TECHNICAL SALES BRIEFING

utmost™ WEALTH SOLUTIONS

OVERSEAS INSURANCE BONDS AS TRUST INVESTMENTS

KEY POINTS

- An overseas single premium life assurance or capital redemption bond ('Overseas Insurance Bonds' – referred to as 'OIBs' or 'bond' throughout this document) can be a very tax efficient vehicle for a UK resident trust, allowing for flexibility, tax deferral and potential tax mitigation if assigned to a non-tax paying beneficiary
- An OIB can reduce the administrative burden for the trustees and can simplify tax reporting requirements. OIBs can also be used effectively in conjunction with many UK inheritance tax (IHT) mitigation arrangements, such as loan trusts and discounted gift trusts (DGTs). Here, the 5% tax-deferred entitlement of an OIB can be especially useful for such schemes, allowing the trust to make payments without an immediate charge to tax.

This briefing document looks at why bonds issued from overseas insurers can be a highly effective investment vehicle for a UK resident trust.

CAN THE TRUST INVEST IN AN OVERSEAS INSURANCE BOND?

Initially, the trustees should establish whether they can make an investment into an OIB. Various factors should be looked at and these are considered here:

DOES THE TRUST DEED GIVE THE APPROPRIATE INVESTMENT POWERS TO THE TRUSTEES?

Most trust deeds, and the majority of wills, give the trustees wide investment powers "as if they were beneficial owners" meaning they can invest in OIBs.

It's important to be aware that depending on the nature of the trust and the terms laid out in the deed, investment into an OIB may be limited or prohibited. In addition, as OIBs are non-income producing assets, some trusts (especially older drafts) may not permit investment into such assets. However, many modern trust drafts will allow investment into non-income producing assets, even where there is a life tenant.

If the deed does not give the trustees wide investment powers, then they should refer to the statutory investment powers applicable to the trust in question. For example, if the trust is written under the laws of England and Wales these powers are given in the Trustee Act 2000.

Finally, most overseas and UK life companies will issue their own range of sample trust deeds and most of these will generally allow re-investment into another provider's bonds.

This information is based on Utmost Wealth Solutions' understanding of current law and HM Revenue and Customs' practice as at **1 Jan 2025**. Tax rules may change and depend on individual circumstances. This information does not constitute legal or tax advice and must not be taken as such. We can take no responsibility for any loss which may occur as a result of relying on any information in this technical briefing.

IS THERE A NEED TO PROVIDE INCOME TO A BENEFICIARY?

Whilst the trust deed may stipulate that the trust fund can invest in non-income producing assets, the trustees must ultimately decide whether they need to invest in assets that produce an income for the beneficiaries of the trust.

Here the trustees may refer back to the non-binding letter of wishes provided by the settlor and/or consider the background of why the specific type of trust was chosen. For example, the settlor may have stipulated that they wanted the life tenant to receive an income for life.

Whilst OIBs can be very tax-efficient, the trustees shouldn't let tax be the sole basis for a decision to invest in one, consideration should also be given to the overall wishes of the settlor when they settled the trust.

WHAT IS THE LENGTH OF INVESTMENT PERIOD?

All trusts have a defined term, referred to as the perpetuity period, and must come to an end at some point. For example, following the Perpetuities and Accumulations Act 2009, trusts written under the law of England and Wales now have a perpetuity period that cannot exceed 125 years. After this period, the trust must come to an end and the deed will usually specify what will happen to the trust fund at this point, commonly known as the default clause. For example, this clause may say that the remaining trust assets should be distributed to a nominated charity.

How long the trust has been running and how the deed was originally drafted, will determine a timeframe for the underlying investment. For example, if the trust only has a few years to run, the selection of an OIB would not be suitable as it is a medium to long term investment (typically meaning a five to 10 year timescale). If the beneficiaries would become entitled to receive benefit in the near future, the trustees may wish to consider short term assets for investments.

10 ADVANTAGES OF OVERSEAS INVESTMENT BONDS HELD IN TRUST

An OIB, as a trust investment, could be an option for the trustees once they are sure the terms of the trust allow such an investment as discussed previously. The taxation of an OIB combined with the administrational efficiencies makes it a very effective trustee investment.

1. NON-INCOME PRODUCING ASSET

As an OIB is a non-income producing asset, it can help to delay a charge to tax arising for the trust. In certain circumstances, it could help to mitigate tax entirely if assignments to beneficiaries can be managed appropriately. This will usually involve transferring ownership of the OIB (or policies within the bond) to beneficiaries who are on lower rates of income tax, for encashment at their own marginal rates.

As OIBs don't produce income they can also be extremely useful for non-domicile and UK resident individuals who may not wish to claim the remittance basis of taxation.

A full guide to bonds for people who become UK resident is available on our uTech site. Refer to **Inheritance Tax Liability and the Statutory Residence Test document**.

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2. GROSS-ROLL UP AND FUND LINK OPTIONS

Any gains within an OIB roll up free of income tax and capital gains tax. The only tax on which some overseas funds may be liable is withholding tax which is deducted at source.

If the trustees (the policyholder) are UK resident and retain the power of selection, then the investments that can be linked to the bond are covered by the UK Personal Portfolio Bond rules.

Under these rules the terms of the bond allow the policyholder (the trustees) to purchase assets that are permissible under s571 Income Tax (Trading and Other Income) Act 2005 ("ITTOIA"). These include investments in cash (bank) accounts and numerous types of collective investment schemes such as OEICs, UK authorised unit trusts and investment trusts, extending the available fund links to thousand of collective funds.

OIBs also usually permit links to discretionary management services and fund platforms, extending the trustees investment options, allowing them to manage trust assets more efficiently.

Furthermore, some of these discretionary options, including some products provided by Utmost PanEurope, will also allow for wider fund selection by removing the power of selection under the bond providing for even more flexibility.

3. TAX EFFICIENT SWITCHING WITHIN THE OVERSEAS INSURANCE BOND

As the underlying assets of the bond are the property of the non-UK resident life company, no capital gain is crystallised by the trust when switching investments within the OIB. As no tax events occur due to the switches, UK self-assessments are not required, reducing the administrative burden on the trustees.

4. CONTROL OVER FINAL ENCASHMENT

Bonds can be issued on a capital redemption basis which are based on an actuarial calculation rather than a human life. Conversely, life assurance bonds will end on the death of the relevant life assured – if multiple lives are used this can be set so they end on either the first death or the last death.

Capital redemption bonds can be ideal investments for trusts where the trustees want to maintain control over when benefits are paid from the trust. The capital redemption bond will run for a defined period, say 99 years, without depending on one or multiple lives. As no chargeable event is automatically created until the trustees decide, this type of bond can be very useful when combined with UK trust planning. As explained earlier in this briefing, a trust written under the laws of England and Wales will have a perpetuity period of 125 years so the capital redemption bond can better match the length of the trust.

This cannot necessarily be achieved where a life assurance bond is used, as the bond could end unexpectedly on the death of an individual (life assured). However, life assurance bonds, written on multiple lives (multi-life) and set up on a last life basis, can be used to increase the longevity of the OIB.

5. CONTINUITY – THE BOND CAN CONTINUE EVEN BEYOND THE DEATH OF THE SETTLOR

A capital redemption option is also useful here as ownership is held by the trustees and the longevity of the bond is not dependent on the life of a particular individual, such as the settlor. This means the death of the settlor does not trigger a tax charge and the trustees can instead continue to maintain the trustee investment following their death.

Similarly, a life assurance bond can also be useful by careful selection of the lives assured. Appointing younger lives could help the trustee maintain the investment after the death of the settlor.

6. SEGMENTATION AND ASSIGNMENT OF OVERSEAS INSURANCE BONDS OR POLICY SEGMENTS

Most OIB providers dealing with the UK market will issue segmented bonds. Here the initial premium is split into a series of identical policies and these are all managed under one wrapper, with the resulting policies referred to as policy segments.

HMRC's guidance in the Insurance Policyholder Taxation Manual 7330 covers this setup and refers to the wrapper as a 'bond' or 'cluster policies'. Importantly these segments must exist in their own right and can be individually surrendered or assigned to the beneficiaries as the trustees see fit (subject to the life company's minimum value on managing the respective cluster(s)). This segmentation mechanism, together with the ability to assign each individual policy segment, is incredibly useful for trustees' investments.

The assignment of any OIB, or individual policy segment, to a UK beneficiary is not a chargeable event providing this is not for money or monies worth. This means trustees can use their powers of distribution to assign the bond or policy segments to UK beneficiaries, without creating a charge to tax on either the trustees or the UK resident beneficiary. Following the assignment the beneficiary can then utilise their own tax rates, which can be a very useful planning tool if the beneficiary is a lower or non-tax payer.

Consider this position against an unwrapped investment, whereby the assets would need to be either sold or distributed in-specie, which would usually trigger UK chargeable gains liability against the trustees as outlined earlier.

Furthermore, where easily divisible numbers of segments are used, it can make it easier for the trustees to distribute equal benefits to a number of beneficiaries. Here the trustees should consider the number of segments issued and make sure they are divisible by the number of beneficiaries to allow for maximum flexibility.

Segmentation is not generally recognised in Europe and therefore OIBs issued overseas for other markets will generally not be segmented. If in doubt you should refer to the policy documentation or speak with the provider of the OIB to see whether the bond was segmented.

7. EASE OF ADMINISTRATION

The taxation of UK trusts is very complex for unwrapped investments, especially around discretionary-type trusts. Bonds radically simplify tax reporting for trustees as the trustee investment is simply the OIB, rather than the underlying assets which are held in the name of the life company.

OIBs also help to simplify areas such as the Common Reporting Standard, as trustees only need to provide self certifications to one overseas bond provider, instead of to multiple institutions which is likely with unwrapped investments.

The use of platforms and discretionary managers can also further streamline reporting and information gathering, for both trustees and their advisers.

8. MITIGATING THE TRUSTEE RATE WITH BONDS – USING ASSIGNMENTS

Where a bond, or a policy segment, is to be surrendered by trustees to make payment to a beneficiary, consideration should first be given to utilising any available 5% tax-deferred entitlement or assignment.

Assignment of a bond, or a policy segment, from trustees to a beneficiary (for no consideration) would not normally give rise to a chargeable event. Following the assignment, the beneficiary would then be assessed for tax on the bond or policy segment(s) as an individual, using their marginal rates of tax. As a result, this course of action should be effective in reducing tax where the beneficiary's marginal tax rate is lower than the trustees' (or settlor's) rate. Given the trustee rate is 45%, assignment will usually be a beneficial option for basic and higher rate taxpayers. It will also allow the beneficiary to claim any available top-slicing relief and/or time apportionment relief where applicable. However, care should be taken regarding possible IHT exit charges that may arise due to the assignment.

Where the beneficiary is a minor, a deed of appointment of beneficial interest can be used with an assignment to make sure the bond, or policy segment, is taxed against the beneficiary using their rates of tax.

An OIB could be particularly attractive here as, unlike their UK counterparts, gains within the fund roll up free of income tax and capital gains tax. The only tax to which the funds may be liable is that which is deducted at source. This is known as withholding tax and cannot be reclaimed.

9. THE 5% TAX-DEFERRED ALLOWANCE

With a single premium OIB, the 5% per annum tax-deferred entitlement is available. Withdrawals of up to 5% of the initial premium paid can be made each year. This tax-deferred entitlement is cumulative and can be stored for later years. The tax-deferred entitlement is available whether the bond is held by individuals or by a UK resident trust company. These withdrawals are tax-deferred, meaning that no UK tax liability will arise immediately as long as the 5% per annum tax-deferred entitlement is not exceeded. In turn this means no annual filing of tax returns for the UK resident trustees and no tax falling on the UK settlor whilst they are alive. Once the bond is surrendered the withdrawals are then added to the surrender value to increase the total benefits. Beyond standard gift trusts, some bond providers have built specialist products which combine bonds with trusts. These products make use of the tax-deferred entitlement with OIBs to generate withdrawals without causing UK tax events and the associated administration necessary. A full explanation of these products is beyond the scope of this document, but the following points seek to highlight where holding a bond (utilising the 5% tax-deferred entitlement) can be advantageous for the trust:

i) Standard Gift Trusts

The 5% per annum tax-deferred entitlement can be used as a way for the trustees to make distributions of capital to UK beneficiaries without triggering a chargeable event.

ii) Loan Trusts

The settlor lends the trustees an amount of money, interest free and repayable on demand. The growth belongs to the trust and beneficiaries but the loan remains in the estate of the lender (settlor) as creditor. The 5% per annum tax-deferred entitlement can be used to drip feed regular sums back to the settlor, reducing the outstanding loan (as long as repayments are spent). As there is no immediate charge to tax, there is little ongoing administration for the trustees.

iii) Discounted gift trusts (DGTs)

A DGT is set up to provide the settlor with an 'income' each year from the bond / trust. As this 'income' is fixed at outset and cannot be amended or stopped, the value of this future income falls outside the settlor's estate for IHT purposes. Here the amount gifted to the trust is discounted by the open market value of the settlor's future income rights for IHT purposes. Again, the 5% tax-deferred entitlement can be used to set the regular withdrawals with no immediate annual tax charge and no additional administrative burden on the trustees.

10. TAX ADVANTAGES OF OVERSEAS INSURANCE BONDS

As outlined earlier in this briefing, the taxation of insurance bonds under the chargeable events regime allows for tax efficient structuring and distributions for UK resident trustees. This includes:

- Ability to use the 5% tax-deferred entitlement to pay beneficiaries without triggering a tax charge
- Gains falling on the UK settlor during their lifetime allowing the trustees to mitigate the trustee rate of tax and enabling top-slicing relief to still apply
- Unrestricted assignment of the bond or policy segments to beneficiaries, to further mitigate the trustee tax rate with no charge to tax at the time of assignment
- Beneficiaries can utilise their rates of tax following assignment and potentially make use of their own rates of tax including personal allowance, starting rate band for savings and personal savings allowance. Beneficiaries can also utilise top-slicing relief where applicable.

A full technical sales briefing discussing top-slicing relief and the taxation of overseas insurance bonds is available on our uTech site.

THE INCOME TAX POSITION OF OVERSEAS INSURANCE BONDS HELD BY TRUSTS

As mentioned earlier, as a non-income producing asset, the bond can achieve effective tax-deferral, potential tax mitigation and ease of administration for the trustees in terms of tax reporting.

An OIB will give rise to a charge to UK savings rates of income tax on the happening of a so called 'chargeable event'.

Chargeable events include:

- Surrender of the bond or individual policy segments
- Part-surrender in excess of the 5% tax-deferred entitlement
- Assignment of the bond or policy segment(s) for money or monies worth
- Death of relevant life assured (life assurance policies only).

However, when most of these events happen, they can often be controlled by the trustees, unlike the position with an unwrapped investment. Under an unwrapped investment, any income received will be subject to trustee rates of tax and any gains will be assessed where assets are sold and repurchased.

Who is then liable to pay tax once a chargeable event occurs depends on the type of trust and other circumstances such as the residence of the settlor.

WHO IS LIABLE FOR THE TAX?

Bare Trust

Where a bond is held subject to a bare trust, any gains on the happening of a chargeable event will be taxed on the beneficiary at their marginal rates of tax, regardless of the beneficiary's age.

Again, like unwrapped investments, this is the case unless the parental settlement rules apply. These rules ensure that any gains arising on the bond over the value of £100 are taxed as the parent(s) income, as opposed to the beneficiary's income (if the beneficiary is aged under 18).

Other trusts types including Discretionary Trusts

For most other forms of trust, including Discretionary Trusts, if the settlor of the trust is alive (or was alive in the tax year in which the gain occurs) and is/was UK resident, any chargeable event gains will be assessed upon the settlor.

However, where the settlor of the trust has died in a previous tax year, or is not UK resident, gains will be assessed on the trustees if the trust is considered UK resident for tax purposes.

A trust will be UK resident for income tax if:

- All the trustees are UK resident s475(4);
- At least one trustee is UK resident and the settlor was UK resident[1] at the time of the settlement OR the settlement arose because of the settlor's death and immediately before death they were UK resident.

[1] If the settlement is created before 6 April 2025, either due to a settlement being created or as a result of a settlement in a will, then the trust will be UK resident if the settlor was UK resident or domiciled. Following changes in the Autumn Budget, the domicile position no longer applies to settlements created on or after 6 April 2025.

CONCLUSIONS

Whilst some older trust drafts may restrict investments in non-income producing assets, most modern trusts will allow such investments which permits investment into an OIB. For many UK resident trusts an OIB can be a tax-efficient vehicle; allowing for simplified tax and reporting administration, whilst providing a tax-efficient wrapper and distribution mechanism in the form of assignments. These features make the UK trust and the OIB a powerful tried and tested combination.

TECHNICAL SERVICES
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