The complaint

Mr J complains the advice Aviva Life & Pensions UK Limited ("Aviva") gave was unsuitable because the bond it advised him to invest in was an onshore not an offshore bond.

What happened

In 2007 on advice received from Aviva, Mr J invested around £60,000 given by relatives for the benefit of his children for their university-years' costs. According to the advice letter, those costs would arise in ten to fourteen years' from the date of the advice.

Aviva recommended Mr J invest in an investment bond, which held various investment funds. The advice letter noted capital gains tax (CGT) and basic rate income tax wasn't payable on the bond proceeds. It said the CGT treatment was why it recommended the bond instead of OEICs (a collective investment that is subject to capital gains tax), given the long investment time-horizon (which gave potential for a large taxable gain to develop over time).

Our investigator considered Mr J's complaint but didn't agree the taxation of the bond, and how this differed from an offshore bond, made Aviva's recommendation unsuitable. Our investigator thought an onshore bond was still a suitable place for Mr J to invest savings for his children. Our investigator noted that offshore bonds typically involve higher charges, Aviva didn't offer an offshore bond and Aviva had been clear it could only recommend products from its own range.

But our investigator thought Aviva was right to offer Mr J £150 for inconvenience it caused him by having kept him waiting on the phone and then giving him incorrect information when he was asking whether the bond was in trust. Our investigator also thought the funds used by the bond made it unsuitable because they carried too much investment risk.

Aviva didn't agree its advice was faulty by reason of the riskiness of the selected funds. Mr J told us a tax adviser believed Aviva had mis-sold the bond and had said:

"The difference between onshore and offshore comes in if beneficiaries are non-taxpayers when they take money from the bond. The onshore bond pays tax within the fund that is assumed that 20% tax is paid. In reality it's around 14%. If they are non-taxpayers, they have paid tax for no reason. If they are basic rate payers, there's no further liability unless they're pushed into the higher band from the gains. The offshore bond rolls up gross with only a small withholding tax paid. If the beneficiaries are basic rate taxpayers, they will pay 20%. If pushed into the 40% band they could pay at the higher rate on gains above the threshold. If non-taxpayers, they can use allowances to effectively take £17,570 gain without paying any tax. It is an important consideration when recommending bonds."

Mr J explained the beneficiaries had withdrawn a significant sum as non-taxpayers while they were students and only one was now a taxpayer who *"would be drawing a relatively small share of the total fund (essentially her share of what will be left from Capital <u>growth</u> since it was invested)."*

Mr J said he now understands Aviva didn't sell offshore bonds *"but had this been made* *clear, at the outset, perhaps I would have decided on a different investment strategy."*

As the matter wasn't resolved informally, it has been passed to me to decide.

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.

Having done so I've arrived at broadly the same conclusions as our investigator, except for on the issue of whether the fund selection made the bond too risky. I'll explain my reasons.

Our investigator did question the suitability of the choice of funds made for the bond, given that they were quite risky. But I'm satisfied Mr J was aware of the degree of risk the funds involved and was comfortable with the approach taken. The investment's long time-horizon gave scope for the selected funds to provide good returns. Moreover the fund selection, in which it appears Mr J's own preferences played a part, appears to have been a success, and Mr J didn't raise concerns about it when he came to us. With this and all I've said above in mind, I'm satisfied Aviva's advice wasn't unsuitable by virtue of the funds being too risky.

Mr J's bond was an onshore (meaning a UK based) investment, so returns generated by the underlying investment funds within the bond were subject to UK corporation tax. The tax paid by the owners of investment bonds when the proceeds are drawn is income tax.

Tax paid on the funds within an onshore bond is deemed to cover all the income tax liability for basic rate taxpayers, so they pay no further tax on the bond proceeds. For higher rate taxpayers, income tax is paid at the higher rate less a credit set to reflect, notionally, the tax already paid on the funds within the bond. The tax actually paid by the funds may be less in practice and it is worth noting that tax rates and bands changed over bond's lifetime.

So for an onshore bond like Mr J's, tax is paid on the funds in the bond but there is notional credit given for this, so taxpayers pay less or no further tax on the gains made by the bond.

For non-taxpayers this is not a benefit – as they wouldn't pay income tax on gains anyway – and the tax paid on the funds within the bond can't be reclaimed by non-taxpayers like tax on interest can be. So the tax treatment of the investment bond proceeds is not as beneficial for a non-taxpayer as it can be for basic or higher rate taxpayers.

Offshore bonds have the advantage of incurring less tax on the funds within the bond than an onshore bond does. On the other hand, basic rate and higher rate taxpayers pay income tax on gains from offshore bonds at their full rates, so there is no credit for tax paid like with an onshore bond. But this isn't a disadvantage for non-taxpayers who don't pay income tax on gains. But offshore bonds do tend to be more expensive and the advantage of the lower tax on returns won't always offset this higher cost, particularly in the short term.

For Mr J, his children would be non-taxpayers when they drew from the bond if they did this while in education and when their work earnings were low enough to not incur income tax – and so long as their bond drawings didn't increase their income to a taxable level. In that situation, they could have potentially benefited from the tax treatment of an offshore bond.

So in my view Mr J's situation was one in which an offshore bond could've been a suitable recommendation, despite the higher charges involved. I say this bearing in mind of course that drawings were expected to be taken from the bond many years in the future, so there was necessarily some uncertainty associated with what the circumstances would be exactly at that time, in terms of tax rates and also Mr J's children's own situations. It is reasonable to assess the advice based primarily on the relative tax treatment of the different options as existed at the time of advice, and also taking into account Mr J's children's expected future situations, even though neither were guaranteed at the start to be borne out in practice.

That said, the issue here is whether because an offshore bond was potentially a suitable answer to Mr J's needs, this made an onshore bond unsuitable – such that Aviva ought not to have recommended it to Mr J and should instead have told him to seek advice from someone who could recommend an offshore bond (Aviva did not offer one at the time).

I've thought about this carefully. On balance I think the onshore bond did offer a suitable vehicle for long term investment in Mr J's circumstances, even though it didn't offer some of the advantages that an offshore bond offered that might have been useful to Mr J. So I think Aviva did discharge its duty to give suitable advice. Both routes had potential advantages.

An offshore bond had different advantages that in Mr J's case, if his children drew the bond proceeds at the time and in the way that was expected, had the potential to work out more favourably than an onshore bond, depending on investment performance and charges. But I don't think this meant Aviva's onshore bond recommendation didn't fall within the range of suitable answers that could be given to Mr J's needs in his circumstances. The existence of alternatives that were also suitable and might have been better in some respects, doesn't in my view make the onshore bond an unsuitable recommendation here.

Aviva made clear to Mr J that it only offered products from its own range and not from the whole of the market. It follows that if the whole market were considered instead, alternatives might be found that might have advantages over what Aviva was offering. I agree that if what Aviva was offering hadn't included a suitable option to meet Mr J's needs – for example if an offshore bond was the only suitable answer for him - then Aviva would've been at fault for making a recommendation and recommending the onshore bond. But, on balance, my view, like our investigator's, is that this wasn't the case here. The fact Aviva could recommend only products from its range, and offshore bonds weren't in that range, in my view doesn't mean that it needed to decline to make a recommendation for Mr J and instead refer him elsewhere – because in my view the onshore bond was a suitable option.

I've seen no evidence that Aviva discussed offshore bonds with Mr J. But as Aviva had a suitable option to offer from within its range, on balance I don't think not discussing an alternative it couldn't make available or recommend to Mr J is a fault here that gives me reason to uphold Mr J's complaint or make an award in his favour.

In light of all I've said above, and for the reasons I've given, I've decided not to uphold Mr J's complaint about the suitability of Aviva's advice. But I agree Aviva was right to offer £150 to Mr J for the service failings it admitted which our investigator also noted. So I find Aviva at fault on that point.

So, in light of what I've said above, I uphold Mr J's complaint in part.

Putting things right

Aviva's poor service caused Mr J inconvenience as I've found and described in brief outline above. Aviva Life & Pensions UK Limited should put this right by paying Mr J £150 for this if it hasn't already done so.

My final decision

I uphold Mr J's complaint in part. Aviva Life & Pensions UK Limited should put things right by doing what I've said above.

Under the rules of the Financial Ombudsman Service, I’m required to ask Mr J to accept or reject my decision before 12 February 2024.

Richard Sheridan
Ombudsman