



Bonds v OEICs/UTs - what factors to consider?

The summary below compares bonds and OEICs/UTs from the perspective of taking an income, capital growth and various tax and estate planning options. Whilst the choice of investment should not be made for taxation reasons alone it will be a critical factor. Other key factors will include product pricing, fund choice, asset classes, death benefits and trust options.

Investment Bonds	OEICs & UTs
Taking an income <ul style="list-style-type: none">• 5% withdrawals can be taken per annum without incurring an immediate tax charge and any unused allowance can be carried forward to future years.• Bonds are a useful way of providing an 'income' without any impact on an investor's personal allowance and/or age allowance, (within the 5% allowance).• If withdrawals exceed the 5% allowance (or higher cumulated amount), tax may be payable depending on the tax position of the investor and whether the bond is onshore or offshore. The links highlighted explain the calculations.• Because investment bonds are non-income producing assets there is no need for annual tax returns, unless there has been a chargeable event (such as exceeding the 5% annual allowance) resulting in a chargeable gain.	Taking an income <ul style="list-style-type: none">• The income from an OEIC/UT will be taxable whether taken or reinvested. Non-Equity funds (which hold greater than 60% in cash or fixed interest) have income paid as an interest distribution net of 20% tax (and non-taxpayers can reclaim). Equity funds (which hold less than 60% in cash or fixed interest) have income paid as dividend income with a 10% non-reclaimable tax credit. The link highlighted explains the tax calculations for the different taxpayers.• Income paid (or reinvested) from an OEIC/UT will be included in the assessment of an investor's personal allowance and/or age allowance.• Disposal of shares/units to supplement income is a disposal for capital gains tax, although this may be covered by the annual CGT allowance. The rate of CGT payable will depend on the allowances and reliefs available to the investor and on their income tax position. The links highlighted will explain the calculation.• Because OEICs/UTs produce income they will normally need to be reported each year to HMRC, even if accumulation units or shares are chosen. Capital gains may also need to be reported when a disposal takes place.
Capital growth <ul style="list-style-type: none">• When the bond is surrendered tax may be payable depending on the income tax position of the bond owner and whether the bond is onshore or offshore. The links highlighted explain the calculations.• Switching funds in an investment bond can take place with no tax implications for the investor.	Capital growth <ul style="list-style-type: none">• When shares/units are cashed in, this is a disposal for capital gains tax although this may be covered by the annual CGT allowance. The rate of CGT payable will depend on the allowances and reliefs available to the investor and on their income tax position. The links highlighted will explain the calculation.



- Where a taxpayer held accumulation shares/units, on disposal a reduction in the disposal proceeds is allowed for the reinvested income. Where a taxpayer held income units from which the income was reinvested, there is no deduction from the disposal proceeds allowed as each amount of reinvested income will purchase further shares/units.
- Losses on disposals can be offset against other capital gains.
- Taper relief and indexation allowance is no longer available.
- Switching funds within an OEIC/UT is a disposal for CGT with possible tax and reporting requirements.

Tax & Estate Planning

- Individuals may be able to alter their level of income to reduce or avoid tax on surrender of the bond, e.g. those who have pension income in drawdown may be able to reduce it.
- Gifting the bond (i.e. by assigning it) to a lower/non taxpayer such as a spouse or child in further education will not create any liability to CGT or income tax, and it can reduce or avoid the tax that would otherwise be payable by the investor. The link highlighted explains how this works.
- Individuals may be able to make a pension contribution to reduce or avoid tax on surrender of their bond. The link highlighted explains how this works.
- Gifting the bond to another (i.e. assigning into trust or to an individual) will be a transfer of value for IHT purposes, although this may be covered by an exemption.
- Having multiple lives assured can avoid any chargeable event upon death of the bond owner.

Tax & Estate Planning

- Individuals may be able to alter their level of income to reduce the tax rate payable on a capital gain e.g. those who have pension income in drawdown may be able to reduce it.
- Transferring the OEIC/UT to another individual or into trust (i.e. by stock transfer) will be a disposal for CGT purposes although this may be covered by the annual CGT allowance. Gift holdover relief may also be available depending on the type of trust.
- Individuals may be able to make a pension contribution which in turn could reduce the rate at which they pay CGT.
- Transferring the OEIC/UT to another individual or into trust (i.e. by stock transfer) will be a transfer of value for IHT purposes, although this may be covered by an exemption.
- No CGT is payable on death.
- Investors who are both non UK resident and ordinarily resident will not be liable to UK CGT on disposal of their OEIC/UT. However, anti-avoidance legislation means they will need to remain non UK resident and ordinarily resident for five complete tax years for the gain to remain exempt from CGT.



- If a chargeable gain arises in a tax year in which the investor is non-UK resident then there will be no liability to UK income tax. There may be a tax liability in their country of residence. New anti-avoidance legislation taxes the chargeable gain if the non-resident returns to the UK within five years.
- A special relief (known as time apportionment) applies to offshore bonds. It reduces the tax liability on chargeable gains for individuals who have been non-UK resident for any period of their investment. The relief is extended to onshore bonds that commence after 5 April 2013 or existing onshore bonds that are assigned after this date.
- **Offshore** bonds offer investors who are UK resident but **not** UK domiciled opportunities to save tax, such as IHT and the remittance basis tax charge. The links highlighted explain how these work.
- Investment bonds are not generally included within the means test for local authority residential care funding.
- OEICs/UTS are included within individual's assessment for local authority residential care funding.

Taxation of Fund

Onshore Bond funds' internal taxation is extremely complex. In general terms it can be summarised as follows:

- Interest and rental income are subject to corporation tax at 20%. Dividends are received with a 10% tax credit which satisfies the fund manager's liability.
- Corporation tax is payable on capital gains at 20%. Indexation allowance is available to reduce the gain.
- Investors are given a non-reclaimable 20% tax credit to reflect the fund's taxation.

Offshore Bond funds are typically located in jurisdictions which impose no tax upon investment funds, such as Dublin, the Channel Islands and the Isle of Man. And so:

- Interest, dividends and rental income are tax free. Some non-reclaimable withholding tax may apply to certain overseas income.
- No corporation tax is payable on capital gains.

Taxation of Fund

OEICs/UTs are only subject to tax within the fund on income received, and so:

- Interest and rental income are subject to corporation tax at 20%. Dividends are received with a 10% tax credit which satisfies the fund manager's liability.
- No corporation tax is payable on capital gains within the fund.