

Estate Control Bond - By Isle of Man Assurance

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The Estate Control Bond is an innovative inheritance tax-planning offshore pooled fund portfolio bond from the stable of Isle of Man Assurance. This article, the latest in a series of regular product analyses, examines the Bond to see what is different about it and why it is proving so popular amongst UK IFAs.

Company

Isle of Man Assurance (Ioma) is an independently owned insurance company, established in the Isle of Man in 1971. It is therefore arguably the "daddy" of the offshore life business. For the record, let me declare on this occasion that in a consultancy capacity I am Ioma's actuary and an adviser on Ioma's board. That said, I can claim no credit whatsoever for the clever tax planning parts of products such as ECB, which is what I intend to feature below.

Ioma prides itself on a number of things, including innovation and service. Innovation is demonstrable in the form of a succession of niche products written by Ioma over the years. Its Capital Redemption Bond for example made Ioma one of the leading single premium companies in the offshore life industry in 2004-05, and other products such as the Estate Control Bond (ECB) continue a long history of innovation, both in relation to life business and non-life business. Ioma is also well-known in the UK for having given birth to the long-standing Holiday Property Bond (and those Judith Chalmers adverts), which has been so successful as a product as to have been spun off into an associated life company.

In relation to customer service capabilities, Ioma has been credited with the Quality Standard BS EN ISO 9001 since 1997, and in its 2006 review by AKG was rated "Very Good" for quality of service.

Ioma writes business from the Isle of Man into a number of countries, not just the UK. Its operations are supported by sister companies including Isle of Man Financial Trust, a licensed trust services provider. All of this makes Ioma well placed to manufacture and administer both bespoke insurance solutions (including highly personalised bonds and private

company shares) and important complementary services to meet the specific investment and tax-planning needs of clients. Ioma is subject to the prudential regulation of the Insurance and Pensions Authority (IPA) in the Isle of Man and is also regulated by the Financial Services Authority (FSA) in respect of the conduct of UK investment and non-investment business.

ECB – The Tax-Planning Story

Launched in September 2006 for investments of £75,000 and above, the Estate Control Bond is a pooled fund portfolio bond (PB) aimed exclusively at the UK IFA market, and directed squarely at the needs of investors undertaking inheritance tax (IHT) planning. Key competitors in this UK-centric world therefore include larger companies such as AXA, Canada Life, Royal Skandia, AEGON Scottish Equitable, Friends Provident, Prudential, Scottish Life and Scottish Provident. Ioma has a range of other products for the UK and other markets, but for ECB the story is all about IHT mitigation.

Ioma has designed its ECB in conjunction with Nick Chadwick, following the Finance Act 2006 changes which brought most trusts within the Discretionary Trust and the Chargeable Lifetime Transfer (CLT) regime. The Bond is assigned on commencement into a special Interest in Possession trust. The death benefit and the surrender value are gifted away via the trust.

The Estate Control Bond is structured as a series of insurance policies, the terms of which are chosen by the investor to meet their future needs. Policies can be written to mature in 1, 5, 8 or 20 years' time, for example. The clever bit is that the maturity value of these contracts is retained by the investor. Only the surrender value and death benefit are gifted away. This gives the investor potential access to capital at predetermined dates in the future (eg annually).

Furthermore, maturities do not have to be taken when they fall due, thus improving the settlor's flexibility and access if their need for capital changes in the future. On each maturity date, the settlor's appointed Trustees can decide how to distribute the maturity proceeds – in full, in part or not at all (the maturity date can be extended to achieve this deferral).

The Bond is normally written on a multi-life assured basis, so that it remains intact on the settlor's death, so giving the Trustees the flexibility to best plan encashment in such a way as to optimise tax efficiency and mitigate the chargeable gain.

In IHT terminology, the initial gift into the trust is a Chargeable Life Transfer (CLT). Provided the gift (and any other CLTs in the previous seven years) is less than the IHT Nil-Rate Band, it will not be subject to the 20% CLT charge. Ioma state that maturities are not subject to an exit charge, and the value of maturities taken will not be accumulated for the purposes of calculating any potential 10-year anniversary IHT charges. Any maturity that is extended is not deemed to be a new CLT. Provided the gift was more than 7 years before the death of the settlor, the policy value falls outside the estate; if not, only the growth is outside the estate.

Other features of the trust are that it permits the trustees to pass trust assets to the nominated beneficiaries prior to death; policy segmentation enables this to be achieved tax-efficiently. The Bond may be issued as up to 100 policies, subject to a minimum of £750 per policy.

The approach taken by the Estate Control Bond is quite different to the majority of IHT-planning products, which involve the use of discounted gift trusts (DGTs). Compared to a DGT, the Ioma bond has a number of notable differences:

- As noted above, ECB beneficiaries can be advanced money prior to the settlor's death, should circumstances require it. This is an advantage in terms of flexibility. [In contrast, typical DGT plans have no flexibility and beneficiaries must wait until the settlor's death before getting access to trust monies.]
- The Ioma Bond can be written with up to 10% of policies maturing each year, so giving the settlor access to annual capital and growth. Furthermore, maturities do not have to be taken when they fall due, so the ability to extend the maturity date of individual policies and thus to change the "income" stream provides added flexibility. [In contrast, with DGT plans, all withdrawals must be taken and, if not spent, passes back to the settlor's estate for IHT purposes. "Income" provided through the 5% pa withdrawal route used for DGT plans is taxable after 20 years. Withdrawals can be provided monthly, rather than annually. To the extent that it is within the 5% pa allowance, the income is tax-deferred.]
- With the ECB, maturities are not taken into account for the purposes of calculating the periodic CLT tax charge. Trustees can encash individual policies to pay the charge if required. [In contrast, with DGT plans, when periodic CLT charges occur, the trustees typically have to raise money elsewhere to settle the tax.]
- On the settlor's death the bond does not have to end. Instead, the unused 5% pa withdrawals can be exploited so that tax-free loans or assignment of policies can be made to beneficiaries, including any widow or widower. The trustees can control when final encashment occurs, and thus when income tax liability is incurred.
- The Estate Control Bond does not hinge around the use of discounts to the estate if the settlor dies in the first 7 years. There are no such discounts due to the Trustees' ability to advance capital to the beneficiaries while the settler is still living. [In contrast with DGTs, the estate is discounted on death during the first 7 years. However it can be argued that anyone who is eligible for the larger discounts (ie younger clients) is, by virtue of their age, most likely going to survive the 7 years anyway, and so the discount is irrelevant. Equally, anyone who actually needs a discount (ie those who are very old or are in poor

health) will only get a small discount.]

In summary, the Estate Control Bond provides significant flexibility, compared to the more regimented "straitjacket" of Discounted Gift Trust plans. It is aptly named in this respect.

Investment Options

The Estate Control Bond provides full access to the entire range of pooled fund assets permitted by the personal portfolio bond tax regime in the UK. There are no limitations (as with some recent products in the market) to platform-only funds or to UK-only funds, and there are also no controls over how much of the Bond has to be held in cash. Assets can be managed by self-selection or through a discretionary adviser (who can also provide custody). A range of internal Ioma funds, including a £ money market fund, is also available to policyholders and advisers.

The Estate Control Bond does not permit investment in "highly personalised" assets, such as individual equities or private company shares, but a range of other Ioma products is available for clients who do require such investment options.

Design and Charges

The Ioma Bond has a simple, clean design which is unsupported by fund manager retrocessions. The annual management charge is 0.75% per annum, applied at each quarterly valuation. In addition, there is a monthly administration charge of £7.50 (ie £90 per annum). There are no dealing charges, except to the extent these are levied by external third parties.

Investments are subject to a small establishment charge, which is 0.5% for premiums in excess of £250k, 1.25% for premiums between £100k and £249k, and 1.75% for premiums between £75k and £99k.

These charges are clean, and thus are particularly well suited to fee-based advisers. For advisers requiring commission, this is provided through additional matching initial and/or annual charges.

The charging structure of the Estate Control Bond is therefore clean and competitive, and particularly so relative to the corresponding products of larger companies such as Standard Life and Legal & General.

Summary

The Estate Control Bond by Isle of Man Assurance is an innovative and cost-effective approach to IHT-planning. The Bond's main attributes can be summarised thus:

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The use of a specially designed Interest in Possession trust and the structure of the Bond as a series of endowment policies provides the settlor with significant added flexibility, enabling them to gift capital but retain access to capital and growth each year, on a very flexible basis, until death.

- On death the monies are IHT-free, provided the settlor survives for 7 years. The Bond does not have to end on death – although income tax will be payable on final encashment, the unused 5% pa withdrawals can be used to maximise tax-efficiency.
- Income tax is only paid by the settlor as and when he/she takes maturities.
- Money can be advanced to beneficiaries even during the lifetime of the settlor.
- Concentration on the needs of UK customers and IFAs
- A clean, transparent design and competitive charges.