



Global Pension Options

Why is cross border financial planning so important?

A survey by Clerical Medical in 2006 found that one in three UK residents intended to retire abroad. Of these, half planned to retire to Europe, with Spain and France being the most popular destinations. At the end of 2006, 850,000 Britons had a holiday home abroad.

Good advance financial planning can reduce dramatically and in some cases eliminate completely the tax paid on their savings by those people who do move abroad. For a financial advisor some simple steps allow them to not only provide good advice to their clients before they move abroad but also to continue to service them after they move.

Why is an Offshore Bond ideal for those moving abroad?

While the exact tax treatment of financial products varies significantly from country to country, offshore bonds offer significant tax advantages over other investments for those moving abroad, especially to the most popular European destinations of France and Spain. Listed below are seven reasons why offshore bonds make ideal investments for those considering moving abroad.

- The UK is a relatively high tax country for savings. With the exception of capital gains which are taxed at a flat rate of 18% most other investment income and gains are taxed at the marginal rate of income tax. From 2010, the marginal rate of income tax in the UK can be up to 50%. Most countries in Europe tax savings at a lower rate than income. For example, in Spain investment gains and income are subject to a flat tax of 18%. Offshore bonds allow gross roll up whereby no tax is paid on savings as they accumulate and the tax is paid when the funds are withdrawn from the bond. By deferring withdrawals until the bond holder has left the UK they will pay tax on their savings at the lower overseas rate rather than the higher UK rate. Other investment options such as bank accounts or mutual funds do not have the option of deferring tax in this way.
- Where withdrawals are made from an offshore bond while the bond holder is still resident in the UK they are taxed at their marginal income tax rate on the gain proportion of the withdrawal. Withdrawals of up to 5% per annum of the original premium are allowed without being subject to tax. This 5% allowance can be carried forward if unused. Where an offshore bond has been in force for a number of years before the individual moves offshore, the bond holder can take advantage of their unused cumulative 5% allowances to make a large tax free withdrawal before they leave the UK. In many countries the bond holder will be deemed to have paid UK tax on the withdrawal made before leaving the UK despite the fact that no tax was actually paid. In this way it is possible to withdraw a proportion of the gains made on the bond and legitimately pay tax nowhere in the world on the gain.

For example if someone put £100,000 into an offshore bond eight years ago that had grown to £160,000 now they could withdraw £40,000 ($8 * 5% * £100,000$) without paying any tax in the UK. If they then moved to France and immediately surrender the policy in full they would receive £120,000 less French tax. In France only £45,000 of the £120,000 would be deemed taxable as they assume that £15,000 of the £40,000 withdrawn in the UK was taxed in the UK. In this way £15,000 of the gain on the policy pays tax nowhere in the world. This 5% withdrawal allowance is only available on insurance contracts.

- Assets such as mutual funds which are liable to capital gains tax have a potential sting in the tail for people who move abroad. Where a mutual fund is held in the UK before the unit holder moves abroad, they could be liable to UK capital gains tax if they return to the UK within five years of leaving the UK and have disposed of the mutual fund while they were overseas. There are no such provisions applying to offshore bonds where withdrawals made while abroad are only taxable abroad.
- Where an individual does return to the UK after spending time abroad they are potentially liable to UK capital gains tax on the full gain on assets such as mutual funds or shares. Offshore bond gains are effectively only taxed on the proportion of the gain that accrued while the individual was resident in the UK. This means that

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significant gains built up while residing overseas can be withdrawn in the UK and not be liable to tax anywhere in the world.

- When an individual moves abroad their investment needs will need to be reviewed to take into account such factors as the currency of the country where they are now residing. Within an offshore bond it is possible to make significant changes to the underlying portfolio without triggering any tax consequences for the bond holder. Where assets are held directly such as mutual funds a restructuring of the portfolio could give rise to significant tax implications.
- Where an individual moves abroad, any assets that they retain in the UK such as bank accounts, onshore life assurance policies, property etc. will potentially be liable to UK inheritance tax regardless of where they are resident when they die. An offshore life assurance policy can avoid this issue.
- The tax systems of other countries are often byzantine and operate in very different ways to the UK system. For example in France tax is assessed at a household level rather than on an individual. Holding an investment portfolio within an offshore bond can simplify dramatically the tax calculations necessary in a foreign country as the life assurance company normally takes care of all of the tax payments. The alternative of holding assets such as mutual funds directly rather than through an offshore bond would generate significantly more complex tax reporting on each of the distributions received and on any gains realised.
- With one in three of an IFA's customers potentially moving abroad, it is important that the IFA is able to continue to service those clients in the future. Using an offshore bond minimises the level of country specific tax knowledge that an IFA needs to develop and also allows them to sell across Europe without having to take on MIFID regulation.

Selecting an offshore bond as the optimum tax wrapper for a client who may move abroad is only the first step. Like any other product there are differences to be considered between the product terms offered from the different offshore bond providers in terms of charges, investment options etc. However, unlike other products there are numerous attributes of the offshore bond provider itself that can have a meaningful impact on the features available on the product, the tax treatment of the product and the ability of the IFA to service the product. All of these factors are crucial in deciding which offshore bond provider to go with.

- EU versus non EU base. Most offshore bond providers are based in one of Ireland, Isle of Man/Channel Islands, and Luxembourg. Ireland and Luxembourg are both in the EU, while the Isle of Man and the Channel Islands are not. EU countries are not allowed discriminate against life assurance companies from other EU countries but they are free to discriminate against non EU countries and many do so. For example in Ireland a life assurance product from an EU life company is taxed at 28% while a life product from a non EU company such as one based in the Isle of Man is taxed at 40%.
- Fiscal Representative network. A Fiscal Representative is an agent of the life assurance company who is responsible for paying tax to the tax authorities in a particular country on behalf of the life assurance companies clients who are resident in that country. In many countries there are significant tax advantages in using a company who has a Fiscal Representative in the country. For example in Spain, only companies with Fiscal Representatives enjoy gross roll up, life assurance policies from companies without Fiscal Representatives are subject to tax on an annual basis based on the growth of the policy even if no withdrawals are made. In France, where the life assurance company doesn't have a Fiscal Representative any gains on a life assurance policy are taxed at the marginal income tax rate. Where there is a Fiscal Representative the policyholder has the choice of either taxing the gain at the marginal income tax rate or have a flat rate of tax deducted by the life company. The flat rate of tax can get as low as 0% after 8 years.
- General Good capabilities. The EU single market allows insurers to sell their products across Europe without having to establish an operation in each country. However, in each country the insurer must comply with the local general good requirements. These cover areas like cooling off periods, disclosure, contract terms and conditions. Where a client moves to another European country, the contract can only be topped up where the life assurance company can comply with the general good requirements of that country.

- Local market knowledge. Most offshore insurers trading in the UK do not market their products actively across Europe. Unless an insurer is active in a particular market they are unlikely to be aware of the subtle nuances of that country. This is particularly true of the tax rules. Most European countries now have personalised portfolio bond rules with significant tax consequences of falling outside the rules. The rules vary from country to country, and, without having an active presence in the country it is very difficult to learn all of the countries rules and to keep the knowledge up to date. Some countries have what appear to be illogical rules from a UK perspective. For example in Spain the availability of the option to switch into or out of a property fund would invalidate the gross roll up of a life assurance contract. Most products sold in the UK would fall foul of this rule, but without access to local market knowledge the IFA would be totally unaware of the risk.

Any reference to legislation and tax is based on Global Pension Options' understanding of current legislation and practice at the date of production. These may be subject to change in the future. Tax rates and reliefs may be altered. The value of tax reliefs to the investor depends on their financial circumstances. No guarantees are given regarding the effectiveness of any arrangements entered into on the basis of these comments. We recommend that investors seek advice from professional advisers regarding their own personal circumstances.