

Tax-efficient solutions for wealthy individuals

Outline

Pensions and ISAs are the go-to tax-efficient wrappers for many savers, but certain higher earners and high-net-worth individuals (HNWIs) who are already maxing out their allowances may want to – or need to – consider some additional solu-

tions for implementing an effective tax planning and wealth management strategy. This factsheet outlines some of the solutions that HNWIs can utilise in order to implement financial efficiencies and optimise their wealth.

Summary: Tax-efficient solutions for HNWIs

| Solution | Attractive for |
|--------------------------------------|---|
| Offshore bonds | <ul style="list-style-type: none"> Investors who have large cash deposits and are looking to invest in a tax-efficient manner, having maxed out other tax wrappers such as pensions and ISAs Those who want to efficiently pass their assets on to their family at a time of their choosing, and at potentially more favourable tax rates Investors who wish to have flexibility on when they pay tax on their investment growth |
| Gift and loan trusts | <ul style="list-style-type: none"> Those investors who wish to start IHT planning, but don't wish to relinquish control of their cash assets at this stage |
| Venture capital trusts (VCTs) | <ul style="list-style-type: none"> Those looking to mitigate capital gains tax and achieve other forms of tax relief/tax efficiencies (where applicable) |
| Enterprise investment schemes (EISs) | <ul style="list-style-type: none"> Those looking to defer or mitigate capital gains tax and achieve other forms of tax relief/tax efficiencies (where applicable) |

Pensions and ISAs

The two main tax-efficient wrappers in the UK are pensions and ISAs. These both provide a valuable shelter against income tax and capital gains tax (CGT).

Adults can pay a maximum of £20,000 per year into an ISA (or £40,000 if a couple were to use both their annual allowances). This allowance is only available for a given tax year and cannot be carried over. Under-16s can contribute £9,000 a year into ISAs, while those who are 16 or 17 can additionally contribute up to £20,000 into an adult cash ISA equivalent.

The standard pension annual allowance, the maximum amount that can be contributed into a

pension and benefit from tax relief, is £60,000. Certain taxpayers may be eligible to make increased pension contributions in a tax year by carrying forward any unused annual allowances from the three previous tax years. You must use the annual allowance in the current tax year first, before using carry forward from prior years.

Extra care is needed for certain higher earners, who may be subject to a tapered annual allowance if their adjusted earnings are above £260,000. The annual allowance is reduced by £1 for every £2 of adjusted income over the limit of £260,000. A minimum annual allowance level of £10,000 applies to those earning over £360,000.

High level comparison

There are a number of different aspects to consider when it comes to tax efficiency:

| | Tax efficiency | Investment choice | Liquidity | Flexibility |
|------------------------------|----------------|---------------------|------------------|------------------|
| ISAs | Yes | Wide | Yes | Yes |
| Pensions | Yes | Wide | Yes | No (age 55/57) |
| Offshore bonds | Yes | Depends on solution | Limited | Limited |
| Gift & loan trust | Yes | Depends on solution | Partially (loan) | Some (with loan) |
| VCT/EIS | Yes | Narrow/high-risk | No | No |

Offshore bonds

Offshore bonds, which are also known as international bonds, are tax-efficient investment vehicles. You can typically invest in a wide range of funds covering assets including equities, property, and fixed-interest securities. Investments are held in tax-efficient jurisdictions outside of the UK.

Many offshore investment bonds consist of segments that can be gifted/assigned to designated beneficiaries in a tax-efficient manner. If you are investing in offshore bonds you should have a long-term investment horizon.

Typical advantages:

- Investments within an offshore bond are not subject to annual CGT or income tax. This means your investments can grow tax-free initially. This process is sometimes referred to as gross roll-up.
- You only pay tax when you encash the bond. You pay income tax on the chargeable gain at your highest marginal rate at the time of encashment. This can be a useful planning tool if you will be a lower rate taxpayer when you encash the bond.
- Savers can benefit from 'top slice relief'. This means you can divide the chargeable gain by the number of years it has been active, to keep you within basic/higher rate tax bands.

- You can withdraw 5% per annum of the original investment amount and see tax deferred on this sum. This is useful if you wish to draw a yearly income before fully encashing the bond. This 5% allowance also accumulates, eg. after two years, you can draw 10% of the original investment with tax deferred on this amount.
- You can assign segments of the bond to beneficiaries, without incurring any immediate tax liability. The assignment remains within your estate for seven years, but after this period it is considered outside of the estate, and is not subject to inheritance tax (IHT). If the recipient is a lower rate taxpayer at the time of encashment then this is another useful tax efficiency.
- Plans can be set up to include 'lives assured' status. In the event of the death of one of the 'life assured', the plan continues until all assured individuals die.

Potential drawbacks:

- Offshore bonds can incorporate a complex charges structure. Provider fees and total costs should be examined carefully.
- Withdrawals that exceed 5% are subject to an immediate tax charge at your highest marginal rate.

Tax charges when encashing an offshore investment bond

Assumptions: Investment bond encashed after 10 years; figures rounded.

| | |
|-------------------------|----------|
| Original investment | £500,000 |
| Growth per annum | 4% |
| Value in 10 years' time | £740,000 |
| Gain | £240,000 |
| Tax at basic rate | £48,000 |
| Tax at higher rate | £96,000 |
| Tax at additional rate | £108,000 |

- When brought into the UK, certain investments may be subject to a 'withholding tax' charge.
- Policy surrenders and encashment procedures can be complicated, which can lead to delays in receiving funds.

Offshore bonds vs. general investment accounts

General investment accounts (GIAs) can be accessed at any time, and there is no limit on your contributions or annual withdrawals. You have access to all the funds without charge or surrender penalties, although some disposals can trigger a CGT charge. Losses on disposal can be offset against gains made in the same year. GIAs have a more cost-effective charging structure than off-

shore bonds, but do not benefit from the same tax advantages. Any gains on investments held within a GIA are subject to both CGT and income tax at your highest marginal rate in the relevant tax year. Unlike offshore bonds, GIAs can only be set up in your name, and the plan ends when you pass away (there are no 'lives assured' protection possibilities).

Gift and loan trusts

A gift and loan trust allows you to retain control of the original invested capital and draw an 'income' from this investment. This may be a suitable solution for someone who wants to start inheritance tax planning, while retaining access to the original capital. If the gift and loan trust is set up in an offshore structure, such as an investment bond, then investment growth is deferred, meaning that any investment income or capital gains can roll up 'gross', and so no tax returns are required each year.

Since a loan is not an outright gift, the original loan amount remains within your estate. However, given that the assets are held in trust, any growth will fall outside of your estate, which helps limit potential IHT liabilities for your beneficiaries when you pass away.

For 20 years, you can withdraw up to 5% of the original capital each year with no immediate tax liability. Any unused 5% withdrawals accrue. So, for example, after a period of three years, if you

haven't accessed any capital, you can draw 15% with no immediate tax liability. If you draw an amount that exceeds your 5% withdrawal limit this will trigger a chargeable event, and there may be a tax liability charged to the settlor within that tax year.

Further tax considerations include:

- The settlor has access to the original loan amount, but any investment growth accrues outside of the estate.
- When beneficiaries come to draw from the investment proceeds, they will be taxed on the overall gain at their highest marginal rate for income tax.
- However, the beneficiaries are able to 'top slice' the gain if it takes them into a higher rate band. Top slice relief allows you to divide the chargeable gain by the number of years it has been active, in order to keep you within basic rate or higher rate tax bands for income tax purposes.

VCTs and EISs

Venture capital trusts (VCTs) and enterprise investment schemes (EISs) can form a very useful part of a tax planning strategy for HNWIs. If your VCT pays dividends, there is no tax to pay, and you won't need to declare them on your tax return. If you decide to sell your VCT shares, and you make a profit, the proceeds won't be liable for CGT after the initial holding period.

EISs allow you to claim income tax relief in the year the investment is made into each EIS company. Alternatively, you can opt to carry it back to the previous tax year.

You can also defer CGT on a capital gain made on any asset, provided that the investment into the EIS is made up to one year before making the capital gain, or three years afterwards. For the purposes of deferral relief, it's the capital gain not the proceeds of sale that should be invested. The

gain will be deferred until the earlier of any of the following events:

- The EIS shares are sold (unless sold to a spouse/civil partner).
- The company ceases to qualify within three years of investment.
- The investor ceases to be a UK resident within three years of investment (unless it is because of working temporarily abroad and the investor becomes resident in the UK within three years of leaving and still holds the shares on their return).

When the deferred gain comes back into charge, it will be subject to the relevant CGT rate, although it is possible to further defer the capital gain by reinvesting into a new EIS-qualifying investment. If, however, the investor still owns the EIS shares upon death, the deferred gain will be eliminated.

VCTs and EISs are complex and high-risk investments, and you should ensure that you fully understand them before taking any action. An independent financial adviser can explain the various implications and risks.

Past performance is not a guide to future returns. The value of investments may fall as well as rise, and you may get back less than the original amount invested. Lumin has carried out extensive due diligence on products available in this area.

| VCT and EIS tax relief | | |
|--|----------|--|
| Benefit | VCT | EIS |
| Tax-free capital gains | Yes | Yes, after 3 years |
| Income tax relief | 30% | 30% |
| Maximum annual investment eligible for income tax relief | £200,000 | £1m, or £2m if anything over £1m is in knowledge-intensive companies; not into company that the individual is a director of |
| Tax relief carry back | | Yes, 1 year |
| Minimum hold period for income tax relief | 5 years | 3 years |
| Tax-free dividends | Yes | No |
| Capital gains deferral | No | Yes, up to 100% of amount they invested in scheme against any CGT incurred up to 1 year before, or 3 years following, share disposal |
| Loss relief | No | Yes, less any tax relief received |
| IHT relief | No | Yes, after holding for two years |

Comprehensive wealth management solutions for HNWIs

Lumin provides a range of services for high-net-worth individuals, including integrated investment management and financial planning solutions. Clear financial planning and tax-efficient management of investments can lead to potentially large tax savings. Comprehensive financial planning considers all your financial affairs, and

all the pieces of your personal jigsaw. This includes your pension pot, savings and investments, retirement and estate planning, and protection for your family/business. Independent financial advice provides peace of mind that you've planned for all eventualities.

In expert hands with Lumin

Lumin is a leading independent financial adviser headquartered in St Albans, with particular reach across London and the South East. We offer trusted and professional advice on pensions and retirement, investments, inheritance and tax planning, financial protection for individuals and businesses, and mortgages. Lumin's financial plans are geared toward growing, or protecting, wealth by optimising our

clients' income, assets, tax burden and financial security. Whatever your financial ambitions, you can count on our expertise to provide peace of mind. We are backed by VZ Group, the leading independent financial services provider in Switzerland.

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