Investment Bonds

An Investment Bond is an alternative wrapper which can be useful if other more tax efficient allowances have been fully utilised in a tax year. The investment is generally made by way of a cash lump sum which is invested in investment funds. Bonds can also be an efficient planning tool for anyone needing a tax efficient regular income whilst still retaining the capital funds to benefit from potential market growth. The investment funds within a bond are typically unit trusts and OEICs.

Regular Income

Once a lump has been invested, up to 5% pa of the initial investment can be withdrawn from the bond as a return of capital for 20 years before income tax becomes potentially payable. This can be useful for clients who wish to suppress their taxable income in retirement. It should be noted that any adviser charges payable from the bond e.g. Keeleys 1% pa annual management charge will be included in the 5% allowance which therefore reduces the available tax-free withdrawals of capital to approximately 4% pa. If the 5% pa allowance is exceeded, this may trigger a chargeable gain calculation. An important point to note is that the 5% pa allowance can be carried forward into future years if it remains unused in any one year.

Onshore Bond Taxation

- As withdrawals received within the 5% allowance are a return of capital you do not need to complete an annual tax return in this respect.
- Any chargeable gains incurred do not suffer CGT, instead they fall within the income tax assessment.
- On any encashment, 20% basic rate tax is deemed to have been deducted, therefore basic rate tax payers will not suffer any further income tax liability provided the withdrawals, when notionally added to their other income, has not pushed them into the higher rate bracket. For higher and additional rate tax payers they will need to pay a further 20% and 25% income tax respectively.
- If a gain moves an investor from one tax bracket to another, top slicing relief may be available in order to reduce or remove the income tax liability.
- Top slicing relief applies a spreading mechanism to the gain for the number of years that an investment bond has been held. In brief, when an investment bond is fully encashed, or another chargeable gain occurs, the gain is divided by the number of complete years held to work out the notional average gain per year which is then added to the investor's income for that year to determine whether it falls into basic, higher or additional rate income tax.

Additional advantages

- A single premium investment bond is not normally considered when means testing is applied by a Local Authority for residential care.
- Can be a tax-efficient trust investment as no income tax nor CGT is incurred by the Trustees when rearranging (buying/selling) investments within the Bond.

Offshore Bonds

Offshore bonds are generally held in locations where companies can offer growth on their funds which are largely free from tax (up until the point of withdrawal) e.g. Channel Islands, Isle of Man and Dublin.

Offshore bonds are very similar to onshore bonds, but the main difference is that where an onshore bond will pay tax at the 20% basic rate tax within the bond on capital gains, this is not payable for gains within an offshore bond.

However, when funds are withdrawn from the offshore bond, you will then pay tax on the gains at your highest marginal rate. A potential benefit being that the offshore bond may grow faster than an onshore bond as the tax is not incurred initially on the growth within the bond, only at the point of withdrawal.

Offshore bonds are generally considered a useful strategy for those who anticipate that they will either not be taxpayers or pay minimal tax in retirement when withdrawals are made. They can also be a useful planning tool for paying children's further education costs, as the funds can be assigned to an adult child who is unlikely to have any taxable income in their name and could therefore draw up to the personal income tax allowance before being liable to any income tax.

Further points to note

Bonds suffer internal corporation tax which can result in the investment returns being marginally lower than other wrappers such as ISAs or Unit Trusts. However, this tax is dealt with internally by the Investment Administrator.

As bonds are an equity-based product the value of the investment may fall as well as rise. The full product Key Features supplied by the insurer or investment provider should be read for specific details as this is only a summary.