

The complaint

Mr and Mrs L complain they were mis-sold an offshore bond by SG Kleinwort Hambros Bank Limited ("KHB"). They say the advice they received failed to take account of their tax status and investment objectives leading to them facing a large tax liability.

What happened

In July 2014, Mr and Mrs L received investment advice from KHB. They had recently sold a development property and were looking to invest the proceeds to generate income to fund their lifestyle needs. Their recorded objectives were to invest to achieve a regular income yield alongside the potential for capital growth. Mr and Mrs L were assessed as having a balanced attitude to risk.

KHB advised Mr and Mrs L to invest a lump sum of £2,000,000 into an offshore bond. The offshore bond was recommended to provide a tax-efficient solution for the cash flow desired. Income of £100,000 per year was to be drawn from the bond – the aim being for the underlying investments to generate a natural income of around 4% to 4.5%, combined with capital withdrawals to generate the full 5% that was required.

In September 2020, Mr and Mrs L raised a complaint about the advice they received. They said the bond wasn't tax efficient as any gain can only attract income tax as opposed to a mix of income and capital gains tax (CGT) as with onshore investment. They said they had no other income and as a result of the advice, an ever-increasing pot of, albeit deferred, income taxable gains has been created - and this has pushed them into the highest rate tax band without using their annual income tax or CGT allowances. They also said they have been told the offshore bond would be complex to withdraw from.

KHB responded but did not uphold the complaint as it believed the offshore bond was suitable as it met Mr and Mrs L's needs at the time of the recommendation. In summary it said:

- The recommendation letter mentioned by investing in the portfolio through an offshore bond the high income produced by the portfolio would be deferred and not immediately taxable. The bond also provided the option to take cash flow through the ability to draw up to 5% annually, with tax deferred until such time all of the original capital was paid back, or the bond was surrendered.
- This was a more tax-efficient method of providing income than receiving the natural income from the portfolio taxable on an arising basis. There was the possibility that they would leave the UK and further planning opportunities would have become available over more conventional exit strategies.
- The Balanced Income Plus strategy the bond is invested through hasn't had a negative impact on their financial position. While it is not possible to say with certainty that the offshore bond has precluded a better outcome, by investing through the offshore bond their exposure to income tax has been reduced. So, the offshore bond did provide a tax efficient wrapper for their investments.
- The deferral of tax is likely to have had a positive effect on maintaining loan to value ratio on their borrowing as gross income was fully reinvested. By rolling up returns gross (rather than net of tax) the portfolio retained a higher value.

- The fees incurred are in line with the benefit conferred by the offshore bond.

Mr and Mrs L didn't accept this response, so referred their complaint to this service for an independent review. One of our investigators looked into the complaint. He didn't think it should be upheld. In summary he said:

- The way investment products are made subject to tax, vary from one to another. There may be other aspects of how the products operate that mean that tax efficiency is weighed against other considerations to reasonably meet all investment objectives.
- While they may now incur a higher tax liability than they were expecting and with the benefit of hindsight other investments may be now deemed more suitable and less costly, the alternative investment options available at the time would likely have performed differently and may in themselves have resulted in some form of tax liability that could have been more or possibly less. This doesn't automatically mean the advice given was unsuitable.
- The recommendation letter gives a risk warning that you should obtain tax advice from your own tax advisor as you consider necessary before deciding whether or not to proceed with the recommendations.
- The investment was made to provide an income equal to around 5% of the total initial investment each year. The advice left sufficient cash reserves and the investment also set aside cash for expenses. Mr and Mrs L's attitude to risk was medium to high and the investment met this requirement. They were willing to invest for the medium to long term, which was a minimum of five years, but long term could extend this.
- They also confirmed they may leave the UK in the future, which would have been considered in the advice they received as there are possible benefits for investing offshore if the holder is a non-UK resident.

Mr and Mrs L didn't agree with the investigator's findings and requested their complaint to be passed to an ombudsman to reach decision. They said the warning given that they should seek tax advice shouldn't give KHB impunity from making inappropriate recommendations or remove it from responsibility for the advice.

What I've decided – and why

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

At the outset I think it would be helpful to explain that I'm only considering the advice Mr and Mrs L received to invest in the offshore bond in 2014. While they have a longstanding private banking relationship with KHB, the advice to take out the bond was provided by the UK regulated entity of KHB – so therefore within our jurisdiction. I note Mr and Mrs L have other concerns which they have raised with KHB that fall outside of our jurisdiction. These have been separately considered by the relevant alternative dispute resolution scheme.

Mr and Mrs L's complaint concerns the suitability of an offshore bond – but specifically the tax efficiency of the product they were recommended. While they haven't raised specific concerns about the broader suitability of the underlying investment, I have considered this as part of my overall findings on the suitability of the advice. Their attitude to risk was assessed alongside their capacity for loss, taking into account their wider circumstances. The bond recommended was suitable for their recorded need for capital growth and to provide an annual income in the region of £100,000 per year to meet their spending needs. They don't appear to have had a need for access to the funds over the short term, outside of the requested annual income, so the product was suitable for the medium to long term.

The key issue in dispute is the tax implications of the offshore nature of the bond and the suitability of that for Mr and Mrs L's needs and circumstances. In reaching my decision, I must consider the advice based on their circumstances and objectives at the time. This means I'm required to reach a decision without the benefit of hindsight of changes in their circumstances, objectives and the performance of the investment since they took it out.

Mr and Mrs L had a recorded objective to invest a lump sum capable of generating a high level of income balanced against the prospect for long term capital growth. As mentioned, the recommendation letter records they had no immediate need to access the lump sum and were investing for the medium to long term. It was recorded that they want to invest in a tax efficient manner and wish to determine the time of any encashment to suit their tax needs. So, it is apparent that tax efficiency was an objective.

The advisor provided reasons for recommending this type of product – including the ability to take regular payments and referred to the tax position that the 5% regular payment facility is actually a return of capital, so provides the opportunity for tax-deferred capital growth. He also mentioned that the bond could be surrendered during a period of non-UK residence without liability for UK tax on the profits, although still subject to rules in the new country of residence. It was explained the offshore bond would form part of a wider wealth structuring plan providing a benign tax environment within which investments returns can be compounded gross. There is reference to managing the structure of the investment throughout its life (including exit) with consideration given to other sources of income and wealth. There is also a section in the recommendation letter just covering taxation, which supports tax implications were considered as part of the recommendation. It gives details of the specific tax treatment of this type of product.

There is evidence to support alternative strategies considered by the advisor. The recommendation letter states an unwrapped investment portfolio was considered but was discounted due to the risk of increased capital erosion due to the level of income Mr and Mrs L required. There is also a suggestion that the offshore product gave potential benefits for future planning should they move abroad in the future. It is noted in the sales paperwork that this was a possibility in the medium term. While I don't think in isolation this possibility would make the bond suitable, it is a factor that can be considered as part of the overall suitability of the advice.

There were advantages to an offshore bond from the fact no UK taxes are paid by the fund, allowing the amount invested to grow without deductions – known as gross roll-up. This type of product allowed for growth potential to be maximised. With Mr and Mrs L's income requirements and aim for the bond to produce 4 to 4.5% growth (in order to limit the amount of capital reductions need to supplement the income drawn), this does give reason to support the suitability of the recommendation. It is also recorded Mr and Mrs L were planning to purchase properties to generate further income. But they would prefer to purchase these properties by way of a lending facility to free up capital to generate an income. I note that the bond was used as part of a lending facility to maintain a loan to value ratio for the borrowing for the investment properties. So, taking into account Mr and Mrs L's income requirements and the use of the bond as part of the lending facility, the gross roll-up was suitable to help the portfolio retain a higher value to support them achieving their objectives.

I acknowledge Mr and Mrs L's argument that they were basic rate taxpayers and this doesn't support the suitability of an offshore bond. From the evidence available, it appears Mr and Mrs L had significant assets in 2014, and had intentions further increase their capital base and income through future property investments. So, in my view their tax status is something that could change over the medium term and beyond, and there wasn't certainty around the level of tax they may pay in future years. They were looking to hold the investment for a number of years. So, the performance and growth of their assets would be a factor in their

marginal rate of tax. All of this means that, I don't find the points Mr and Mrs L make here sufficient to say the initial advice was unsuitable.

I also acknowledge the points Mr and Mrs L make about the risk warning KHB gave to seek independent tax advice. I agree that providing this type of warning doesn't absolve KHB from its obligations to provide suitable advice. It is prudent to give this type of warning but the recommendation made still needs to be suitable for the customers' circumstances. So, I accept that providing this type of warning wouldn't make an unsuitable recommendation, suitable.

Mr and Mrs L have also raised concerns about the level of charges associated with the bond. I note that these were set out within the recommendation letter. The annual fee from the product provider was disclosed, as well as the KHB's fee for the establishment of the bond. When taking into account the overall recommendation and the fact charges were clearly set out, I don't find that the relative cost of the product is sufficient in itself to be reason to say the advice was unsuitable.

Overall, I haven't found reason to uphold this complaint. The offshore bond did offer potential tax advantages. It was a suitable recommendation to meet the objectives that were established through the advice process. It is possible with the benefit of hindsight that investing in an alternative product could have met those objectives and potentially incurred less of a tax liability. But I don't think this means the original advice must have been unsuitable. In conclusion, I've not been persuaded that the complaint should be upheld, so I don't find that KHB needs to do anything further.

My final decision

I do not uphold this complaint.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr and Mrs L to accept or reject my decision before 21 December 2023.

Daniel Little

Ombudsman