GUIDE TO CORPORATE INVESTMENTS

For financial advisers looking to provide investment advice to corporate clients

Ablestoke
SMART PLANNING FOR SMART PEOPLE

INVESTMENTS

This brochure looks at company tax, the trend of reducing corporate tax rates, and the opportunities for investing cash held on deposit in alternative products.

It covers the key tax principles applying to some of the available investment products we offer and provides some working examples to bring this to life.

WHAT TAX DOES **A COMPANY PAY?**

Corporation tax is what a company pays on profit it makes from:

- doing business ('trading profits')
- **investment income and gains** (covered in this brochure)
- selling assets for more than they cost ('chargeable gains').

If the company is based in the UK, it pays corporation tax on all its profits from the UK and abroad.

CURRENT UK CORPORATION TAX LAWS AND TRENDS

Recent year-on-year reduction in corporation tax now makes investing surplus cash more attractive. There has been a steady fall in corporation tax rates which companies pay on any taxable profits.

Corporation tax (main rate) was reduced:

- from 28% to 26% in the 2011/12 tax year
- to 24% in 2012/13
- to 23% in 2013/14
- to 21% in 2014/15
- to 20% regardless of the size of company in 2015/16
- to 19% in 2017/18
- Maintained at 19% in 2019/20 and again in 20/21.

This maintains the rate at 19% rather than reducing it to 17% from 1 April 2020 as was previously planned.

The charge to Corporation Tax and the main rate will also be set at 19% for the financial year beginning 1 April 2021

Corporate investors should be encouraged by this to consider investing any excess money (rather than holding it on deposit) as they can now expect to pay reduced rates of corporation tax on future investment gains.

USING EXCESS **CASH**

With excess cash available to invest, a company has a number of options to choose from, but selecting one that offers a full range of benefits can prove difficult.

Whichever option is chosen, a top priority is usually tax-efficiency, ideally combined with the additional benefits of security, easy access and flexibility.

Many companies simply hold cash on bank or building society deposits if they have no immediate plans for it, and substantial sums may build up over a number of years.

The instant access and relatively safe (but modest) returns offered by deposit accounts may be a reasonable default position, but they have become less attractive with falling interest rates and rising inflation.

Trying to balance all these factors has inspired many companies to look at other investment solutions for their liquid assets.

When considering a suitable investment, it is important to consider the company's investment objectives and the attitude to risk of the individuals running the company. Selecting a suitable investment might not just be about tax; different investment vehicles can introduce differing levels of administration and it is important that this is not overlooked.

TREATMENT OF CERTAIN INVESTMENTS – **LOAN RELATIONSHIP RULES**

The loan relationship rules are complex and deal with the taxation of loans between a company and another party (whether a company or not). These rules include certain investments which are viewed to be loans owed to the company.

The loan relationship legislation was originally introduced in the Finance Act 1996. The Finance Act 2008 extended the loan relationship rules to include life assurance policies. Capital redemption policies, debt instruments and collective investments (where the underlying investment was more than 60% invested in debt-based stock-cash deposit, fixed interest or Government stock for instance) were already subject to these rules.

The exact treatment of reporting these 'loan relationships' depends on the company's size and general accounting practices.

COMPANY ACCOUNTING PRACTICES

There are two principal practices used by UK companies.

FAIR VALUE ACCOUNTING

Under this method, any increase in the investment over the accounting period will be taxed as a non-trading credit. Corporation tax will be due if there is a gain over the period, regardless of whether the policy was surrendered in full or in part during the tax period.

HISTORIC ACCOUNTING:

Under this accounting method, corporation tax is only levied on a company when part or all of the policy is realised, such as when a full or part surrender is made. They should be declared in the accounting period they are made. If the resulting surrender has resulted in a loss, this can be offset against any other non-trading credits.

TAXATION OF CORPORATE INVESTMENTS - **ACCOUNTANCY PRACTICES**

The accountancy practice a company adopts will be dictated by their position under the Financial Reporting Standard 102 (small entities) and 105 (micro-entities). The eligibility criteria for each regime is shown below.

UK ELIGIBILITY CRITERIA		
Regime	Micro-entities regime	Small entities regime
Source of eligibility criteria	Sections 384A and 384B of the Companies Act 2006	Sections 382 to 384 of the Companies Act 2006
Eligible entities	• Companies • Limited Liability Partnerships [1] and qualifying partnerships	• Companies • Limited Liability Partnerships [1] • Any other type of entity that would have met the criteria of the small companies regime had it been a company incorporated under company law e.g. charities
Size thresholds	A company qualifies if it does not exceed two or more of the following criteria: • Turnover £632,000 • Balance sheet total £316,000 • No. of employees 10	A company qualifies if it does not exceed two or more of the following criteria: • Turnover £10.2m • Balance sheet total £5.1m • No. of employees 50
Ineligible entities	• Any company excluded from the small companies regime • Financial institutions including credit and insurance institutions • Charities • Small parent companies that choose to prepare group accounts • Companies that are not parent companies but whose accounts are included in group accounts	• Public companies • Financial institutions including insurance companies and banking companies
Accountancy practice	• Historic accounting	• Fair value accounting

1. As set out in the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008 (SI 2008/1911). The thresholds differ from those applicable to companies.

- Businesses meeting the criteria for the micro-entities regime can apply the smaller entities regime if they wish.
- Businesses which exceed the criteria for small entities will be taxed on a fair value basis.
- Investment companies are excluded from the micro-entities regime so will apply a fair value basis for loan relationships.

WHAT DOES THIS MEAN FOR **COMPANIES WHO WISH TO INVEST**

SUMMARY OF POSITIION ON LOAN RELATIONSHIPS

Mirco-entities (historic accountancy) – for micro-entities, investments are taxable on realisation i.e. full and part surrender/disposal.

Small companies (fair value accountancy) – investments which meet the description of a 'basic financial instrument' will be taxable on realisation i.e. full and part surrender/disposal. Investments which do not meet this description will need to be reported annually.

HOW DOES THIS RELATE TO THE INVESTMENTS WE OFFER?

For companies using fair value accounting, onshore and offshore bonds are unlikely to be considered 'basic financial instruments' and as such they will need to be reported annually.

Collective investments where the underlying investment is more than 60% invested in debt-based stock (cash deposit, fixed interest or Government stock for instance) will also need to be reported annually.

Collective investments with 40%+ investment in equities do not fall within the loan relationship rules. A tax liability only arises on realisation of the asset, although 'income' is taxable on an arising basis.

This can be summarised as follows:

	Collectives	Collectives	UK life assurance	Offshore life or redemption
Investment allocation	60%+ invested in debt/fixed interest etc.	40%+ invested in equities	No distinction between investment allocation	No distinction between investment allocation
Applicable tax rules	Loan relationship rules apply	Loan relationship rules do not apply	Loan relationship rules apply	Loan relationship rules apply
Tax due	Corporation Tax on increase year on year	Corporation Tax only levied on realisation of asset*	Corporation Tax on increase year on year	Corporation Tax on increase year on year
Tax credit available	Nil	Nil	Tax credit for life fund taxation available on final encashment.	No life fund taxation
Income from investment	'Income' taxed on arising basis	'Income' taxed on arising basis	'Income' taxed within life fund. Will contribute towards any increase year on year.	'Income' not taxed within the bond. Withholding taxes may apply. Will contribute towards any increase year on year.

* From 1 January 2018, companies cannot apply indexation to the base cost for calculating gains.

SOME ADDITIONAL POINTS TO CONSIDER WHEN SELECTING AN INVESTMENT

PRODUCT TAXATION

- **Collective investments.** Distributions from collectives are paid gross. Corporation tax is payable on interest payments received. D ividends from equity funds are not taxable where they are considered ABGH distributions. These are dividend distributions made up of payments from underlying investments which meet the descriptions under paragraphs A, B, G, and H in section 1000 of the Corporation Tax Act 2010. If a collective fund provides a dividend payment from sources which do not meet this description, corporation tax may be payable.
  Ablestoke will inform the account holder of the total dividend paid for each fund. However, the account holder will be required to contact the fund manager for a detailed break down to determine whether they are ABGH distributions.
- Onshore bonds - the UK based bond provider is liable to corporation tax on income and gains made on the underlying investments. On partial or full surrenders of the bond a credit is available to the policyholder for this tax paid when accounting for the gain.
- Offshore bonds - benefit from having to pay no tax at source on the growth of the investment, other than some 'withholding tax'. This is a tax on some dividend and interest income deducted in the country where the income was derived which cannot be reclaimed. This predominantly tax free growth is known as 'gross roll-up'.

FUND SWITCHES

- Switches on collective investments will be considered as 'disposals' so will need to be accounted for within the company accounts
- Onshore and offshore bonds are structured differently as the bond provider owns the assets within the bond. The effect of this is that any fund switches will not trigger a gain or loss position for the company.

REPORTING

- Income earned on a collective is taxable on an arising basis, therefore all income earned during the accounting period will need to be included within the company accounts. In addition, depending on the fund asset allocation (fixed interest or equity), gains will also need to be reported either year on year (fixed interest) or when realised (equity).
- Income within a bond is not taxable on the company so does not need to be accounted for. Instead the bond value is accounted for year on year (fair value) or as a static value (historic cost). Disposals on either basis will need to be accounted for.

RISKS AND CONSIDERATIONS

The size of the investment could impact on the availability of the two different tax exemptions/allowances available, namely capital gains tax entrepreneur's relief and inheritance tax business property relief. Therefore, specialist tax advice should be obtained before investing in any product.

It is important to look at the company's financial arrangements holistically to make sure the investment fits with the firm's overall objectives and plans.

INVESTMENTS HELD BY COMPANIES **USING DIFFERENT ACCOUNTING PRACTICES – EXAMPLES**

EXAMPLE A: BOND INVESTMENT, HISTORIC COST BASIS ACCOUNTING

ABC Co makes a bond investment of £135,000 at the start of their accounting year in April 2016 which increases by 5% each year. If the company makes no disposals then no corporation tax would be levied year on year. The value stated in the accounts would be the same as that shown at the start of the accounting period. The company can also choose the best time to encash the bond gain in order to reduce tax.

Accounting year	Value end of year	Tax rate	Tax due if no encashments	Tax due if investment fully encashed	Net investment return (after encashment)*
1/4/2016 – 31/3/2017	£141,750	20%	zero	£1,350	£140,400
1/4/2017 – 31/3/2018	£148,838	19%	zero	£2,629	£146,209
1/4/2018 – 31/3/2019	£156,279	19%	zero	£4,043	£152,236
1/4/2019 – 31/3/2020	£164,093	19%	zero	£5,528	£158,565
1/4/2020 – 31/3/2021	£172,298	17%	zero	£6,341	£165957

*Net investment return amounts shown assumes there are no early surrender charges, or any other charges incurred after encashment.

HISTORIC COST BASIS ACCOUNTING – PART SURRENDER/DISPOSAL

If using the above example, a partial withdrawal of £56,279 at the end of year three would be taxed as follows:

Establish cost price – £56,279/£156,279 x £135,000 = £48,616.03

Gain on partial withdrawal is calculated by taking £56,279 withdrawal minus cost price of £48,616.03 = £7,662.97

Offshore Bond

£7,662.97 will be accounted for as a non-trading credit for the accounting period.

£7,662.97 x 19% = £1,455.96 tax due.

However, the company may be able to offset the liability against other non-trading losses.

Onshore Bond

A UK insurer will have paid tax on the income and gains on the assets in the funds underlying the contract. There are rules that broadly treat the tax paid at source as being equal to the basic rate of income tax (20%) – this can be used to offset tax due on non-trading credit.

Using the above example:

- Gross up the gain: £7,662.97/(100-20%) = £9,578.71
- This is reported in the accounts as a non-trading credit and is taxed at 19%: £1,819.95.
- Tax treated as paid: £9,578.71 x 20% = £1,915.74 tax treated as paid.
- The tax treated as paid exceeds the tax due for this non-trading credit, therefore there is no further tax liability.

SUMMARY

If the company makes no disposals then no corporation tax would be levied year on year. The company can also choose the best time to encash the investment gain in order to reduce tax. For example, ABC Co could encash the bond during an accounting period when it has trading losses (or for example where they have made a substantial pension payment to the employee scheme, which has led to an overall loss), so that the gain from the bond can be offset against these losses and reduce their overall corporation tax liability.

So, using the historic cost basis, the value stated in the accounts would be the same as that shown at the start of the accounting period.

EXAMPLE B: BOND INVESTMENT, Fair Value accounting – no encashment/disposal

XY Z Co makes a bond investment of £150,000 at the start of their accounting year in April 2016 which increases by 5% each year. The company must account for the 'fair value' of the investment year on year.

Accounting year	Value end of year	Tax rate	Gain in value	Tax due if no encashments
1/4/2016 – 31/3/2017	£157,500	20%	£7,500	£1,500
1/4/2017 – 31/3/2018	£165,375	19%	£7,875	£1,496
1/4/2018 – 31/3/2019	£173,644	19%	£8,269	£1,571
1/4/2019 – 31/3/2020	£182,326	19%	£8,682	£1,650
1/4/2020 – 31/3/2021	£191,442	17%	£9,116	£1,550

FAIR VALUE ACCOUNTING – FULL OR PART SURRENDER/DISPOSAL

If XY Z Co surrenders 50% of the rights under the contract policy on 5 October 2018 for £84,500 and the value immediately before the part surrender is £169,000, the value at 31 March 2019 of the rights under the contract retained by the company is £88,500.

Accounting period ending 31 March 2017: There is a non-trading credit of £7,500 (£157,500 – £150,000, the increase in value of the policy over the accounting period).
Accounting period ending 31 March 2018: There is a non-trading credit of £7,875 (£165,375 – £157,500).
Accounting period ending 31 March 2019: There is a non-trading credit on the part disposal on 5 October 2018 of £1,812.50, calculated as proceeds £84,500 less the proportion of the fair value of the contract at the previous account period end date relating to the part disposed of (50% x £165,375 = £82,687.50).

There is also an annual non-trading credit relating to the movement in value over the accounting period of the part of the contract retained: Value at 31 March 2019 (£88,500) less 50% x fair value at 31 March 2018 (£82,687.50) = £5,812.50.

In summary: There are non-trading credits totalling £7,625 (£1,812.50 + £5,812.50) for the accounting period ending 31 March 2019.

Offshore Bond

£7,625 will be accounted for as a non-trading credit for the accounting period.
£7,625 x 19% = £1,448.75 tax due. However, the company may be able to offset the liability against other non-trading losses.

Onshore bond

For an onshore bond, a UK insurer will have paid tax on the income and gains on the assets in the funds underlying the contract. There are rules that broadly treat the tax paid at source as being equal to the basic rate of income tax (20%) – this can be used to offset tax due on nontrading credit. The credit can't be applied to annual non-trading credits arising on a contract owned by a company that uses fair value accounting. However, it does take account of the earlier credit in allowing relief when there is a subsequent disposal from the contract.
If we apply this to the accounting period ending 31 March 2019 above we have:
The partial withdrawal of £84,500 is a 'related transaction' so an allowance can be made for tax treated as paid. The gain on disposal is £1,812.50 and tax treated as paid is calculated as follows:

- £84,500 represented 50% of the rights under the contract at the time of the surrender. 50% of the original premium is £75,000. Therefore overall growth over the full period is £9,500 (£84,500-£75,000).
- Gross up the gain: £9,500/100%-20% = £11,875. This is reported in the accounts as a non-trading tax credit and taxed at 19%: £2,256.25.
- Tax treated as paid: £11,875 x 20% = £2,375.

This changes the summary position in the last year to show non-trading credits of £10,000. This is made up of £1,812.50 (the part surrender mid year) + £5,812.50 (the annual growth of the fund for the period) + £2,375 (the tax treated as paid).

£10,000 non-trading credit is added to the account for a year and is taxed at 19%: £1,900. The tax treated as paid (£2,375) exceeds the tax due for this non-trading credit, therefore there is no further tax liability.

Where the tax treated as paid exceeds the company's liability, the excess is not repayable nor can it be set off against corporation tax in any other accounting period.

SUMMARY

So, unlike the historic cost basis, where the value stated in the accounts would be the same as that shown at the start of the accounting period, under the fair value basis the increased value of the investment is instead shown at the end of the accounting period. As a result, corporation tax would be payable on the increase in the value of the bond each year and the company would not have the same flexibility in choosing when to encash in order to reduce the overall corporation tax liability.

There are still significant benefits of investing in alternatives to cash in order to seek better returns/profits for the business. Investment wrappers can offer access to a broad range of investments whilst offering significant flexibility and simplicity for companies.

Example C: Capital gains made on Collectives not subject to Loan Relationship rules

Money Co makes an investment of £200,000 at the start of their accounting year in April 2018 into equity-based investments which increase by 4.5% each year. If the company makes no disposals then no corporation tax would be levied year on year on the increase in capital value. Income in the form of interest would need to be accounted for on an arising basis. However, there is no further liability on dividend income.

On encashment, the capital gain is taxable as profit.

Accounting year	Value end of year	Tax rate	Taxable gain in value	Tax due if disposed of in full
1/4/2018 – 31/3/2019	£209,000	19%	£9,000	£1,710
1/4/2019 – 31/3/2020	£218,405	19%	£18,405	£3,496.95
1/4/2020 – 31/3/2021	£228,233	17%	£28,233	£4,799.61
1/4/2021 – 31/3/2022	£238,504	17%	£38,504	£6,545.68
1/4/2022 – 31/3/2023	£249,236	17%	£49,236	£8,370.12

* For illustrative purposes, a corporation tax rate of 17% has been assumed from 2019/2020 onward.

Partial disposals would be calculated using the formula: **cost price x A/A+ B** where:

A = Proceeds

B = Market value of the part of the investment remaining

SUMMARY

Assets which don't fall under loan relationship rules are treated similarly to those which are accounted for on the historic cost basis. Often there might be increased administration burdens on investments of this type – see page 6.

Please note that these examples are fictional and used for illustration purposes only.

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