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Key benefits of using an International Bond

- ▶ Bonds can be written under trusts which could mitigate your client's inheritance tax liability.
- ▶ No annual trustee tax returns required if the bond is the only trust investment, unless there is a chargeable gain.
- ▶ Bonds can be assigned to another adult owner, meaning the amount of tax paid is based on the recipient's tax status.
- ▶ Assignment of individual bond segments can be made as and when required, giving the trustees control over when and how much is assigned.
- ▶ Unlike onshore bonds, your client's fund won't normally be charged tax on income and gains until money is taken out of the offshore bond*.

Case study

“I've planned ahead to give my children the best start to their adult life, but I want to retain some control to make sure the money is put to good use! The only problem is I'm taxed at the higher rate and I don't want this eating into the return.”

*Irrecoverable withholding tax may be payable on certain investment funds, as in some countries withholding tax is deducted from dividend and interest payments. See Important information on page 2 for more information.

**This figure is an example and isn't guaranteed. What your client may get back depends on how their investment performs, and the tax treatment of the investment.

Mark decided that he wanted to invest £100,000 for his children's future. He wanted to make sure that his two children, Karen, 8, and John, 13, would get as much benefit from this investment as possible. He needed an investment that would be IHT effective and tax efficient, as well as easy to administer with a range of investment options.

Mark met with his adviser and he recommended that Mark transfer the £100,000 into a Standard Life Gift Plan discretionary trust and that this is then invested in a Standard Life International Bond. Mark appointed himself, his wife and his sister as trustees, and Karen and John are within the class of discretionary beneficiaries. As the trustees invested in an International Bond, they don't have to complete an annual trustee tax return unless there is a chargeable gain.

10 years later

Ten years later when the trustees hold their annual meeting they decide that they want to use the International Bond to help Karen and John. John is in employment and is looking to buy his first flat, while Karen is due to start university in the autumn. No withdrawals have been made and

the International Bond is now worth £162,890**, written in 100 separate policies. The trustees decide to earmark and pay out John's half of the bond (50 policies) for the deposit on a flat and use 6 policies to provide Karen with nearly £10,000 to fund her first year at university.

For tax efficiency, the trustees' adviser recommends that they assign (transfer) 50 policies to John and 6 policies to Karen rather than cashing in the policies.

IHT charges

- ▶ The trustees may have a further IHT liability on each 10 yearly anniversary of the Trust being set up. The maximum charge is 6% of the value of the fund at this time and in many cases is a lot less than this.
- ▶ The charge is based on the value of the trust fund at the 10 yearly anniversary. If this value is less than the available nil-rate band there will be no charge.
- ▶ There may also be a charge to IHT when payments are made to the Beneficiaries. These are known as 'exit charges'.

What happens when Karen and John cash in their policies after the assignment?

Karen pays no tax on her gain from the bond

As Karen has no income, she is a non-taxpayer. Her 6 policies are worth a total of £9,773. She cashes these in and makes a chargeable gain of £3,773. This is comfortably within her personal allowance, and she has no income tax to pay.

John pays £6,289 tax on his gain from the bond

John is a management trainee at a financial company and earns £23,000 a year. His 50 policies are worth £81,445 and he makes a chargeable gain of £31,445 when he cashes them in. His tax charge is calculated as follows:

Gain = £31,445 (£81,445 proceeds less £50,000 paid for these policies)

Tax = £31,445 x 20% = £6,289

As John is a basic-rate taxpayer he can use 'top slicing relief' to reduce the impact of his gain. Top slicing relief allows a basic-rate taxpayer who would become a higher-rate taxpayer as a result of the gain on their investment to reduce their liability to tax by spreading the gain over the number of years the policy has been in force. The policies were in force for 10 complete years from the start date, so he can divide the gain (£31,445) by 10 giving him a 'slice' of £3,144.50. When this is added to his taxable income of £15,525 (after deduction of the personal allowance of £7,475), he is still comfortably in the basic-rate tax bracket (£35,000 in 2011/12).

What would happen if the trustees cash in the policies instead of assigning them?

As settlor of the trust, Mark would be liable for £14,087 of income tax on the gain from the bond

Mark earns £90,000 and is already paying higher-rate tax. If the trustees had cashed in the 56 policies he would have made a chargeable gain of £35,218. His tax, which he can reclaim from the trustees, would be calculated as follows:

Gain = £35,218 (£91,218 proceeds less £56,000 paid)

Tax = £35,218 x 40% = £14,087

In this example, not only does assigning save £7,798 in tax, it also ensures Mark doesn't lose his personal allowance by keeping his income below the key £100,000 threshold.

If the trustees had cashed in the policies, and Mark had paid the tax due without reclaiming it from the trustees, this could be treated as a further chargeable transfer to the trust. This would complicate his IHT planning and may have tax consequences.



Important information

- ▶ All information in this document relating to taxation is based on our understanding of law and practice in Ireland and the UK at May 2011. The future tax position of the bond or your client's own tax position may alter. The tax information given only applies if your client is resident in the UK for tax purposes.
- ▶ The information in this document does not constitute any form of advice and Standard Life International is not responsible for any advice given on the basis of this document.
- ▶ No guarantees are given regarding the effectiveness of any arrangement entered into on the basis of this document.
- ▶ All examples are for illustrative purposes only.
- ▶ For the purposes of this example, 2011/12 tax rates have been used throughout unless otherwise stated.
- ▶ While invested in the bond, your client won't normally pay tax on any growth. Instead, tax is paid when they take money out of the bond, and will be based on their circumstances at that time. There may also be withholding tax payable on certain investment funds. This is a tax that some countries deduct from dividends and interest payments to foreign investors. It is not possible to reclaim withholding tax. If your client invests in a net fund, where tax is paid on returns within the fund, where possible Standard Life International will reclaim the tax paid within the fund and return this to your client. We may not be able to reclaim tax if there are changes in HM Revenue & Customs practice.
- ▶ The assumed rate of growth for the International Bond is 5%. The projection does not take account of the effect of charges on the bond.
- ▶ The value of investments can go down as well as up. Your client may not get back as much as they invest.

This case study is an example and it is provided for information only. It does not provide full details of how an International Bond, trust or Gift Plan operates. Details are available in the Key Features Documents and Estate Planning section on www.adviserzone.com

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