45% | £0 |
| Savings Income | £500 | 0% PSA | £0 |
|  | £0 | 20% | £0 |
|  | £0 | 40% | £0 |
|  | £0 | 45% | £0 |
| UK Chargeable Gain | £0 | 0% | £0 |
|  | £5,000 | 20% | £1,000 |
|  | £5,000 | 40% | £2,000 |
|  | £0 | 45% | £0 |
| **Total** | **£55,270** |  |  |
| Onshore Tax Credit | (£10,000) | 20% | (£2,000) |
| Top-Slicing Relief |  |  |  |
| **Actual Tax Due** |  |  |  |

Now, not much has changed here. We’ve highlighted in the table in YELLOW anything that has changed, and have explained below.

* The amount of the gain that has fallen into the higher-rate tax bracket has reduced from £45,000 to just £5,000. This has correspondingly reduced the higher-rate tax due from £18,000 to just £2,000.
* The total income for the client has fallen from £95,270 down to £55,270. This is not significant in this particular case, however, **if the client originally had income over £100,000 which caused their Personal Allowance to be tapered, when the calculation is redone on the slice for the purpose of calculating ‘B’, the slice is used which may mean they get back their whole personal allowance and the entire table will need redone!**
* The onshore tax credit is now based on the slice of £10,000, of which 20% is £2,000.

Now we have our table, we can establish ‘B’ in the same way that we calculated ‘A’: calculate the total tax on the bond, and deduct the Onshore Tax Credit. Total tax on the bond (according to our table) is £1,000 + £2,000 = £3,000. And the Onshore Tax Credit is £2,000. So £3,000 - £2,000 = £1,000.

**\*This is the part people often forget to do\***

What you now need to do is multiply the £1,000 up by the number of years. £1,000 x 5 years = £5,000. B is therefore £5,000.

**TSR = £9,000 – £5,000 = £4,000**

And now we can finish off our original table:

|  |  |  |  |
| --- | --- | --- | --- |
| **Income Source** | **Amount** | **Tax Rate** | **Amount of Tax** |
| Salary | £12,570 | 0% Personal Allowance | £0 |
|  | £32,200 | 20% | £6,440 |
|  | £0 | 40% | £0 |
|  | £0 | 45% | £0 |
| Savings Income | £500 | 0% PSA | £0 |
|  | £0 | 20% | £0 |
|  | £0 | 40% | £0 |
|  | £0 | 45% | £0 |
| UK Chargeable Gain | £0 | 0% | £0 |
|  | £5,000 | 20% | £1,000 |
|  | £45,000 | 40% | £18,000 |
|  | £0 | 45% | £0 |
| **Total** | **£95,270** |  | **£25,440** |
| Onshore Tax Credit | (£50,000) | 20% | (£10,000) |
| Top-Slicing Relief |  |  | (£4,000) |
| **Actual Tax Due** |  |  | **£11,440** |

### The Rule of Thumb

You may have heard that there’s a shortcut for most chargeable gains. Simply take the gross chargeable gain and divide it by the number of years for TSR purposes to get the slice. If the slice does NOT take the client into higher-rate tax when added to their other income for the year, then there’s no further tax to pay. This is generally correct and can be demonstrated with numbers. All we’ll do is take Lucious and revise his salary down by £5,000:

|  |  |  |  |
| --- | --- | --- | --- |
| **Income Source** | **Amount** | **Tax Rate** | **Amount of Tax** |
| Salary | £12,570 | 0% Personal Allowance | £0 |
|  | £27,200 | 20% | £5,440 |
|  | £0 | 40% | £0 |
|  | £0 | 45% | £0 |
| Savings Income | £500 | 0% PSA | £0 |
|  | £0 | 20% | £0 |
|  | £0 | 40% | £0 |
|  | £0 | 45% | £0 |
| UK Chargeable Gain | £0 | 0% | £0 |
|  | £10,000 | 20% | £2,000 |
|  | £40,000 | 40% | £16,000 |
|  | £0 | 45% | £0 |
| **Total** | **£95,270** |  | **£23,440** |
| Onshore Tax Credit | (£50,000) | 20% | (£10,000) |
| Top-Slicing Relief |  |  | (£8,000) |
| **Actual Tax Due** |  |  | **£5,440** |

Top-Slicing Relief calculation as follows:

A = (£2,000 + £16,000) – (£50,000 x 20%) = £8,000

B =

|  |  |  |  |
| --- | --- | --- | --- |
| **Income Source** | **Amount** | **Tax Rate** | **Amount of Tax** |
| Salary | £12,570 | 0% Personal Allowance | £0 |
|  | £32,200 | 20% | £6,440 |
|  | £0 | 40% | £0 |
|  | £0 | 45% | £0 |
| Savings Income | £500 | 0% PSA | £0 |
|  | £0 | 20% | £0 |
|  | £0 | 40% | £0 |
|  | £0 | 45% | £0 |
| UK Chargeable Gain | £0 | 0% | £0 |
|  | £10,000 | 20% | £2,000 |
|  | £0 | 40% | £0 |
|  | £0 | 45% | £0 |
| **Total** | **£50,270** |  |  |
| Onshore Tax Credit | (£10,000) | 20% | (£2,000) |
| Top-Slicing Relief |  |  |  |
| **Actual Tax Due** |  |  |  |

£2,000 tax on slice - £2,000 onshore tax credit = £0

£0 x 5 years = £0

B = £0

**TSR = £8,000 – £0 = £8,000**

**As you can see from the top table, we had £18,000 of tax to pay on the bond. However, this has been completely wiped out by the combined onshore tax credit and TSR, to the penny!**

### Offshore Bonds

If this was an offshore bond calculation, the only thing that would change is the availability of the onshore tax credit, so the Actual Tax Due would be £21,440. However, the top-slicing amount wouldn’t change – it’s still calculated in exactly the same way. However, note that a ‘theoretical’ 20% onshore tax credit is used in the top-slicing calculation (because we need to deduct it from ‘A’ and the first part of ‘B’).

|  |  |  |  |
| --- | --- | --- | --- |
| **Income Source** | **Amount** | **Tax Rate** | **Amount of Tax** |
| Salary | £12,570 | 0% Personal Allowance | £0 |
|  | £32,200 | 20% | £6,440 |
|  | £0 | 40% | £0 |
|  | £0 | 45% | £0 |
| Savings Income | £500 | 0% PSA | £0 |
|  | £5,000 | 20% | £1,000 |
|  | £45,000 | 40% | £18,000 |
|  | £0 | 45% | £0 |
| **Total** | **£95,270** |  | **£25,440** |
| Onshore Tax Credit | (£50,000) | 0% | (£0) |
| Top-Slicing Relief |  |  | (£4,000) |
| **Actual Tax Due** |  |  | **£21,440** |

For more complex cases, particularly where dividends are involved, or where the client has low levels of non-savings income and can therefore use their 0% Starting Savings Rate, offshore bond tax can be very different (i.e., it’s not just the availability of the onshore tax credit). This is because of the order of taxation.

**Financial Advisers should be aware that non-savings income (salary, pension) is taxed first (as per our table). Then savings income. Then dividends. Investment bonds fit into this order differently, depending on whether they’re UK or offshore. Offshore bond chargeable gains are taxed as savings income (i.e., before dividends) whereas UK bond chargeable gains are taxed after dividends.**

**UK bonds can still use the Personal Savings Allowance to offset chargeable gains. However, because of the availability of the Onshore Tax Credit, this will only be relevant where some Income Tax is payable. If the client has some or all of their PSA available, when they complete their self-assessment to pay the Income Tax on their chargeable gain, they could get a rebate of up to £100 (20% of the £500 PSA for higher-rate taxpayers).**

## Income Tax Calculation – Higher Rate

For higher/additional rate top-slicing relief, the process is virtually identical.

Marcus has a salary of £99,500, savings income from his cash savings account of £500, and an **offshore** investment bond chargeable gain of £100,000. Marcus has held the bond for 10.5 years.

|  |  |  |  |
| --- | --- | --- | --- |
| **Income Source** | **Amount** | **Tax Rate** | **Amount of Tax** |
| Salary | £0 | 0% Personal Allowance | £0 |
|  | £37,700 | 20% | £7,540 |
|  | £61,800 | 40% | £24,720 |
|  | £0 | 45% | £0 |
| Savings Income | £0 | 0% PSA | £0 |
|  | £0 | 20% | £0 |
|  | £500 | 40% | £200 |
|  | £0 | 45% | £0 |
| Offshore Gain | £0 | 0% | £0 |
|  | £0 | 20% | £0 |
|  | £50,000 | 40% | £20,000 |
|  | £50,000 | 45% | £22,500 |
| **Total** | **£200,000** |  | **£74,760** |
| Onshore Tax Credit | (£100,000) | 0% | (£0) |
| Top-Slicing Relief |  |  |  |
| **Actual Tax Due** |  |  |  |

### Working Out ‘A’

Again, we calculate the total tax on the bond, and deduct the **theoretical** Onshore Tax Credit. Remember it’s only a theoretical onshore tax credit here because it’s an offshore gain. Total tax on the bond (according to our table) is £20,000 + £22,500 = £42,500. And the **theoretical** Onshore Tax Credit is £20,000. So, £42,500 - £20,000 = £22,500.

**TSR = £22,500 – B**

### Working Out ‘B’

And again, we’re going to repeat our table. **Note that because we’re repeating the table based on just a £10,000 slice, we’re getting back some of our Personal Allowance!**

The Personal Allowance is reduced by £1 for every £2 of adjusted net income over £100,000. Our adjusted net income based on the slice is £110,000. The reduction is £10,000 (the excess over £100,000) divided by 2, which is £5,000.

**£12,570 standard Personal Allowance - £5,000 reduction = £7,570**

Note also that when the Personal Allowance comes back, the basic-rate band doesn’t change – it is fixed at £37,700. **It’s the higher-rate band that adjusts.** This is demonstrated in the table.

Because we’re also now a higher-rate taxpayer (rather than additional-rate) **we also get to reclaim our PSA of £500 for higher-rate taxpayers!**

|  |  |  |  |
| --- | --- | --- | --- |
| **Income Source** | **Amount** | **Tax Rate** | **Amount of Tax** |
| Salary | £7,570 | 0% Personal Allowance | £0 |
|  | £37,700 | 20% | £7,540 |
|  | £54,230 | 40% | £24,720 |
|  | £0 | 45% | £0 |
| Savings Income | £500 | 0% PSA | £0 |
|  | £0 | 20% | £0 |
|  | £0 | 40% | £0 |
|  | £0 | 45% | £0 |
| Offshore Gain | £0 | 0% | £0 |
|  | £0 | 20% | £0 |
|  | £10,000 | 40% | £4,000 |
|  | £0 | 45% | £0 |
| **Total** | **£200,000** |  | **£36,260** |
| Onshore Tax Credit | (£100,000) | 0% | (£0) |
| Top-Slicing Relief |  |  |  |
| **Actual Tax Due** |  |  |  |

Next, we take the tax on the slice of £4,000 and deduct our theoretical tax credit of 20% on the slice (20% of £10,000, which is £2,000). This gives us £2,000.

£2,000 x 10 years = £20,000, which is ‘B’.

**TSR = £22,500 – £20,000 = £2,500**

This allows us to complete our original table as follows:

|  |  |  |  |
| --- | --- | --- | --- |
| **Income Source** | **Amount** | **Tax Rate** | **Amount of Tax** |
| Salary | £0 | 0% Personal Allowance | £0 |
|  | £37,700 | 20% | £7,540 |
|  | £61,800 | 40% | £24,720 |
|  | £0 | 45% | £0 |
| Savings Income | £0 | 0% PSA | £0 |
|  | £0 | 20% | £0 |
|  | £500 | 40% | £200 |
|  | £0 | 45% | £0 |
| Offshore Gain | £0 | 0% | £0 |
|  | £0 | 20% | £0 |
|  | £50,000 | 40% | £20,000 |
|  | £50,000 | 45% | £22,500 |
| **Total** | **£200,000** |  | **£74,960** |
| Onshore Tax Credit | (£100,000) | 0% | (£0) |
| Top-Slicing Relief |  |  | (£2,500) |
| **Actual Tax Due** |  |  | **£72,460** |

If he’d had the onshore tax credit, this would have been £20,000 Marcus could have shaved off the tax bill. But this is the price Marcus has paid for going offshore and benefiting from gross roll-up within the life fund. This is explored in the next section.

Note that the amount of top-slicing awarded of £2,200 means that Marcus has effectively paid 40% higher-rate tax on the entire chargeable gain. It’s a £100,000 chargeable gain and he’s paid £40,000 in Income Tax on it. This is the same principle as discussed earlier: **in most cases**, if the sliced gain does not take the higher-rate taxpaying policyholder into the additional-rate tax bracket, they’ll pay higher-rate tax on the whole gain.

Another important point is that, while we have been able to use the slice for the purpose of determining Marcus’s Personal Allowance and the availability of the PSA to calculate ‘B’, it is only for the purpose of calculating ‘B’ within the top-slicing calculation and does not apply to the actual Income Tax calculation.

## Onshore V Offshore

Statistically, if you’re a basic-, higher-, or additional-rate taxpayer in the tax year of encashment, you’re almost always more tax-efficient with a UK bond compared to offshore. However, for non-taxpayers, offshore bonds win. This is purely mathematical, as follows:

### Non-Taxpayers

As per the flowcharts, offshore bonds are winning out because we’ve had gross rollup and no personal Income Tax to pay on the chargeable gain. However, with an onshore bond, we’ve paid tax within the life fund at a deemed rate of 20% and we can’t claim this back!

### Basic-Rate Taxpayers

Here, it’s a zero-sum game. In both cases, we’re paying 20% tax. Theoretically, it’s better to opt for an onshore bond because even though the tax within the life fund is **deemed** paid at 20%, because life funds pay not tax on dividends, we’ve probably not paid that much tax in practice. This is especially the case if the life fund is investing in high dividend paying equities. Furthermore, there’s no need to make a manual Income Tax payment to HMRC or adjust our tax code for next year, so it’s the simpler solution.

**However, it’s worth pointing out that basic-rate taxpayers, depending on their personal circumstances, may be able to make use of their 0% Starting Savings Rate and/or £1,000 PSA to offset chargeable gains on offshore bonds, so this needs to be considered!**

### Higher-Rate Taxpayers

For higher- and additional-rate taxpayers, the difference is in understanding that the personal Income Tax liability for UK bonds is based on the net £8,000 figure. It is the £8,000 figure that we see on our chargeable event certificate and that we need to put on our tax return. The 20% tax is based on this £8,000 figure, not the £10,000 gross gain. But it is with the offshore bond. 40% of £8,000 (£3,200) is clearly less than 40% of £10,000 (£4,000).

Higher-rate taxpayers are unlikely to have any 0% Starting Savings Rate to offset offshore chargeable gains, but they may do if their high income is due to dividends rather than non-savings income (such as salary, self-employed profits, and pension income).

Higher-rate taxpayers may have their £500 PSA available, and this can be used to offset chargeable gains on both UK and offshore bonds.

### Additional-Rate Taxpayers

For additional-rate taxpayers, the gap between UK and offshore after-tax gains has widened.

As with higher-rate taxpayers, additional-rate taxpayers are unlikely to have any 0% Starting Savings Rate to offset offshore chargeable gains, but they may do if their high income is due to dividends rather than non-savings income (such as salary, self-employed profits, and pension income).

Additional-rate taxpayers have no PSA to offset chargeable gains on either UK or offshore bonds.

## Pension Contributions

Returning to our earlier examples of Lucious and Marcus, let’s now consider how each of them could have saved tax by making personal pension contributions.

### Lucious’s UK Bond

Lucious will make a £4,000 net (£5,000 gross) personal pension contribution. He has the UK Relevant Earnings for full tax relief due to his salary.

|  |  |  |  |
| --- | --- | --- | --- |
| **Income Source** | **Amount** | **Tax Rate** | **Amount of Tax** |
| Salary | £12,570 | 0% Personal Allowance | £0 |
|  | £32,200 | 20% | £6,440 |
|  | £0 | 40% | £0 |
|  | £0 | 45% | £0 |
| Savings Income | £500 | 0% PSA | £0 |
|  | £0 | 20% | £0 |
|  | £0 | 40% | £0 |
|  | £0 | 45% | £0 |
| UK Chargeable Gain | £0 | 0% | £0 |
|  | £10,000 | 20% | £2,000 |
|  | £40,000 | 40% | £16,000 |
|  | £0 | 45% | £0 |
| **Total** | **£95,270****(£5,000 pension)****£90,270 ANI** |  | **£24,440** |
| Onshore Tax Credit | (£50,000) | 20% | (£10,000) |
| Top-Slicing Relief |  |  | (£8,000) |
| **Actual Tax Due** |  |  | **£6,440** |

Top-slicing relief was calculated as follows:

A = £18,000 - £10,000 = £8,000

B = £50,000 / 5 = £10,000. The full £10,000 falls into the basic rate band and is taxed at 20% which is £2,000. The onshore credit on the slice is also £2,000. £2,000 - £2,000 = £0. £0 x 5 years = £0. B = £0.

A – B = £8,000 - £0 = £8,000

The pension contribution has extended the basic-rate band by the gross contribution of £5,000. Now, £10,000 of the chargeable gain is assessed at basic-rate, with just £40,000 at higher-rate.

The result is that we’ve had, from paying in £4,000 into our pension:

* £1,000 relief at source within the pension.
* We’ve extended our basic-rate band, saving us an additional £1,000 of Income Tax. This is known as “higher-rate tax relief” for pension contributions and reinforces the idea that pension contributions receive tax relief at the member’s highest marginal rate.
* We’ve increased our top-slicing relief by £4,000 to £8,000. This is the maximum amount of top-slicing relief we can get (because ‘B’ is £0) and means we’re paying no higher-rate Income Tax on the bond – everything has been covered by the onshore tax credit.

**For our £4,000 pension contribution, we have received £6,000 in tax relief, of which £1,000 is in the pension (via relief at source) and £5,000 in our pocket. This is effective tax relief of 120%!**

The scenario can be compared side-by-side as follows:

|  |  |  |
| --- | --- | --- |
|  | **Before Pension Contribution** | **After Pension Contribution** |
| Tax paid on salary | £6,440 | £6,440 |
| Tax paid on savings | £0 | £0 |
| Gross tax on chargeable gain | £19,000 | £18,000 |
| Total gross tax | £25,440 | £24,440 |
| Onshore tax credit | (£10,000) | (£10,000) |
| Top-slicing relief | £4,000 | £8,000 |
| Actual tax payable to HMRC | £11,440 | £6,440 |
| Amount saved in a pension | £0 | £5,000 |

### Marcus’s Offshore Bond

Marcus will make a £79,600 net (£99,500 gross) personal pension contribution. He has the UK Relevant Earnings for full tax relief due to his salary.

Personal pension contributions reduce Adjusted Net Income for the purpose of calculating the Personal Allowance taper. With our £99,500 gross contribution, our Adjusted Net Income is falling from £200,000 to £100,500. This is £500 over £100,000, so we still have a very slight reduction.

**£500 / 2 = £250. £12,570 standard personal allowance - £250 taper = £12,320**

The £99,500 personal pension contribution also extends the basic-rate and higher-rate tax bands by £99,500. Therefore, our basic-rate bracket has been increased from £37,700 to £137,200!

We’ve also managed to get £500 of our Personal Savings Allowance back, because we’re now technically only a higher-rate taxpayer; not an additional-rate taxpayer.

|  |  |  |  |
| --- | --- | --- | --- |
| **Income Source** | **Amount** | **Tax Rate** | **Amount of Tax** |
| Salary | £12,320 | 0% Personal Allowance | £0 |
|  | £87,180 | 20% | £17,436 |
|  | £0 | 40% | £0 |
|  | £0 | 45% | £0 |
| Savings Income | £500 | 0% PSA | £0 |
|  | £0 | 20% | £0 |
|  | £0 | 40% | £0 |
|  | £0 | 45% | £0 |
| Offshore Gain | £0 | 0% | £0 |
|  | £49,520 | 20% | £9,904 |
|  | £50,480 | 40% | £20,192 |
|  | £0 | 45% | £0 |
| **Total** | **£200,000** |  | **£47,532** |
| Onshore Tax Credit | (£100,000) | 0% | (£0) |
| Top-Slicing Relief |  |  | (£10,096) |
| **Actual Tax Due** |  |  | **£37,436** |

Top-slicing relief was calculated as follows:

A = £30,096 - £20,000 onshore credit = £10,096

B = £100,000 / 10 = £10,000. The full £10,000 falls into the basic rate band and is taxed at 20% which is £2,000. The onshore credit on the slice is also £2,000. £2,000 - £2,000 = £0. £0 x 5 years = £0. B = £0.

A – B = £10,096 - £0 = £10,096

The pension contribution has extended the basic-rate band by the gross contribution of £99,500. Now, £49,520 of the chargeable gain is assessed at basic-rate, with just £50,480 at higher-rate.

The result is that we’ve had, from paying in £79,600 into our pension:

* £19,900 relief at source within the pension.
* We’ve extended our basic-rate band, saving us an additional £27,228 of Income Tax. This is known as “higher-rate tax relief” for pension contributions and reinforces the idea that pension contributions receive tax relief at the member’s highest marginal rate. The higher-rate relief is combined with recovery of our Personal Allowance and PSA.
* We’ve increased our top-slicing relief by £7,596 to £10,096. This is the maximum amount of top-slicing relief we can get (because ‘B’ is £0) and means we’re paying no higher-rate Income Tax on the bond – everything has been covered by the onshore tax credit.

**For our £99,500 pension contribution, we have received £54,924 in tax relief, of which £19,900 is in the pension (via relief at source) and £35,024 in our pocket. This is effective tax relief of 55.2%!**

The scenario can be compared side-by-side as follows:

|  |  |  |
| --- | --- | --- |
|  | **Before Pension Contribution** | **After Pension Contribution** |
| Tax paid on salary | £32,260 | £17,436 |
| Tax paid on savings | £200 | £0 |
| Gross tax on chargeable gain | £42,500 | £30,096 |
| Total gross tax | £74,760 | £47,532 |
| Onshore tax credit | £10,000 | £10,000 |
| Top-slicing relief | £2,500 | £10,096 |
| Actual tax payable to HMRC | £72,460 | £37,436 |
| Amount saved in a pension | £0 | £99,500 |

## Multiple Gains: Number of TSR Years

Where you have multiple investment bond chargeable gains arising in the same year, it is still done as a single calculation – to work out the years to use, take the sum of the gains and divide it by the sum of the slices, and this should be rounded to two decimal places.

# Jointly Owned Bonds

Two people can own a single investment bond together. Most life offices allow this, and the policyholders are known as “joint policyholders”. Typically, these are married couples/long-term partners, but any two people can jointly own a bond.

This means that they each own 100% of the bond. The ownership of the bond is fully shared and is joint and several. Each policyholder has an equal right to the bond. As a jointly owned asset, if one policyholder were to die, **the other would become the sole owner of the entire bond**, regardless of what is in their Will. It is also possible to hold a bond jointly, but in unequal shares, for which there is a specific process involved to inform HMRC.

It’s also possible to arrange ownership of a bond between two (or more) policyholders, where each policyholder owns specific segments within the bond. **In practice, most life offices do not allow bonds to be written this way because each policyholder might as well just write their own bond.** However, once a bond is written, it is possible to use a written document called a Deed of Assignment to assign individual segments to different people or trusts. Each new policyholder can then encash their assigned segments whenever they like. One reason it may be preferable to do this, rather than simply write different bonds, is due to the potential availability of fund-size discounts. This is a discount on the ongoing product charge of the bond based on its value, with higher value bonds benefiting from larger discounts. From an administration perspective, this can prove tricky to keep the bond as a single policy, and much like Lord Voldemort’s soul, once it has been torn into several pieces, it’s virtually unrecognisable. Life offices may decide to treat each policyholders’ segments as their own individual bonds, which also provides flexibility for partial withdrawals and investment options as all segments of a bond need to be identical in terms of both value and investment choice.

And, similar to Lord Voldemort’s soul, it could prove difficult from an administration perspective to put the bond back together. Theoretically you could use more Deeds of Assignment and ‘Frankenstein’ it, but it’s unlikely to be exactly as it was from the life office’s perspective.

**It remains to be seen if, like Lord Voldemort’s soul, one of the segments will attempt to hunt down and destroy the others…**

Anyhow, when two people purchase an investment bond together, life offices will usually administer it as a jointly owned policy, where ownership is joint and several. This is like where a house is purchased under a joint tenancy, as opposed to tenancy in common. (Extending the analogy, the Voldemort soul split is much more akin to tenancy in common, where each policyholder owns a defined portion of the bond).

## Owners V Lives Assured

When a policyholder purchases a bond, it will need a ‘life assured’. This is because investment bonds are legally structured as life assurance contracts, and for a contract of life assurance to be legally valid, someone’s life needs to be assured.

**The terminology of life “assurance” is used as historically this meant that the policy was a whole-of-life contract, so was guaranteed to pay out on death regardless of when this might be, whereas life “insurance” meant a term policy which may not pay out at all if the person insured didn’t die within the term of the policy.**

**These days, the terms are used by life office staff and Financial Advisers interchangeably. However, we’re using “assurance” for old time’s sake!**

On death of the life assured, the bond will become encashed and pay out the surrender value of the investment, plus a little bit extra. This little bit extra is the ‘life assurance’ element – for the bond to be a valid contract of assurance, there needs to be a life assurance pay out, even if it is only a small amount! Typically, the full pay out is calculated as anything between 100.1% and 101% of the surrender value of the bond at the date of death of the life assured.

The life assured is usually the same person as the policyholder. **This is known as an “own life” policy.** On the policyholder’s death, unless the bond has been written in trust, the bond will become encashed and the life office will pay out the surrender value, plus the small life assurance element, to the policyholder’s estate.

However, the life assured doesn’t *have* to be the same person as the policyholder. The policyholder may want someone else to be the life assured. This is usually so the bond can continue to exist after the policyholder’s death for tax planning purposes. However, it could also be because the policyholder is deemed by the life office as too old to be a life assured. For example, a life office may refuse to accept an application from, say, a 90-year-old man because statistically it’s not worth the life office’s while to establish a bond that might only statistically be around for a couple of years before it gets encashed due to his death. It wouldn’t be financially viable for the life office, which is (at the end of the day) a business. **Where the life assured is someone other than the policyholder, this is known as a “life of another” policy.**

Just like there can be multiple policyholders who own the bond, there can also be multiple lives assured. Usually, bonds are automatically written to pay out on the death of the last surviving life assured, which keeps the bond existing for as long as possible. However, this isn’t the case for all bonds, and some are written on a “first death” basis. “First death” bonds could be particularly useful where the policyholders are an unmarried couple who have written the bond into trust, with the proceeds intended to be used to pay the Inheritance Tax (IHT) bill on first death, and where flexibility for tax planning is not needed.

Where bonds are written with someone other than the policyholder as a life assured, usually, the policyholder will *also* be a life assured. Older, less-sophisticated contracts may only allow a couple of lives assured, while more sophisticated bonds may allow a lot more (for example, 10).

The policyholder will need to have their identity checked by the life office before the bond is established to satisfy anti-money laundering regulations. However, the life assured doesn’t usually have to have their identity checked by UK life offices. Offshore life offices may be in jurisdictions with much stricter anti-money laundering regulations which require such checks, though. Dublin is an example of a place where, due to its tax-privileged status, UK life offices have established offshore branches specifically to provide offshore investment bonds to UK customers. But anti-money laundering regulations are much stricter and may require lives assured to be formally identified.

The life assured doesn’t have any ownership of the bond. The bond is owned by the *policyholder*, **not** the life assured. This is often a sticking point for clients who may not understand this.

## Insurable Interest

Policyholders aren’t allowed to just pick anyone they want to be a life assured. Like with any valid contract of assurance, there needs to be “insurable interest”. This means that, at the time the contract of assurance is established, the policyholder would need to suffer a financial loss at least equal to the policy proceeds if the life assured were to die. It’s this rule that stops chancers from insuring the lives of random death row inmates and critically ill people they don’t know.

In the UK, we have **unlimited** insurable interest on our **own life**, and the life of our **spouse**. The rules are a little grey for unmarried partners but the Insurance Ombudsman has previously indicated that unmarried cohabitants and those engaged to be married are okay. However, we do not have unlimited insurable interest on other family members, including our children and parents. Insurable interest therefore needs to be established. **If there is no insurable interest between the policyholder and the life assured at the time the contract is established, the contract of assurance is void.**

At PFE, we live in the real world. We know that the market is full of investment bonds that are not legally enforceable due to a lack of insurable interest at the time of establishment.

It’s not a tax issue, so HMRC wouldn’t be involved – it’s a legal issue. If a contract of assurance was ever challenged on the grounds of a lack of insurable interest (which theoretically someone could do if they wanted to, for example, make life difficult for a sibling who inherited more than they did), and it was proven, it could be voided by the court and the original premium returned. The Financial Adviser who recommended the bond would then need to make a tentative call to his PI insurer. However, to our knowledge, this has never happened. We know of no case law where an investment bond has been voided due to a lack of insurable interest. But it could still happen, by the letter of the law!

It's also worth noting that most life offices do not ‘police’ bond applications for insurable interest – it is up to the Financial Adviser to demonstrate insurable interest and hold clear evidence on file.

***“I used to work for a major UK life office as a Telephone Account Manager. One time, a Financial Adviser was writing an offshore investment bond and there were various issues which could have been easily avoided. The client wanted 11 lives assured on an offshore bond, him plus his 10 grandchildren. It was a sales and administrative nightmare.***

***The bond in question could only facilitate a maximum of 10 lives assured. Both the Adviser and client seemed to be under the impression that this wouldn’t be fair on the oldest grandchild, even though lives assured has nothing to do with ownership. In the end, the decision from the Adviser was to write the bond on a pure ‘life of another’ basis on the client’s 10 grandchildren.***

***Not only was there no evidence I could determine of insurable interest between the client and his grandchildren (which I explained to him, and he duly ignored) but because our offshore branch was based in Dublin, the Adviser had to get personal and address ID for every grandchild which he was sending in piecemeal. This was incredibly difficult as some of the grandchildren were babies and infants, and we needed copies of birth certificates, child benefit letters, parent ID, and all sorts.***

***Anyway, the whole debacle could have been avoided if he’d written a capital redemption bond, but he was concerned about the FSCS cover not being as high, which is insane because for us to go down, the entire global economy would need to be utterly nuked, and the FSCS would be just as dead.”***

**- Source has requested to remain anonymous**

### Solutions for Where There’s No Insurable Interest

**Capital redemption bonds**, as referenced in the ‘horror story’ above, are investment bonds which are not legally structured as life assurance contracts, so there is no life assured. However, they broadly have all the same features and chargeable gains are taxed identically. The difference is that, instead of paying out on death of the life assured, they pay out after a fixed term, for example, 100 years from date of inception (or earlier encashment by the policyholder).

However, because capital redemption bonds are not technically life assurance policies, they are unlikely to qualify for as generous compensation under the Financial Services Compensation Scheme (FSCS). The FSCS treats life assurance-based investment bonds as long-term insurance contracts, so covers them up to 100% with no upper limit. But capital redemption bonds are treated as investments, so are only likely to be covered up to £85,000 per person, per firm. That said, this theory has never been tested because no life office has become insolvent since the formation of the FSCS.

Another issue with capital redemption bonds is that only a limited number of providers sell them, so the market is small with limited competition. They may also only be offered by a particular life office for on or offshore bonds, but not both. Furthermore, some life offices have historically charged a premium for writing bonds on a capital redemption basis, versus more traditional life assurance.

Despite these shortcomings, they’re a useful way to write investment bonds where there is a requirement for the bond to continue existing after the policyholder’s death, and the policyholder has no insurable interest on anyone else who could be an additional life assured. And, for policyholders that are too old to be accepted as lives assured by the life office.

**Loan trusts** are another option. *Note: theoretically you could go to a solicitor and get them to write any trust you like which would do the same thing, but when it comes to the free off-the-shelf trust deeds from life offices, usually only Loan Trusts work with this little trick.*

Where new bonds are written in a life office trust, usually what happens is - technically - the bond is created and then *subsequently* placed into the trust. This is known as an “at issue” trust.

However, Loan Trusts involve the Settlor first gifting cash into trust, and then the Trustees using the cash to purchase an investment bond. So, it is the Trustees who are writing the bond. The Trustees are technically the legal owners of the trust property so can write a bond with themselves as lives assured. The Settlor is free to nominate pretty much anyone they want as a Trustee, which would include people on whose lives he has no insurable interest.

With a Loan Trust, the Settlor will be relinquishing all his investment growth to the trust (he would only retain access to the original capital) but it could nevertheless be a very useful way for an older client to conduct some clever estate planning, especially if they’re too old to be a life assured themselves.

Again, a solicitor could write any trust the Settlor wants to facilitate this, but this costs money, and the only trust typically offered by life offices involving the initial gift of cash and the subsequent purchase of a bond by Trustees is a Loan Trust. But, for example, a Solicitor could write a simple probate trust for the Settlor, with the Settlor as a potential beneficiary. The Settlor could gift the cash into it, and the Trustees could use the cash to write a bond with themselves as lives assured. Meanwhile, the trust would enable the Settlor to have full access to the bond (including its growth, unlike the Loan Trust).

We’re aware we’ve used some unavoidable jargon here. This is a course on investment bonds, not trusts, so anything more technical is beyond the scope of this course.

## Tax on Jointly Owned Bonds

We’ve already covered how chargeable events are taxed on individuals earlier in this course, and the availability of top-slicing relief. This section deals with who the tax is levied on for jointly owned bonds.

**Married couples/civil partners can avoid tax on encashing a jointly owned bond, by first assigning it to the lower-income spouse. The assignment is free of CGT (because it’s not for money or money’s worth), and IHT (due to the spousal exemption). This could even be an opportunity to change the ownership structure completely “Voldemort’s soul style” and assign different segments to each spouse to maximise personal tax allowances and exemptions. However, this is complex, and gifts need to be absolute. One spouse can’t gift a bond to the other, and then on encashment reap the benefit of half the proceeds.**

Where a bond is jointly owned, and one of the policyholders dies, full ownership transfers to the survivor on first death. When the other policyholder dies, the whole gain will be assessed on them as if they’d owned the bond outright the whole time. The tax is assessed on the last to die in the tax year of death. Where two policyholders die simultaneously and it’s impossible to determine the order of death (e.g., in a car accident) the oldest is deemed to have died first.

Where a bond is owned by a single policyholder, and the person dies, but the bond continues due to the survival of the life assured, the policyholder’s Personal Representatives may decide to encash the policy. If they do, they will be liable to Income Tax at 20% of the chargeable gain. *Note that for UK bonds, the charge is effectively nil as it’s covered by the 20% onshore tax credit. Further, there’s no top-slicing relief available.* Therefore, it may be simpler for the Personal Representatives to use Deeds of Assignment to assign bond segments to the beneficiaries (hoping that the number of segments is divisible by the number of beneficiaries!)