

Funding the costs of further education



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Key benefits of using an offshore bond

Any growth is virtually free of tax*.

Bond can be assigned to a non-taxpaying adult, meaning that the amount of tax paid is based on the assignee's tax status.

Assignments of individual bond segments can be made as and when required, giving the original bond owner control over when and how much is assigned.

Case study

"I've looked after my savings so far and I want to use the money to help my son when he's ready for university. I'm taxed at the higher rate, and I don't want this to eat into his education fund."

Anthony has been married for 10 years and has an 8 year old son, Curtis. Anthony is a higher rate taxpayer and has always prioritised saving. As a result of this he has just over £100,000 in cash deposits.

He feels the time is right to take a longer term view with this money and has asked for advice. His specific need is to provide further education funding for Curtis. The most likely time for bills to arise will be from when Curtis reaches 18.

He has done some research, and has found out that the average cost of living for a student is currently around £5,200¹, while course fees are capped at £3,290 in 2010/2011 (England and Wales). He does not want his son to finish his course with a heavy debt and asks his financial adviser about ways to fund this situation.

Investing in an offshore bond

Anthony's adviser suggests investing £100,000 in an offshore bond. Any growth on the investment will be virtually free of tax* until cash for university is needed. Offshore bonds have a wide choice of investment options, allowing Anthony and his adviser to come up with a suitable investment strategy.

Assuming inflation of 3% per annum over 10 years, Curtis would need around £11,400 a year to cover fees and his living expenses. When the money is needed, Anthony wants his son to access it in the most tax-efficient way. There are essentially two ways he could do this.

He could cash in £11,400 from the bond. With an offshore bond, tax deferred withdrawals can be taken each year of up to 5% of the total payments made into the bond, up to a maximum of 100% of the total amount paid into the bond. Any allowance not used in a particular policy year can be carried forward to a future year. Using his cumulative 5% tax deferred withdrawals, Anthony could take this money without paying tax immediately on the gain. However, Anthony pays tax at the higher rate, and does not see this changing in the foreseeable future. So the issue that Anthony pays 40% tax (or even 50% tax if his income and chargeable gains exceed £150,000) on the investment gains when these are realised is only deferred, not solved.

There is, however, a potentially more tax-efficient way.

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

¹ – www.nus.org.uk – NUS Student Experience Report 2008 (£4,900 in 2008 plus 3% increase per year applied in respect of inflation)

“Assigning” an offshore bond

Offshore bonds are usually split into a number of individual policies or “segments”. Anthony has chosen a bond divided into 100 segments, and each is assignable. Individual segments can be assigned to another adult (the “assignee”) over the age of 18. The “assignee” then becomes the legal owner of the segments assigned to them.

After the bond has been invested for 10 years, assuming growth at 5%, the bond could be worth £162,889, made up of 100 segments each worth £1,628.89 (this figure does not take account of any product charges. The value of investments in an offshore bond can fall as well as rise and an investor may not get back the amount originally invested). Assuming Curtis has reached the age of 18 and needs around £11,400 to fully fund his first year at university, Anthony could assign him 7 segments, worth £11,402.23. When Curtis cashes them in, the chargeable gain will be calculated as if he has always owned them. The gain will be £4,402.23, which is comfortably within Curtis’ personal allowance. As Curtis has no other income in that tax year, he will pay no tax on these gains.

Anthony can repeat this process in each year of Curtis’ study. Anthony retains full control of the unassigned segments of the bond and can determine the timing of the transfer of ownership to Curtis.

This means:

- Through careful planning, Curtis has the potential to cash in segments he is assigned each year free of tax.
- Anthony retains full control of the unassigned segments, meaning he can determine if and when they should be assigned to Curtis. He can also change how these segments are invested and can cash them in if his circumstances change (although this may incur tax).

Inheritance tax and university fees planning

Because Anthony is assigning the segments to Curtis for his maintenance and education, this is treated as a capital transfer for family maintenance (section 11 Inheritance Tax Act 1984). This means that the transferred amounts would be immediately treated as if they were outside Anthony’s estate for inheritance tax purposes.

This should be the case as long as:

- The transfers are made for Curtis’ maintenance and/or full-time course of education and
- The transfers are made by 5 April in the last year of Curtis’ course.

As Curtis is over 18, he must remain in full-time education for this to apply.

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 June 2010. 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.
- Any growth is virtually free of tax. Irrecoverable withholding tax may be payable on certain investment funds, as in some countries withholding tax is deducted from dividend and interest payments. 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 due to changes in HM Revenue & Customs practice.
- For the purpose of this example 2010/2011 tax rates have been used throughout unless otherwise stated.
- No guarantees are given regarding the effectiveness of any arrangement entered into on the basis of this document. This is an example only and may not be suitable for all customers. You will need to take account of a client’s individual circumstances before making a recommendation.
- Please note that the value of an investment may fall as well as rise and an investor may not get back the amount originally invested.