DEEP DIVE
FINANCIAL PLANNING



INVESTMENT BONDS IN PLAIN ENGLISH

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IS THIS YOU?

Have you filled your ISAs and pensions and still have a lump sum in a savings account or a share portfolio, paying tax on it every year? Or has someone mentioned a bond as part of a trust, and you'd like to know what you're being offered before you sign?

Or perhaps you've heard the term, nodded, assumed it meant the same thing as a government bond, and never liked to ask. This guide was written for you.

IN THIS GUIDE YOU WILL FIND

- What an investment bond is, and the difference between onshore and offshore.
- The 5% rule, top-slicing and segments, in plain English.
- How the growth is taxed, and which kind suits a higher-rate taxpayer, a future non-taxpayer or a trust.
- Giving a bond, or segments of it, to children and grandchildren who pay less tax than you.
- Why the trusts used for Inheritance Tax planning so often hold a bond, and what happens when you die.
- Costs, safety, the alternatives, and what you have to do afterwards, which is almost nothing.

Prefer a print version? For one that won't slurp up half your toner, email **info@deep-dive.co.uk** and we'll ping it through.

Reading time: about 7 minutes.

By the end of it you'll know what an investment bond is, how the 5% rule, top-slicing and segments work, when onshore beats offshore and when it doesn't, why the trusts used for Inheritance Tax planning so often hold one, and what happens when you die. The last page lists the seven mistakes to avoid and the nine tactics to consider, so you'll know what you're being offered before you sign.

WHAT IT IS

An investment bond is a way of holding investments inside a life insurance policy. You put in a lump sum, the insurer invests it in funds you choose, and it grows with no annual tax to declare until you take money out or cash it in. It has nothing to do with government or company bonds, which are loans; the name is a historical accident.

There are two kinds. An **onshore bond** is issued by a UK insurer, which pays tax on the fund's growth as it goes. An **offshore bond** is issued from somewhere like the Isle of Man, Dublin, Guernsey or Luxembourg, where the fund grows with no tax taken inside it and the whole gain is taxed when you take it out. Both have the same unusual feature: you can draw 5% of what you put in, every year, for twenty years, without any tax to pay at the time.

Bonds are not for everyone. They do three jobs well: holding money tax-efficiently once ISAs and pensions are full, providing an income in retirement on which the tax is put off, and sitting inside the trusts used for Inheritance Tax planning.



THE QUESTIONS PEOPLE ASK

Who are they for?

Someone with a lump sum to invest beyond their ISA and pension allowances, usually a higher-rate taxpayer now who expects to pay less tax later, or a family putting money into trust. If you pay basic-rate tax and will always pay basic-rate tax, there are often simpler answers.

Who provides them?

Onshore, most of the big UK insurers: Prudential, Aviva, Quilter, Canada Life, HSBC Life and others. Offshore, mainly the Isle of Man and Dublin arms of similar groups, with a few issuers in

Guernsey and Luxembourg: Utmost, Canada Life International, Prudential International, RL360 and a handful more. We're independent, so we choose from all of them.

How much do I need?

Onshore bonds typically start at £5,000 to £20,000. Offshore bonds usually want £25,000 to £50,000 or more. Most of our clients use them for six-figure sums.

What does it cost?

A charge from the insurer for the bond itself, usually under 1% a year, plus the cost of the funds inside, plus our fee. Offshore bonds tend to cost a little more than onshore. All of it should be on one page before you sign anything.

What's the 5% rule?

Each year you can withdraw up to 5% of the original investment with no tax to pay at the time, for up to twenty years. Unused allowance rolls forward: skip three years and you can take 20% in year four. The tax is postponed rather than cancelled. The withdrawals are added up and taxed when the bond is finally cashed in, by whoever owns it then, at their rate. Adviser charges taken from the bond count towards the 5%, so in practice we plan on 4%.

How is the growth taxed?

Never as capital gains. When what HMRC calls a "chargeable event" happens (cashing in, taking more than the 5%, or the death of the last person whose life the policy is written on) the gain is treated as income in that year. For an **onshore** bond, the insurer has already paid tax inside the fund, so basic-rate taxpayers owe nothing more and higher-rate taxpayers pay the difference, 20% or 25%. For an **offshore** bond, nothing has been paid inside, so the whole gain is taxed at your rate, 20%, 40% or 45%, though if you have little other income that year, some of the gain can fall within your tax-free allowances.

So which is better, onshore or offshore?

Onshore can suit someone who is and will stay a higher-rate taxpayer: whatever the insurer has actually paid inside the fund, the gain is treated as having had basic-rate tax paid on it, so the further tax is capped at 20%, or 25% for an additional-rate taxpayer. Offshore suits someone who will be a lower-rate or non-taxpayer when the money comes out, is moving abroad, or is building a trust that will hand segments to children or grandchildren. The longer the money stays invested, the more the offshore bond's untaxed growth tends to win. There's no universal answer, which is why it's an advice question.

What is top-slicing?

A relief that spreads the gain over the years you've held the bond when working out your tax rate. A £100,000 gain after ten years is tested as £10,000 a year. For someone whose income sits near a tax threshold, it can turn a 40% bill into a 20% one.

What are segments?

Bonds are usually issued as a cluster of identical mini-policies, often a hundred or a thousand. You can cash in whole segments rather than taking money from the whole bond, which is often cheaper in tax, and you can give segments away.

Can I give a bond to my children?

Yes. Giving a bond away, or segments of it, is called assigning it, and it is not a chargeable event. The recipient then cashes it in at their own tax rate. A grandchild at university with no other income can take gains tax-free that would have cost you 40%. This is also how trusts pass money to beneficiaries.

How do bonds help with Inheritance Tax?

By themselves they don't. Inside a trust, they are the standard vehicle. Bonds produce no income, so trustees have no annual tax returns to file. The 5% withdrawals repay the loan in a loan trust, where you have lent money to the trust, or pay the fixed income in a discounted gift trust, where you have given money away but kept an income from it. And segments can be assigned to beneficiaries, who cash them in at their own rate. Most of the trusts we set up hold a bond.

What happens when I die?

Every bond is written on one or more lives. If yours is the last of them, the bond pays out, usually its value plus a small amount extra, and the gain is taxed as part of your final tax year. That's why we often write the bond on your children's or grandchildren's lives as well as your own: the bond then carries on after your death and nobody is forced to cash it in at a bad moment. A bond held in trust pays to the trustees without waiting for probate.

Is the money safe?

Onshore bonds are covered in full by the Financial Services Compensation Scheme if the insurer fails. Offshore bonds are not. Isle of Man policies have their own scheme covering 90%; Dublin policies have no equivalent. The investments inside can fall as well as rise in either case.

Can I switch funds inside it?

Yes, with no tax consequences. That's an underrated advantage over holding funds directly, where every switch can trigger capital gains tax.

What do I have to do afterwards?

Almost nothing. No annual tax return entries, no dividend statements. Keep a note of what you've withdrawn against the 5% allowance, and talk to us before any large withdrawal or before cashing it in, because the tax year you choose can matter a great deal. The insurer sends a chargeable event certificate whenever one happens, and that goes on that year's return.

What are the alternatives?

- **ISAs** first, always: £20,000 a year each, entirely tax-free.
- **Pensions**, for anyone still eligible to contribute.
- **A general investment account**, holding funds directly. Flexible, but the capital gains allowance is now £3,000 and the dividend allowance £500, so the tax cost has grown.
- **Low-interest government bonds (gilts)**, where the gain on them is free of capital gains tax, for cautious money.
- **Venture capital trusts and Enterprise Investment Scheme shares**, for those comfortable with much higher risk in exchange for income tax relief.

Most of our clients hold several of these. The bond is for the money that doesn't fit anywhere else, and for the trusts.

What does advice involve?

We look at your tax position now and in the years the money will come out, what the bond is for, whether it will sit in trust, and whose lives it should be written on. Then we compare onshore and offshore on your numbers and set it out in writing before anything is invested.

WHAT TO DO NEXT

Email **info@deep-dive.co.uk** and tell us how we can help, or book a free 20-minute call at trustsadvice.co.uk/mattbriefingddfp.

Further reading

If the bond is going into a trust, the choice of trust matters as much as the bond. Book a call with one of our team at trustsadvice.co.uk/mattbriefingddfp and we'll talk you through it.

For the full picture, our one-hour technical webinar takes sophisticated trust planning and breaks it down step by step: deep-dive-trusts.co.uk/resources/videos/technical-inheritance-tax-and-trusts

IN SUMMARY

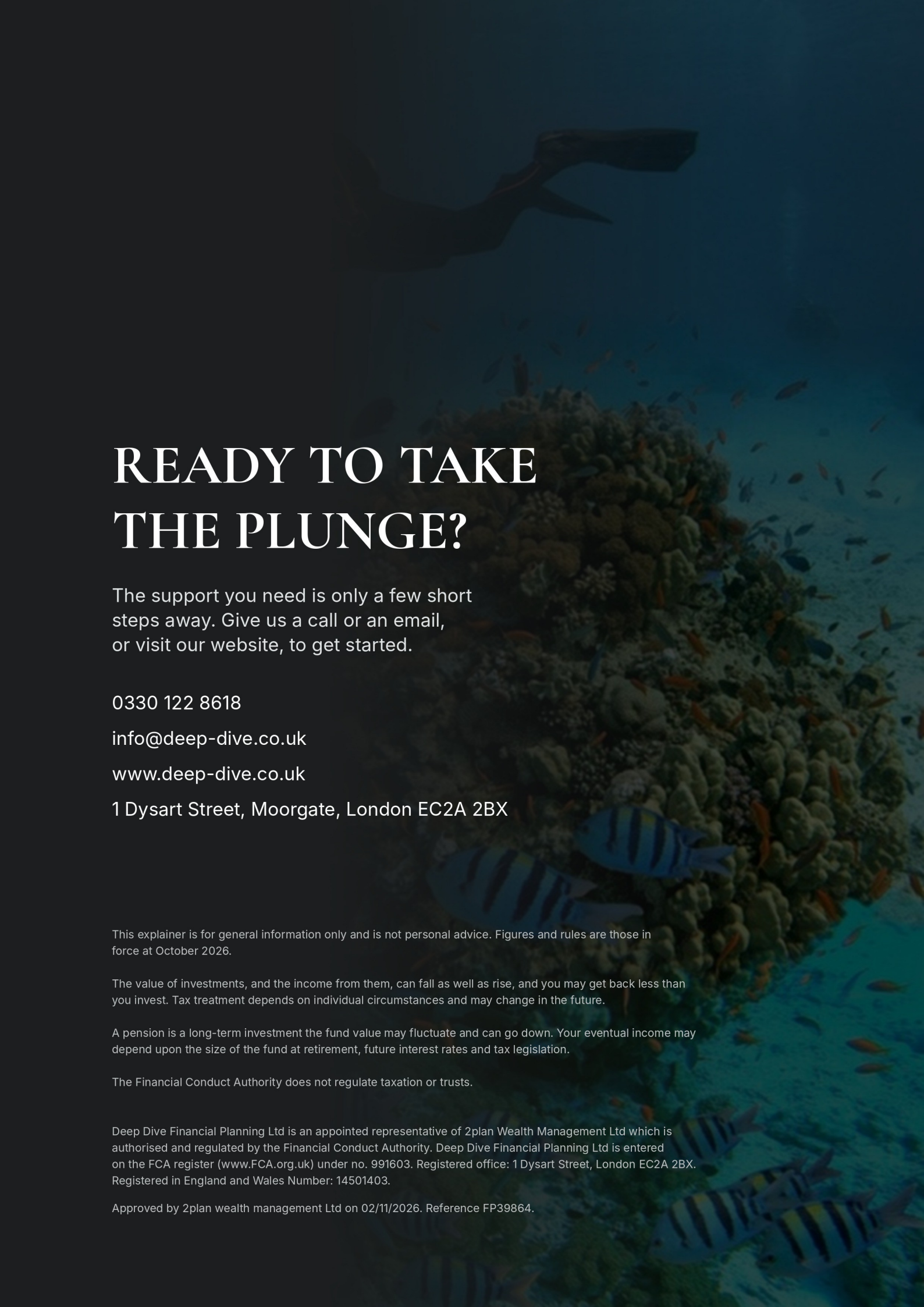
Seven mistakes to avoid

1. Thinking an investment bond has anything to do with government or company bonds. The name is a historical accident.
2. Leaving a six-figure sum in an ordinary investment account without working out the annual tax: a £500 dividend allowance, a £3,000 capital gains allowance, and every switch taxed. Sometimes it is still the right account; it is rarely checked.
3. Treating the 5% as tax-free rather than deferred, and forgetting that adviser charges taken from the bond count towards it.
4. Cashing in the whole bond when segments would have cost less, or cashing in in the wrong tax year.
5. Cashing in yourself at 40% when giving it to someone in a lower band first would have cost nothing.
6. Writing it on your own life alone, so your death forces an encashment at whatever moment that happens to be, taxed in your final year.
7. Assuming an offshore bond is covered by the compensation scheme. Isle of Man covers 90%; Dublin has nothing.

Nine tactics to consider

1. Draw 5% a year for twenty years with nothing to pay at the time, and it rolls forward: skip three years and take 20% in year four.
2. Top-slicing. A £100,000 gain after ten years is tested as £10,000 a year, which can turn a 40% bill into a 20% one.
3. Cash in whole segments rather than dipping into the whole bond. It is usually cheaper in tax.
4. Give segments away. Assigning isn't a taxable event, and the recipient pays at their own rate; a grandchild at university usually pays nothing.
5. Switch funds inside it with no tax at all, where every switch in an ordinary account is a capital gains calculation.
6. Write it on your children's and grandchildren's lives as well as your own, so it carries on after you and nobody is forced to cash in at a bad moment. In trust, it pays out without waiting for probate.
7. Onshore if you are and will stay a higher-rate taxpayer. Offshore if you'll pay less later, are moving abroad, or are building a trust. The longer the money stays in, the more offshore tends to win.
8. Choose the tax year you cash in. It can matter a great deal.
9. Nothing to enter on a tax return while nothing is withdrawn. No dividend statements, no capital gains sums, no accountant.

Email **info@deep-dive.co.uk** and tell us how we can help, or book a free 20-minute call at **trustsadvice.co.uk/mattbriefingddfp**.



READY TO TAKE THE PLUNGE?

The support you need is only a few short steps away. Give us a call or an email, or visit our website, to get started.

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This explainer is for general information only and is not personal advice. Figures and rules are those in force at October 2026.

The value of investments, and the income from them, can fall as well as rise, and you may get back less than you invest. Tax treatment depends on individual circumstances and may change in the future.

A pension is a long-term investment the fund value may fluctuate and can go down. Your eventual income may depend upon the size of the fund at retirement, future interest rates and tax legislation.

The Financial Conduct Authority does not regulate taxation or trusts.

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Approved by 2plan wealth management Ltd on 02/11/2026. Reference FP39864.