

Why Bonds – Financial Planning Opportunities



Introduction

Why bonds?

From a tax perspective, investment bonds and Open-Ended Investment Companies (OEICs) are at opposite ends of the investment spectrum. An OEIC generates income for the investor, albeit that with accumulation shares, income is not distributed but instead reinvested and added to capital. Even so, the distribution remains income for tax purposes.

In contrast bonds are non-income producing investments.

These contrasting features create many investment and planning opportunities and indeed it may be appropriate to blend both in a client's investment portfolio.

While an OEIC fits naturally into the rhythm of the UK tax system, which taxes income and gains, that is not the case with non-income producing investment bonds which have their own special tax regime.

In this guide, our focus will be on investment bonds, both UK and international. Three client types are examined.

- Individuals
- Corporates
- Trustees

Regarding the taxation of individuals and trustees, the 'chargeable event' legislation applies to bonds. In the case of corporates, the 'loan relationship' rules apply. This guide contains an overview of these two tax regimes as they provide the backdrop, against which, potential bond investment opportunities arise.

This document largely focuses on tax planning matters which should guide but not dictate wrapper choice. For example, if the applicant is looking for returns to be 'smoothed', then a bond rather than an OEIC investment should be considered. Please note that we're focusing on bonds, other investment solutions may be available.

Please note that the figures used in this guide are for illustrative purposes only and should not be taken as an indication of past or future performance.

Your client's investment could go down as well as up, they may not get back what they paid in.

Expand the headings below to see a range of client profiles in each category. The links from these will take you to some practical examples.

The chargeable event rules

UK and international investment bonds are taxed under the same chargeable event rules. Both are non-qualifying policies for UK tax purposes. This means that chargeable event gains can arise at any time which contrasts with the position for qualifying policies where broadly, only gains in the first ten years are taxable. Gains are subject to income tax.

HMRC succinctly state that the chargeable event regime proceeds by:

- Identifying a 'chargeable event'
- Calculating the gain arising
- Attributing the gain to a chargeable person

There are five main 'triggers' which give rise to a chargeable event:

- 1) Excess surrenders and part assignments for money or money's worth
- 2) Death giving rise to benefits
- 3) Assignment for money or money's worth
- 4) Maturity (for example an international capital redemption bond)
- 5) Surrender of all the rights

Part and full assignment for money or money's worth are relatively obscure, but the other chargeable event triggers are referred to in the guide.

Just to be clear, with an 'excess surrender', the client continues to have an interest in the bond given there has only been a part surrender, but contrastingly the other four events trigger a finality, where for different reasons the client's interest in the bond ceases. Part surrenders are very popular with individuals and trustees and are therefore very common. If a part surrender occurs, then a calculation needs done at the end of the policy year to see whether total part surrender proceeds exceed the 5% withdrawal allowance. If so, that excess will constitute a gain.

UK bonds

Regarding taxation, chargeable event gains on UK bonds are not liable to basic rate tax. The individual or trustee who is liable for tax under the chargeable event regime is treated as having paid tax at the basic rate on the amount of the gain. This reflects the fact that the funds underlying a UK bond are subject to UK life fund taxation. Any gain is exempt from capital gains tax gains unless, and unusually, the bond was acquired for actual consideration.

International bonds

In contrast, international bonds are issued by life companies based in jurisdictions such as Ireland which impose no tax on the income and gains of the underlying funds – this is known as ‘gross roll-up’. Growth may not be entirely tax-free however, due to the impact of irrecoverable withholding tax which may be deducted from interest and dividends received by the fund. Clearly the individual or trustee is not treated as having paid tax at basic rate.

Top Slicing Relief

The fact that there is no tax due until a chargeable event gain arises can be appealing to many clients, but investors could be disadvantaged by being taxed in a single year on gains that have accrued over a period of time. Top Slicing relief delivers a spreading mechanism to reduce the effective rate of tax charged on the gain.

Detailed analysis

[UK bond facts](#)

[International bond facts](#)

[Top Slicing Relief facts](#)

The loan relationship rules

Companies investing in bonds are taxed under the 'loan relationship' rules, the remit of which extends well beyond investment bonds.

In broad terms, these rules require the taxation treatment of the item in question (in this case an investment bond) to follow the accounting treatment. To understand the tax treatment of a company owned bond, it is therefore necessary to consider the accounting treatment. There are a number of accounting standards that a company might use – principally Historic Cost and Fair Value.

Historic Cost

The bond is simply shown in the Balance Sheet (statement of financial position) at the end of the company's accounting period at the original premium amount, regardless of the actual surrender value. No annual gain (or loss) is recognised in the company accounts, meaning no corporation tax consequences arise until the company realises a profit made on a disposal event such as full surrender, part surrender, assignment for value or death of last life assured.

Fair Value

In this case, the Balance Sheet at the end of the accounting period will include the bond at its surrender value at that date. The movement in value (either a gain or loss) is therefore processed through the Profit and Loss account (income statement). That movement has corporation tax consequences since an annual increase in value will be subject to corporation tax (any decrease is potentially relievable). The company will therefore be subject to tax on the profit made on part surrender, full surrender, assignment for value, death of the last life assured, and/or the increase in value each year.

Over the life of the bond, the company will be subject to tax on the actual profit made regardless of the accounting basis used.

Historic cost or fair value?

The majority of large and medium-sized UK entities apply Financial Reporting Standard (FRS) 102 when preparing their annual financial statements. Under FRS102, an investment bond is accounted for under fair value rules. 'Micro-entities' which are small in size, can apply FRS105 which allows historic cost accounting for investment bonds. A company qualifies as a micro entity if it doesn't exceed two or more of these criteria

- Turnover £632,000
- Balance Sheet total £316,000
- Number of employees 10

Accounting standards are complex and the recognition of the bond in the accounts is, in every case, a matter for the accountant to determine.

UK bond 'tax credit'

The funds underlying a UK bond are subject to UK life fund taxation and as a result 20% tax is deemed paid within the fund. The company can obtain relief for this 20% tax where there is a profit on a disposal i.e. part surrender, full surrender, assignment for value or death of the last life assured. Note however that no relief arises on annual increases in value under the fair value rules and so these increases are subject to corporation tax with the 'tax credit' only applying on a subsequent disposal.

Other matters

Accountants and advisers dealing with trading companies carrying excess cash should be mindful of the potential impact on Inheritance Tax relief for business purposes and Capital Gains Tax Business Asset Disposal Relief where appropriate.

Detailed Analysis

[Corporate investing guide](#)

[Corporate owned bonds – the facts](#)

[Inheritance Tax relief for business property](#)

Individuals



Basic rate taxpayer

Individual with Income Drawdown retirement plan

Non-UK Domiciled

Non-taxpayer

Higher earners and £100k personal allowance trap

Potential future trust planning

Temporary Non-UK resident

Corporates



Investment company

Micro Entity – international bond

Micro Entity – UK bond

Non-Micro Entity – international bond

Non-Micro Entity – UK bond

Trustees



Intestacy – England and Wales

Will Trust – Interest in possession (IIP)

Will trust – Discretionary

Gift Trust – Absolute

Personal Injury Trust – Absolute

University fees planning – Discretionary Gift Trust



Basic rate taxpayer

Scenario

Mary is looking to invest £60,000 for the medium to long-term, five to 10 years or more. She doesn't need an income from the investment but may take withdrawals to fund future pension and/or ISA contributions.

She expects to be a basic rate taxpayer when any withdrawals are taken and would like to minimise tax reporting requirements.

Investing in a bond

- Mary invests in an UK bond.
- She will be owner of the bond.
- She can be life assured but it's possible to have additional lives assured.
- The bond is set up with the maximum number of segments for maximum flexibility.
- Mary can pay for the initial and ongoing advice from the investment.

Summary

- The investment offers the prospect of capital growth over the medium to long-term.
- A bond is a non-income producing investment so there will be no tax implications until a chargeable event occurs.
- Switches between funds will not trigger any tax consequences.
- Mary can take withdrawals within the tax deferred allowance without triggering a chargeable event for income tax purposes.
- Top slicing relief may be available if a significant gain arises and takes Mary into higher or additional rate tax.
- Realised gains come with a 20% 'tax credit' which satisfies a basic rate taxpayer's basic rate tax liability. The effective rate of tax within the fund will however be less than the 20% tax deemed suffered.
- Having the maximum amount of segments can help with tax planning as it provides more flexibility when it comes to crystallising smaller gains.



Individual with Income Drawdown retirement plan

Scenario

Jim is looking to make a single premium investment of £80,000. He would like the investment to grow in a tax efficient environment and minimise tax on an ongoing basis.

He retired five years ago at age 55 and draws his pension income from his Flex-Access Drawdown plan. He has no immediate need for access to these funds but would be prepared to use them to fund his normal expenditure if it helped improve overall tax efficiency.

Investing in a bond

- Jim invests in an international bond.
- He'll be owner of the bond.
- He can also be life assured but it's possible to have additional lives assured. Alternatively an international bond can be set up on a capital redemption basis with no lives assured.
- The bond is set up with the maximum number of segments for maximum flexibility.
- Jim can pay for the initial and ongoing advice from the investment.

Summary

- The investment offers the prospect of capital growth over the medium to long-term, five to 10 years or more.
- A bond is a non-income producing investment so there will be no tax implications until a chargeable event occurs.
- Switches between funds will not trigger any tax consequences.
- Jim can take withdrawals within the tax deferred allowance without triggering a chargeable event for income tax purposes.
- Top slicing relief may be available if a significant gain arises and takes him into higher or additional rate tax.
- There is no tax suffered within the bond except any irrecoverable withholding tax, so returns benefit from gross roll up over the longer term.
- Jim can control the level of income he takes from his Income Drawdown plan to free up nil rate tax allowances to help crystallise gains on the bond tax efficiently.
- If the chargeable gain falls within Jim's available starting rate for savings, personal savings allowance or personal allowance the gain will suffer no tax.
- Having the maximum amount of segments can help with tax planning as it provides more flexibility when it comes to crystallising smaller gains.

Non-UK Domiciled



Scenario

Tom is UK resident but not UK domiciled. Property owned absolutely by a non-UK domicile is outside the scope of IHT if it is located outside the UK. He plans to remain in the UK and expects to become UK domiciled in the future. He has around £800,000 in a non-UK bank account and is looking to generate capital growth over the medium to long-term, five to 10 years or more.

He doesn't need to generate an income but wants to retain access to the funds. He would also like the potential to use the funds for his family's benefit while he's alive and after death without requiring probate. He would also like the investment to grow in a tax efficient environment and minimise tax on an ongoing basis.

Investing in a bond

- Tom sets up an international bond and transfers the bond into a discretionary Excluded Property Trust.
- Tom is automatically a trustee but also appoints his wife and eldest son to be additional trustees. They will be owners of the bond in their capacity as trustees.
- Tom can be life assured but it's possible to have additional lives assured. Alternatively an international bond can be set up on a capital redemption basis with no lives assured.
- The bond is set up with the maximum number of segments for maximum flexibility.
- Tom can pay for the initial advice from the investment and the trustees can pay for the ongoing advice or from the investment.

Summary

- With the Excluded Property Trust, the trust fund will remain excluded from IHT charges even if Tom later becomes UK domiciled providing the trustee continue to hold excluded property.
- As Tom is non-UK domiciled at outset there is no chargeable lifetime transfer (CLT). The transfer is exempt because the Investment bond is excluded property. As such there will be no liability to an entry charge, 10 year periodic charges or exit charges.
- Tom is a potential beneficiary of the trust and therefore can gain access to trust funds if required (any funds received from the trust will form part of his estate for UK IHT purposes if not spent before death).

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- Tom's spouse/widow, children and remoter descendants will be potential beneficiaries and there is scope to add or remove beneficiaries should he wish to do so.
- The investment offers the prospect of capital growth over the medium to long-term.
- A bond is a non-income producing investment so there will be no tax implications until a chargeable event occurs.
- Switches between funds will not trigger any tax consequences.
- The trustees can take withdrawals within the tax deferred allowance without triggering a chargeable event for income tax purposes.
- If Tom is alive and UK resident when a gain arises the gain will be assessed against Tom. Top slicing relief may be available if the gain takes Tom into higher or additional rate tax.
- There is no tax within the bond except any irrecoverable withholding tax, so returns benefit from gross roll up over the longer term.
- Having the maximum amount of segments can help with tax planning as it provides more flexibility when it comes to crystallising smaller gains.
- The trustees can assign individual segments of the bond to any of the potential beneficiaries without immediately triggering a chargeable event.
- If the beneficiary realises the gain post segment assignment it will be assessed for tax at their marginal rate. If the gain falls within their available starting rate for savings, personal savings allowance or personal allowance it will suffer no tax which is advantageous for beneficiaries with little or no income. Top slicing relief may be available if the gain takes the beneficiary into higher or additional rate tax.

Non-taxpayer



Scenario

Ellie is looking to invest £100,000 for the medium to long-term, so five to 10 years or more. She doesn't need to generate an income at present but expects to take withdrawals in the future when she expects to be a non-taxpayer. She's keen to invest in a tax efficient manner and minimise tax payable.

Investing in a bond

- Ellie invests in an international bond.
- She will be owner of the bond.
- She can be life assured but it's possible to have additional lives assured. Alternatively an international bond can be set up on a capital redemption basis with no lives assured.
- The bond is set up with the maximum number of segments for maximum flexibility.
- The initial and ongoing advice to the client can be paid for from the investment.

Summary

- The investment offers the prospect of capital growth over the medium to long-term.
- A bond is a non-income producing investment so there will be no tax implications until a chargeable event occurs.
- Switches between funds will not trigger any tax consequences.
- Ellie can take withdrawals within the tax deferred allowance without triggering a chargeable event for income tax purposes.
- Top slicing relief may be available if a significant gain arises and takes Ellie into higher or additional rate tax.
- There is no tax within the bond except any irrecoverable withholding tax, so returns benefit from gross roll up over the longer term.
- If the chargeable gain falls within Ellie's available starting rate for savings, personal savings allowance and personal allowance the gain will suffer no tax.
- Having the maximum amount of segments can help with tax planning as it provides more flexibility when it comes to crystallising smaller gains.



Higher earners and £100k personal allowance trap

Scenario

Helen recently cashed in a share portfolio and wants to reinvest the £150,000 proceeds for the medium to long-term, so five to 10 years or more. One of the reasons for cashing in the share portfolio is because she currently earns £98,000 a year and the income generated by the shares was resulting in her losing personal allowance.

Having already maximised her pension and ISA contributions she wants to invest for capital growth and doesn't want to generate income in order to protect her personal allowance.

Investing in a bond

- Helen sets up a UK or international bond.
- She'll be owner.
- She can be life assured but it's possible to have additional lives assured. Alternatively an international bond can be set up on a capital redemption basis with no lives assured.
- The bond is set up with the maximum number of segments for maximum flexibility.
- Helen can pay for the initial and ongoing advice from the investment.

Summary

- The investment offers the prospect of capital growth over the medium to long-term.
- A bond is a non-income producing investment so there will be no tax implications until a chargeable event occurs.
- Switches between funds will not trigger any tax consequences.
- Helen can take withdrawals within the tax deferred allowance without triggering a chargeable event for income tax purposes.
- Having the maximum amount of segments can help with tax planning as it provides more flexibility when it comes to crystallising smaller gains.
- Depending on Helen's tax circumstances when a gain is realised, top slicing relief may be available if any gain takes Helen into higher or additional rate tax.

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- If Helen is likely to be a taxpayer when gains are realised a UK bond could be suitable. Gains realised from a UK bond come with a 20% 'tax credit' which satisfies the taxpayers's basic rate tax liability. The effective rate of tax within the fund will however be less than the 20% tax deemed suffered.
- With an international bond there is no tax within the bond except any irrecoverable withholding tax, so returns benefit from gross roll up over the longer term.
- An international bond could be appropriate if Helen expects to have little or no income when gains are realised as the gains will suffer no tax if the gain falls within her available starting rate for savings, personal savings allowance or personal allowance.



Potential future trust planning

Scenario

Andrew is looking to invest £300,000 to achieve capital growth for the medium to long-term, so five to 10 years or more. He doesn't need to generate an income from the investment and wants the ability to gift some or all of the investment into a discretionary gift trust for the benefit of his children and grandchildren in the future with no immediate tax consequences when making the gift.

Investing in a bond

- Andrew sets up a UK or international bond.
- He'll be owner.
- He can be life assured but it's possible to have additional lives assured. Alternatively an international bond can be set up on a capital redemption basis with no lives assured.
- The bond or individual segments of the bond can be assigned into trust at a later date at which point the trustees will become owners of the bond. This will be a transfer of value for IHT purposes.
- The bond is set up with the maximum number of segments for maximum flexibility.
- Andrew can pay for the initial and ongoing advice from the investment. If the bond is placed into trust ongoing advice to trustees can be paid for from the investment.

Summary

- The investment offers the prospect of capital growth over the medium to long-term.
- A bond is a non-income producing investment so there will be no tax implications until a chargeable event occurs.
- Switches between funds will not trigger any tax consequences.
- Andrew (or the trustees if later assigned to trust) can take withdrawals within the tax deferred allowance without triggering a chargeable event for income tax purposes.
- Having the maximum amount of segments available can help with tax planning as it allows the client (or trustees if later assigned to trust) to trigger smaller gains than they could with less segments.

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- Andrew can assign the bond or segments of the bond into a Gift Trust with no income tax or capital gains tax consequences.
- The trustees can assign individual segments of the bond to any of the potential beneficiaries without immediately triggering a chargeable event.
- While Andrew is the sole owner top slicing relief may be available if any gains realised take Andrew into higher or additional rate tax.
- If later assigned to trust, gains assessable against the trustees in tax years after his death can't benefit from top slicing but trustees can assign the bond or individual segments to trust beneficiaries first in order for gain to be assessed against the beneficiary. Top slicing relief may be available if any gains take the beneficiary into higher or additional rate tax.
- If Andrew or future beneficiaries are likely to be taxpayers when gains are assessed against them a UK bond could be suitable. Gains realised from a UK bond come with a 20% 'tax credit' which satisfies a basic rate taxpayers basic rate tax liability. The effective rate of tax within the fund will however be less than the 20% tax deemed suffered.
- With an international bond there is no tax within the bond except any irrecoverable withholding tax, so returns benefit from gross roll up over the longer term.
- An international bond could be appropriate if Andrew or future beneficiaries have little or no income as gains assessed against them will suffer no tax if the gain falls within their available starting rate for savings, personal savings allowance or personal allowance.

Temporary Non-UK resident



Scenario

Bill has secured a contract to work abroad on a project expected to last six years. His wife is going with him and as the kids have left home they have sold their house as this was something they had been considering anyway. Bill wants to invest the £500,000 proceeds from the sale of his house in a tax efficient environment. He doesn't expect to require access while he's abroad but will want to cash in the investment on his return to the UK after the project is complete to buy a new home.

Investing in a bond

- Bill sets up an international bond.
- He can be life assured but it's possible to have additional lives assured. Alternatively an international bond can be set up on a capital redemption basis with no lives assured.
- The bond is set up with the maximum number of segments for maximum flexibility.
- Bill can pay for the initial and ongoing advice from the investment.
- This solution covers UK tax implications. As the client will be temporary non-UK resident the advice should be complimented with international tax advice to understand how the investment would be treated for tax purposes in the country Bill is moving to on a temporary basis. This advice should be sought before the recommendation is put in place.

Summary

- The investment offers the prospect of capital growth over the medium to long-term.
- A bond is a non-income producing investment so there will be no UK tax implications until a chargeable event occurs and Bill is UK tax resident again.
- Switches between funds will not trigger any UK tax consequences.
- Bill can take withdrawals within the tax deferred allowance without triggering a chargeable event for UK income tax purposes.
- There is no tax within the bond except any irrecoverable withholding tax, so returns benefit from gross roll up over the longer term.

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- Time apportionment relief is available for the period Bill was a non-UK resident which reduces the chargeable event gain. If Bill was a non-UK resident for the whole period then the gain will be nil.
- If the investment is not immediately surrendered as expected on returning to the UK, top slicing relief may be available if a gain arises and takes Bill into higher or additional rate tax. The number of complete policy years will be reduced by the number of complete years Bill was non-UK resident.
- Having the maximum amount of segments can help with tax planning as it provides more flexibility when it comes to crystallising smaller gains.

Investment Company



Scenario

Lochern Ltd is an investment company. Following a recent disposal, it has cash to invest for the medium to long-term, so five to 10 years or more. A suitable fund has been identified offering the prospect of a smoothed return. This is available in an investment bond wrapper. There is a concern however that a life assurance bond may not be appropriate because the company needs to demonstrate insurable interest in the selected lives assured. Typically, lives assured would be directors whose death would cause financial detriment to the company. This might not be the case with a non-trading company.

The company prepares accounts under FRS102.

Investing in a bond

- The company invests in an international capital redemption bond offering the prospect of smoothed returns.
- The capital redemption bond is set up with Lochern Ltd as the owner with no lives assured required.
- The bond will mature after 99 years but will probably be surrendered prior to that.
- The bond will be accounted for under fair value rules.
- Annual increases in value are taxable.
- The adviser and accountant liaise as this impacts investment, accounting and tax matters.
- The advice fee is paid from the company bank account.

Summary

- If cash is required, the bond can be partially or fully surrendered without penalty.
- The investment offers the prospect of better returns in a smoothed environment.
- The Balance Sheet at the end of each accounting period will accurately reflect the bond's surrender value.
- Growth on the bond is recognised annually and taxed.
- No corporation tax liability arises on fund switches.
- Paying the advice fee from the company bank account is the simpler approach. If instead it is paid from the bond, that triggers a part disposal, and the profit (or loss) needs to be calculated.



Micro-Entity international bond

Scenario

Ken More is an IT contractor. With his services in demand, he has accumulated a surplus cash balance of £50,000 in his company, Ken More Ltd. He is unlikely to use this for business purposes, but has decided to delay extracting these funds until he winds up his company in just over ten years. Disappointed at the interest being earned, he is looking to achieve a better return without introducing undue volatility concerns. He wants his investment to grow in a tax-free environment (accepting that irrecoverable withholding tax may arise).

The company is a micro-entity and prepares accounts under FRS105.

Investing in a bond

- Ken More Ltd invests in an international capital redemption bond offering the prospect of smoothed returns.
- The capital redemption bond is set up with Ken More Ltd as the owner with no need for Ken to be the life assured. Therefore, it'll not end if Ken was to die.
- The bond will be accounted for under historic cost rules.
- The adviser and accountant liaise as this impacts investment, accounting and tax matters.
- The advice fee is paid from the company bank account.

Summary

- If cash is required, the bond can be partially or fully surrendered without penalty.
- The investment offers the prospect of achieving a better return in a smoothed environment.
- Simple accounting – no annual gain (or loss) needs to be recognised in the company accounts.
- Growth is not recognised in the accounts (the tax treatment follows the accounting treatment).
- Regarding a gain on 'disposal', the company will be subject to corporation tax at the prevailing rate (currently 19%). There will be no 'basic rate credit' as it is not a UK bond.
- No corporation tax liability arises on fund switches.
- Paying the advice fee from the company bank account is the simpler approach. If instead it is paid from the bond, that triggers a part disposal, and the profit (or loss) needs to be calculated.

Micro-Entity UK bond



Scenario

Ailsa Craig is a 50 year old medical consultant providing private healthcare to patients via her company, Ailsa Craig Ltd. Fee income has been good, and she has steadily built up a surplus cash balance in her company of £100,000. Her plan is to keep those 'nest egg' funds inside her company and ultimately access them for personal use when she retires and winds up her company. Noting the poor return being earned on these funds under deposit, she is looking to achieve a better return without introducing undue volatility concerns.

The company is a Micro-entity preparing accounts under FRS105.

Investing in a bond

- Ailsa Craig Ltd invests in a UK investment bond offering the prospect of smoothed returns.
- The company is the owner and Ailsa is the sole life assured.
- The bond will be accounted for under historic cost rules.
- The adviser and accountant liaise as this impacts investment, accounting and tax matters.
- The advice fee is paid from the company bank account.

Summary

- If cash is required, the bond can be partially or fully surrendered without penalty.
- The investment offers the prospect of better returns in a smoothed environment.
- Simple accounting – no annual gain (or loss) needs to be recognised in the company accounts.
- There will be no annual corporation tax liability on growth since growth is not recognised in the accounts (the tax treatment follows the accounting treatment).
- Regarding a gain on 'disposal', the company will be entitled to a 'basic rate credit' given that it is a UK bond.
- If a disposal gain arises, no corporation tax will be due unless corporation tax rates (currently 19%) rise above the tax deemed paid within the life fund (currently 20%).
- No corporation tax liability arises on fund switches.
- Paying the advice fee from the company bank account is the simpler approach. If instead it is paid from the bond, that triggers a part disposal, and the profit (or loss) needs to be calculated.



Non-Micro Entity international bond

Scenario

Dawson MacLeod Ltd is a medium sized company providing landscaping services to the domestic market. Business has been good in recent years and with the directors being prudent regarding profit extraction, the company now has a surplus cash balance of £1m. In the medium to long-term, so five to 10 years or more, they intend using these funds to expand into the corporate market as they are concerned that profitability in the future will fluctuate as the domestic market becomes more competitive.

The accounts are prepared under FRS102.

Investing in a bond

- The directors choose an international capital redemption bond offering the prospect of smoothed returns. Smoothing is important as the funds are earmarked for a specific purpose.
- The capital redemption bond is set up with Dawson MacLeod Ltd as the owner. None of the directors need to be lives assured (therefore it will not end on death of the last life assured).
- The bond will be accounted for under fair value rules.
- Annual increases in the value of the bond are subject to corporation tax.
- This international solution avoids concerns that could arise with a UK bond where the tax credit on disposal can't be fully utilised because the tax credit can only be offset against the overall corporation tax liability for the accounting period in question. If the credit exceeds the company's corporation tax liability then the excess is not repayable and neither can it be set off against any prior or future accounting periods. This would have been a concern for the directors given the anticipated fluctuating profitability of the company.
- The adviser and accountant liaise as this impacts investment, accounting and tax matters.
- The advice fee is paid from the company bank account.

Summary

- If cash is required, the bond can be partially or fully surrendered without penalty.
- The investment offers the prospect of better returns in a smoothed environment.

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- The Balance Sheet at the end of each accounting period will accurately reflect the bond's surrender value.
- Growth on the bond is recognised annually and taxed.
- There is no 'basic rate credit' on disposal with an international bond as the fund enjoys gross roll-up (subject to any irrecoverable withholding tax). This avoids concerns which can arise with a UK bond that the tax credit might not be fully utilised.
- No corporation tax liability arises on fund switches.
- Paying the advice fee from the company bank account is the simpler approach. If instead it is paid from the bond, that triggers a part disposal, and the profit (or loss) needs to be calculated.



Non-Micro Entity UK bond

Scenario

Clyde and Spey Ltd is a medium sized, long established engineering company with stable profits which are expected to continue in the future. On the advice of their accountant, the directors adopt a prudent approach to extracting profits and accordingly a surplus cash balance of £750,000 has arisen. Conscious that these funds might be required in several years time to move premises, the directors are looking to achieve a better return without introducing undue volatility concerns. The directors are very traditional and wish to invest in the UK.

The company prepares accounts under FRS102.

Investing in a bond

- Clyde and Spey Ltd purchases a UK investment bond offering the prospect of smoothed returns.
- Clyde and Spey Ltd is the owner and two of the directors are lives assured.
- If either or both of the lives assured leave the company, the company owned investment bond will continue. It will however payout if both lives assured die.
- The bond will be accounted for under fair value rules.
- Annual increases in value are taxable despite the underlying life fund being subject to tax (i.e. net growth is taxed). The benefit of the 'tax credit' on the UK bond is only realised on a subsequent disposal.
- The tax credit on disposal can only be offset against the overall corporation tax liability for the accounting period in question. If the credit exceeds the company's corporation tax liability then the excess is not repayable and neither can it be set off against any prior or future accounting periods.
- The adviser and accountant liaise as this impacts investment, accounting and tax matters.
- The advice fee is paid from the company bank account.

Summary

- A UK bond satisfies the directors desire to invest in the UK.
- If cash is required, the bond can be partially or fully surrendered without penalty.
- The investment offers the prospect of better returns in a smoothed environment.

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- The Balance Sheet at the end of each accounting period will accurately reflect the bond's surrender value.
- Growth on the bond is recognised annually and tax is subject to corporation tax.
- Regarding a gain on 'disposal', the company will be entitled to a 'basic rate credit' given that it is a UK bond.
- The long-standing stability of trading profits means the directors are confident that the overall corporation tax liability will be sufficient to fully absorb the UK bond tax credit so that none of it is wasted when a disposal occurs in a later accounting period.
- No corporation tax liability arises on fund switches.
- Paying the advice fee from the company bank account is the simpler approach. If instead it is paid from the bond, that triggers a part disposal, and the profit (or loss) needs to be calculated.



Intestacy – England and Wales

Scenario

Jill recently passed away unexpectedly without leaving a Will. Under the laws of intestacy in England and Wales her estate passed to her 10 year old son Ian ,however, as he is a minor (under 18), a statutory “bereaved minor’s trust” is automatically created.

Jill’s sister Anthea and her husband are acting as administrators of Jill’s estate and will act as trustees of the trust until Ian reaches age 18. Jill’s estate includes various assets including cash of £250,000 which the trustees want to invest for growth for the next 8 years. The trustees are concerned about the trustee rate of tax which could apply to income and gains until Ian has a vested interest at 18 and consider that a Vulnerable Person’s Election might be unduly complex.

Investing in a bond

- The trustees invest in an international investment bond.
- The trustees are the owners with the bond being set up with the Ian as the life assured.
- The bond is set up with the maximum number of segments to for maximum flexibility.

Summary

- The investment offers the prospect of capital growth over the medium to long-term, so five to 10 years or more.
- There is no tax within the bond except withholding tax so returns benefit from gross roll up.
- A bond is a non income producing investment so there will be no tax implications until a chargeable event occurs.
- Trustees can make withdrawals within the tax deferred allowance if they wish to advance capital for the benefit of the beneficiary while they are a minor without triggering a chargeable event.
- The trustees can make an appointment of segments in favour of the minor beneficiary so that when those segments are encashed any gain will be taxed on the beneficiary at their personal tax rate rather than the trustee rate that would apply until the beneficiary attains age 18.
- If an appointment is made, gains within Ian’s Personal Allowance, Starting rate for Savings, or Personal Savings Allowance will suffer no tax. This is advantageous for those with little or no income.
- When Ian attains age 18 and becomes absolutely entitled, the trustees will assign the segments to Ian.
- Switches between funds will not trigger any tax consequences.



Will Trust – Interest in Possession (IIP)

Scenario

Elizabeth Connelly died and in her Will created a trust which gave her spouse Andrew, a right to live in the main residence which was owned solely in her name. Elizabeth also had various investments and cash deposits which were left to the trust. Andrew is entitled to any income generated from these assets and the trust states that the trustees can advance capital to him at their discretion.

The trustees have retained Elizabeth's significant OEIC portfolio and expect this will generate sufficient income for Andrew, however, there is still £400,000 in cash which they want to invest.

Upon Andrew's death the trust property passes to her two sons who are acting as trustees along with Andrew. Both Andrew and the two sons are basic rate taxpayers.

Investing in a bond

- The trustees invest in a UK investment bond.
- The trustees are the owners, with the bond being set up with Elizabeth's children as the lives assured.
- The bond is set up with the maximum number of segments to for maximum flexibility.
- The initial and ongoing advice being provided to the trustees can be paid for from the investment.

Summary

- The investment offers the prospect of real returns to help the capital keep pace with inflation.
- The bond can be held for the ultimate benefit of the children or used to supplement Andrew's if required. This will be achieved by advancing capital.
- The trustees can make withdrawals within the tax deferred allowance without triggering a chargeable event.
- Alternatively, the trustees may assign the bond segments to one of the beneficiaries. When the beneficiary subsequently encashes, any gain will be taxed on the beneficiary at their personal tax rate rather than the trustee rate.
- Gains from UK life funds come with a 20% 'tax credit' which satisfies the basic rate tax liability but the effective rate of tax within the fund will be less than this.
- Top slicing relief may be available to the beneficiary if the gain takes them into higher or additional rate tax.
- Switches between funds will not trigger any tax consequences.



Will trust – Discretionary

Scenario

When William Aitchison passed away his Will created a nil rate band discretionary trust. The potential beneficiaries include William's wife Nina, his two adult children Peter and Paul. Nina and a local solicitor firm have been appointed as trustees.

Nina has sufficient income and assets for her own needs and the intention is that Peter and Paul will ultimately benefit from the trust fund. The trustees want to invest the £325,000 cash held in the trust and expect that distributions will be made on an ad hoc basis over the next 20 years or so. The trustees are concerned about the trustee rate of tax that could apply to income and gains. Peter is a basic rate taxpayer while Paul is a non-taxpayer.

Investing in a bond

- The trustees have the option to invest in one investment bond.
- Alternatively, they could invest in two bonds with an international bond 'earmarked' for the non-taxpayer and a UK bond for the basic rate taxpayer.
- The trustees are the owners of both bonds.
- The international bond can be set-up on a capital redemption basis with no life assured.
- The bonds are set-up with the maximum number of segments for maximum flexibility.
- The initial and ongoing advice being provided to the trustees can be paid from the bonds.

Summary

- The investment offers the prospect of capital growth over the medium to long-term, so five to 10 years or more.
- A bond is a non-income producing investment so there will be no tax implications until a chargeable event occurs.
- The trustees can make withdrawals within the tax deferred allowance without triggering a chargeable event.
- Alternatively, the trustees may assign bond segments to the beneficiaries. When each beneficiary subsequently encashes, any gain will be taxed on the beneficiary at their personal tax rate rather than the trustee rate.

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- Regarding segments assigned from a UK bond, realised gains come with a 20% 'tax credit' which satisfies the basic rate taxpayers's basic rate tax liability. The effective rate of tax within the fund will however be less than the 20% tax deemed suffered.
- Regarding segments assigned from the international bond, realised gains can be mopped up by any unused Personal Allowance, Starting Rate for savings, and Personal Savings Allowance.
- Top slicing relief may be available to the Basic Rate individual if the gain takes them into higher or additional rate tax.
- Switches between funds will not trigger any tax consequences.



Gift Trust – Absolute

Scenario

The trustees of an absolute gift trust have received further cash of £100k from the settlor which they are looking to invest. The aim of the trust fund is to pay for the beneficiaries' school fees over the next 10 to 15 years. The trust beneficiaries are the settlor's 2 grandchildren, Rosie (aged 2) and Tom (aged 3).

The trustees want to ensure they meet their duty of maximising returns but are looking for reduced volatility as there will be ad hoc withdrawals required on an ongoing basis. They would also like to take advantage of the beneficiaries' tax position as they do not have any income.

Investing in a bond

- The trustees invest in an international investment bond.
- The trustees are the owners with the bond being set up with Rosie and Tom as the lives assured. Alternatively an international capital redemption bond with no lives assured could be purchased.
- The bond is set up with the maximum number of segments (divisible by two) for maximum flexibility.
- The initial and ongoing advice being provided to the trustees can be paid for from the investment.

Summary

- The investment offers the prospect of capital growth over the medium to long-term, so five to 10 years or more.
- There is no tax within the bond except any irrecoverable withholding tax, so returns benefit from gross roll up over the longer term.
- A bond is a non-income producing investment so there will be no tax implications until a chargeable event occurs.
- Trustees can make ad hoc withdrawals from the bond to pay the school fees as they arise.
- Trustees can make withdrawals within the tax deferred allowance to pay school fees without triggering a chargeable event but can also encash segments to crystallise gains.
- Any gains are assessed on the grandchildren.
- Gains which fall within the beneficiary's Personal Allowance, Starting rate for Savings, or Personal Savings Allowance will suffer no tax which is advantageous for those with little or no income.
- Switches between funds will not trigger any tax consequences.



Personal Injury Trust – Absolute

Scenario

John suffered an accident at work and was recently awarded a compensation payment which was placed into a Personal Injury Trust. The trustees invested part of the money into an OEIC portfolio but are looking for advice on how to invest the remaining £1m currently sitting in cash.

The trustees are aware of their duty to invest the trust fund but are keen to minimise any tax payable on an ongoing basis. They confirm that John is the sole beneficiary of the trust and his income needs are being met from the existing investments. John is aged 35 so the investment is expected to be in place for the longer term.

Investing in a bond

- The trustees invest in a UK or international investment bond.
- The trustees are the owners with the bond being set up with John as the life assured.
- The bond is set up with the maximum number of segments for maximum flexibility.
- The initial and ongoing advice being provided to the trustees can be paid for from the investment.

Summary

- The investment offers the prospect of capital growth over the medium to long-term, so five to 10 years or more.
- A bond is a non income producing investment so there will be no tax implications until a chargeable event occurs.
- Trustees can make withdrawals within the tax deferred allowance if they wish to advance capital for John's beneficiary's benefit.
- Income from the OEICs will already be utilising the Personal Allowance, but bond gains can mop up any unused Starting rate for Savings, or Personal Savings Allowance.
- Top slicing relief may be available to the individual if the gain takes them into higher or additional rate tax.
- Switches between funds will not trigger any tax consequences.



University fees planning – Discretionary Gift Trust

Scenario

The trustees of the Stevenson Family Discretionary Trust have £400,000 they are looking to invest. The trust was set up by Andrew Stevenson and while the classes of potential beneficiary include the settlor's children and grandchildren, the intention is to use at least some of the trust fund to pay for the 4 grandchildren's university costs.

The grandchildren are aged between 6 and 12 so the money will be invested for 5 years before withdrawals are required to pay for university. The trustees would like to take advantage of the grandchildren's tax position where possible.

Investing in a bond

- The trustees invest in an international investment bond.
- The trustees are the owners with the bond being set up with the beneficiaries as the lives assured. Alternatively the trustees have the option of purchasing an international capital redemption bond with no lives assured.
- The bond is set up with the maximum number of segments for maximum flexibility.
- The initial and ongoing advice being provided to the trustees can be paid for from the investment.

Summary

- The investment offers the prospect of capital growth over the medium to long-term, so five to 10 years or more.
- There is no tax within the bond except any irrecoverable withholding tax so returns benefit from gross roll up.
- A bond is a non-income producing investment so there will be no tax implications until a chargeable event occurs.
- Trustees can make withdrawals within the tax deferred allowance to pay university fees without triggering a chargeable event.
- Alternatively, the trustees may assign (to those aged over 18) or irrevocably appoint (to those aged under 18) bond segments to a beneficiary. When the segments are subsequently encashed any gain will be taxed on the beneficiary at their personal tax rate.
- Gains which fall within the Personal Allowance, Starting rate for Savings, or Personal Savings Allowance will suffer no tax. This is advantageous for those such as students with little or no income.
- Switches between funds will not trigger any tax consequences.

Why Prudential for bonds?



You can access both UK and international bonds through Prudential and Prudential International – part of M&G plc.

Part of M&G plc

M&G plc is a savings and investment company with a long term outlook, bringing the M&G Investments business together under one roof with the UK and European parts of Prudential.

Financial strength

Prudential Assurance Company Limited (PAC) is rated A – (Stable) for financial strength, by Standard & Poors (June 2020). This is one of the highest ratings currently given to any UK life assurance company.

Prudential international benefits from the financial and investment strength provided by the M&G Group and provides financial solutions to customers who want to combine the benefits of investment in an international environment, with the reassurance of a name they can trust.

Smoothing process

Prudential's PruFund range of funds have an established smoothing mechanism which aims to smooth some of the short-term extremes of market volatility.

With-Profits Fund

Prudential's With-Profits Fund in which the PruFund funds invest, is one of the financially strongest with-profits funds in the UK, with funds under management of £136bn (as at June 2020). The fund size and strength allows Prudential to invest in a very wide range of asset types and individual companies.

Expert fund management

M&G's Treasury & Investment Office (T&IO) who manage the PruFund range of funds and OEIC funds, has great strength in depth with a team that includes investment professionals with expertise in capital market research, investment strategy design, liability management, derivatives and portfolio management.

Prudential International Assurance – the advantages of our Dublin location

Tax-efficiency

Investments can grow largely tax-free, subject to withholding tax. Please see page 4 for further details.

Strong regulation

Dublin is a location with a strict legal and regulatory environment. The company is subject to European Law, having to comply with all European directives and regulations and to meet European solvency margins.

Specialist infrastructure

With many high-profile international companies located in Dublin, it has a well-developed financial infrastructure and a sophisticated support network.

Further support



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Please speak to your Prudential Account Manager if you have any questions about the information in this guide or the bonds we offer.

