

The 60% marginal tax rate – how investing in an offshore bond can reduce your liability

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The key benefits of using an offshore bond

Up to 5% of the amount invested can be withdrawn each year with no immediate tax liability.

Any growth is virtually free of tax.*

An offshore bond can hold a wide range of investments.

Case study

“I was aware that from April 2010, the top rate of income tax would be 50%. Although I don't earn above the threshold to pay this rate, I've heard that in real terms, the amount of tax I'll pay on my investments might be even higher.”

*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 notes on page 3 for more information.

One of the benefits of investing in an offshore bond is that you can take 5% tax-deferred withdrawals in a potentially more tax efficient way than by taking an income from direct investment in deposits accounts or mutual funds.

For certain investors, the benefit will be even greater following changes introduced in the April 2009 Budget. The following example illustrates the impact of the changes.

Martyn is 50 years old and earns £95,000 a year. He also receives some income from savings and shares in mutual funds. As Martyn is under 65, he is currently entitled to the standard personal allowance. He's aware of the 50% tax rate that that came in at the start of the tax year for people with income over £150,000 and is glad it won't be affecting him. However, what Martyn doesn't realise is that he is paying an even higher marginal rate on his income over £100,000.

In 2009/2010 Martyn paid £32,930 in tax and in 2010/11 (assuming he has the same taxable income) he has a liability of £34,430. The difference, £1,500, works out as an extra 20% on his income over £100,000, leading him to pay a marginal rate of 60% on this income.

How does the 60% marginal rate work?

Martyn has £12,500 in gross interest from deposit accounts, and interest bearing shares in OEICs. He does not have to contribute to his employer's occupational pension scheme nor does he currently give to charities using gift aid.

In 2009/2010 his tax calculation was as follows:

Martyn's income	
Earned income	£95,000
Savings income	£12,500
Total income	£107,500
Less personal allowance	(£6,475)
Taxable income	£101,025
Tax paid	
£37,400 x 20%	£7,480
(£51,125 + £12,500) x 40%	£25,450
Total tax paid	£32,930

But for the current tax year, the picture is quite different. Because Martyn's 'adjusted net income' is over £100,000, his personal allowance is reduced by £1 for every £2 over this limit. (Note – the personal allowance remained the same in 2010/11).

Martyn's income	
Earned income	£95,000
Savings income	£12,500
Total income	£107,500
Personal allowance	
Standard personal allowance	£6,475
Adjustment 0.5 x (£107,500 - £100,000)	(£3,750)
Personal allowance for 2010/11	£2,725
Taxable income	
Total income	£107,500
Less personal allowance for 2010/11	(£2,725)
Taxable income for 2010/11	£104,775
Tax paid	
£37,400 x 20%	£7,480
(£54,875 + £12,500) x 40%	£26,950
Total tax paid	£34,430

*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 notes for more information.

How an offshore bond can help to reduce Martyn's tax liability

Martyn could cash in his deposit accounts and mutual funds holdings and invest them in an offshore bond. As he has been taking income from these funds, the capital gain on the growth may be within his Capital Gains Tax (CGT) allowance.

He could then take an income of 5% of the total payments made into the offshore bond. The 5% withdrawals would have no effect on his personal allowance. He can also control the timing of when the bond was cashed in for maximum tax efficiency. He would also benefit from any growth on capital being virtually tax free* and no further tax on his 5% withdrawals from the bond.

How to find out more

For more information about investing in an offshore bond, please go to www.adviserzone.com/offshore or speak to your account manager.

Important notes

- The examples used in the case studies are for illustrative purposes only.
- The value of investments and any income from them may fall as well as rise and investors may not get back the amount originally invested. In addition, the value of investments may increase or decrease as a result of changes in exchange rates between currencies.
- 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.
- No guarantees are given regarding the effectiveness of any arrangements entered into on the basis of this article.
- Investments in an offshore bond grow virtually free of tax. Irrecoverable withholding tax may be payable on certain investment funds, as in some countries withholding tax is deducted from dividends 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.