MILESTONE

Practice Note – Offshore Insurance Bonds

Offshore Insurance Bonds
Flexible, Bespoke Solutions for Private Clients

Effective tax and succession planning for UK private clients remains a challenging environment. In this market, fresh innovative thinking always rises to the surface. An example is the emergence of the offshore insurance bond for situations where traditional fiduciary structures are not appropriate.

There is a market perception that offshore insurance bonds provide limited investment possibilities. However, Milestone's structured solutions allow flexibility for tax effective investment. We are repeatedly asked to deliver structures that meet financial and tax planning designs and have, over many years, built a strong reputation for inventive structuring using contracts of insurance. Set out below is a summary of the more common constructions we are asked to advise on – cash bonds, portfolio (and non-portfolio) bonds, protected cell companies, internal life funds and SIPPs.

Executive Summary

- **Cash bond –** for wrapping cash deposits and deferring tax on interest. 5% withdrawals are available for tax deferred access to capital. Particularly attractive for UK resident non-domiciled clients who are, or will be, required to pay the £30,000 remittance based charge. An individual that subsequently leaves the UK may take the proceeds free of UK tax provided they do not return to the UK for one whole tax year.
- **Non-personalised portfolio bond –** a hybrid bond specifically designed to fall outside the PPB rules and enable access to a wider range of investments. This structure is well suited to private banking arrangements. Again, this is particularly attractive for UK resident non-domiciled individuals.
- **Personal portfolio bonds –** despite the punitive tax treatment, there are a number of ways of structuring personal portfolio bonds so they provide significant long term tax benefits, particularly for non-domiciles and those intending to become non-resident. A private company could also be used to hold the ultimate investment and in many cases gearing can be arranged at the private company level. This structure is suitable for property development opportunities and other income generating investments.
- **Protected cell companies –** these may be used to own offshore bonds and provide flexible tax treatment on exit with a gross roll-up in the interim.
- **Internal life fund –** in certain circumstances it is possible to structure an internal life fund to suit particular investment opportunities.
- **SIPP investment –** SIPP trustees seeking a diverse investment strategy can often use personal portfolio bonds to increase investment flexibility.

In more detail

1. Cash Bond

A simple structure that is designed to wrap cash deposits under a single premium life assurance policy. Whether domiciled in the UK or not, there is a significant benefit for UK residents rolling up bank interest (on a gross basis) over the medium-to-long term. Access to capital is available without an immediate liability to tax provided any withdrawal is less than 5% of the capital invested.

This bond is particularly attractive to non-domiciled individuals who have been UK resident for 7 out of 10 tax years and who now face a £30,000 charge to qualify for the remittance basis of taxation. The 5% withdrawal allowance is cumulative so it is possible for an individual to incorporate an offshore bond in their planning to allow access to a greater level of "tax free income" when it is most beneficial.

If the individual subsequently leaves the UK, they may take all of the proceeds of the cash bond free of UK tax provided certain conditions are met. In addition, the cash bond may also assist in 'refreshing' previously mixed income and capital bank accounts.

2. Non-Personalised Portfolio Bond

A punitive UK tax treatment applies to offshore investment bonds that are classified as Personal Portfolio Bonds ("PPBs"). In general terms, a PPB is a bond that invests in a wide range of assets and allows the policyholder to select those underlying assets. Traditionally this has meant that offshore bonds subscribed by UK residents have been primarily restricted to asset classes comprising pooled funds (and thus taken outside the PPB rules).

Milestone has access to a bond that can invest in a wide range of PPB type assets, but which does not itself fall within the rules. This bond is particularly attractive for income producing assets. It carries all of the advantages associated with the 5% annual withdrawal allowance and non-resident surrender options of the cash bond, but has the additional benefit of access to a wider range of investment options.

3. Personal Portfolio Bond ("PPB")

Despite their punitive tax treatment, there are occasions when a PPB works well for UK residents, particularly domiciled individuals.

For example, a policyholder may elect to pay a nominal premium into the bond and accept that it is a PPB (thus subjecting the policyholder to a 15% deemed gain charge on the value of the premium – hence the relatively low contribution). The primary investment made by a PPB would usually be shares in a private company that would own the underlying assets such as real estate, private company shares, hedge fund investments and more esoteric investments such as fine art and wine.

This structure provides UK domiciled and resident individuals with long-term income tax and capital gains tax deferral opportunities and an income tax exit on surrender.

4. Protected Cell Company with Offshore Bond

In many cases the policyholder of the offshore bond will not want nor be able to leave the UK at a time when it is desirable to liquidate an investment structure. In such circumstances, a 40% tax rate will apply to the proceeds. This is extremely inefficient as the underlying assets may have suffered capital gains tax at 18% had they been held directly. In order to structure a less punitive exit, it is possible to hold the bond through a cell in an offshore protected cell company ("PCC"). In addition to the tax advantages of the 5% withdrawal, nonresident surrender and income tax treatment on surrender of the bond, a PCC provides the option to sell the shares to a third party. Any gain on the shares will be subject to 18% CGT. Income and gains arising under the bond can also be rolled up and deferred.

5. Internal Life Fund

In certain circumstances, it may be appropriate for clients to establish an internal life fund that follows a particular investment objective. A life fund is not subject to the punitive PPB tax regulations. The fund must be available to all policyholders (at least of a particular product type) for the period during which the fund is open to new investors.

6. SIPP Investment

Many offshore insurance providers place restrictions on the assets that may be held within offshore bonds. SIPP trustees must therefore weigh up the cost of the insurance wrapper against holding and accounting for the assets themselves. However, SIPP trustees can use an offshore bond to hold some of the following asset classes:

- Discretionary managed accounts
- Private company shares that may allow investment in:
  - Development or investment properties
  - Structured notes
  - Hedge funds
  - Derivatives
  - Private Equity
  - Partnership interests
  - Other private company shares

In addition to the inherent flexibility of an offshore bond wrapper there are several other advantages:

- Gross roll up
- Many jurisdictions provide a statutory policyholder protection scheme meaning that the trustees (policyholders) qualify for compensation of up to 90% (taking the Isle of Man as an example) of the value of the bond in the event that the issuing insurance company is unable to meet claims against it.
- Investment accounting and valuation functions may be undertaken by the life company resulting in operational economies of scale for SIPP trustees.
- Institutional access to investment opportunities and banking facilities.
- Simple conversion to a drawdown facility through regular withdrawals.

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