Pru
part of M&G plc

Investing surplus company cash in an insurance bond

All companies need working capital that is readily accessible as and when they need it. In these circumstances, the company bank account is likely to be the most sensible place to deposit it. But if they have more on deposit than they need, is this surplus cash working hard enough for them?

Why is it a good time to look at a bond for surplus cash?

The directors may be disappointed in interest rates applying to funds held for the medium to long term.

However, despite this companies will want the comfort of knowing the funds will be available when they may be required. Therefore, a second key reason to consider a bond for surplus cash is that directors may be looking for any returns to be 'smoothed' and this could be possible in an insurance bond wrapper. There is no tax benefit from holding a bond over an OEIC but certain investments can be accessed through bonds that cannot be accessed as an OEIC. Examples of this are funds that provide guarantees or funds that have smoothing mechanisms.

It's important to remember the value of any investment can go down as well as up and your customer might get back less than they have put in.

In addition to the above here are some other reasons to consider why an investment in a bond could work for a company investment:

- **'Basic rate credit' mechanism** – tax rules give recognition to the fact that UK bonds will have suffered life fund taxation. Although tax is treated as having been paid at 20% basic rate, the effective tax rate applying to the fund will be less than 20%. Dividends are exempt from tax; gains are taxed at 20%, and where certain capital gains are made on or after 1 January 2018, then indexation allowance will be applied, calculated up to December 2017.
- **No 'surrender penalties'** – although a bond is seen as a medium to long term investment, directors can access it without any penalty or have to leave it invested for a fixed term – they can get their money when they need it. Although the bond itself won't suffer any surrender penalties, it's important to remember that some funds might.

The combination of these factors mean that an investment bond, with an appropriate underlying fund choice could be a more attractive investment opportunity for a company's surplus cash rather than it sitting on deposit.

Tax treatment of a company owned bond

This is an important area to understand.

How a company is taxed depends on what 'size' of company it is. Micro-entities can use historic cost accounting for insurance bonds. Larger companies use fair value rules.

The following hypothetical examples show the difference the two accounting methods have on how the bond is taxed.

A company will be considered a Micro-entity if it has any two of the following:

- A turnover of less than £632,000
- £316,000 or less on the Balance Sheet
- 10 employees or less.

Corporation Tax rates

The following are hypothetical examples to show the different tax methods an investment bond could be taxed under, depending on the size of the company. The figures used are in no way related to any specific investment fund or potential returns. The information is also based on Prudential's current understanding of the law and HMRC rules and practice.

Corporation tax rates			
Financial year 2022/23	Financial year 2023/24	Financial year 2024/25	Financial year 2025/26
19%	25%	25%	25%

The Spring Budget 2021 introduced a three-pronged approach to corporation tax in the future. Subsequently, the 23 September 2022 "mini-budget" reversed these changes but these were then reinstated so we are left with the changes as originally planned and these are:

1. Corporation Tax is 19% for the financial years starting 1 April 2021 and 1 April 2022.
2. From 1 April 2023 the headline (i.e. main) corporation tax rate has been increased to 25% applying to profits over £250,000.
3. Small companies i.e. those with profits under £50,000 will continue to pay 19% known as the small profits rate (SPR).
4. Companies with profits over £50,000 will pay the full main rate but where the profits are below £250,000 they will receive marginal relief meaning their actual rate of corporation tax will increase gradually from 25% to something between the small profits rate and the main rate.

The SPR will not apply to close investment holding companies.

A company with profits falling between £50,000 and £250,000 will pay corporation tax at 25% but then reduced by marginal relief which results in a gradual increase in the corporation tax rates as profits increase from £50,000 until the 25% rate kicks in. The marginal relief fraction is 3/200. The end result is that each £1 of profit between £50,000 and £250,000 is taxed at an effective marginal rate of 26.5%.

In the examples below, it is assumed that the company has taxable profits of £100,000 before any bond gains are included. Accordingly, the 26.5% marginal rate applies.

In Autumn Budget 2024, the government published a corporate tax roadmap which capped the headline rate at 25% for this Parliament. In addition, the small profits rate and marginal relief will also be maintained at their current rates and thresholds.

Historic cost accounting – accounting year end 31 March

- The company invests £200,000 in September 2022
- At 31 March 2023, the value of the bond is £210,000
- At 31 March 2024, the value of the bond increased to £230,000
- In April 2024 the company cashes in the bond for £230,000

Period to 31 March 2023 – historic cost £200,000

- no tax consequences

Period to 31 March 2024 – historic cost £200,000

- no tax consequences

Period to 31 March 2025 – cashed in for £230,000

- Gain: £30,000
- Grossed up (as underlying fund has effectively been taxed at 20% whilst in the bond): £30,000 x 100/80 = £37,500
- £37,500 profit taxed at 26.5% = £9,937
- Available for current year offset = (£7,500)

As the tax has already been paid in the bond, a 'basic rate credit' is applied which is offset against the Corporation Tax liability in this accounting period.

Fair value accounting – accounting year end 31 March

- The company invests £200,000 in September 2022
- At 31 March 2023, the value of the bond is £210,000
- At 31 March 2024, the value of the bond increased to £230,000
- In April 2024 the company cashes in the bond for £230,000

Period to 31 March 2023 – bond valued at £210,000

- Increase of £10,000 x 19% (Corporation Tax) – £1,900 tax due

Period to 31 March 2024 – bond valued at £230,000

- Increase of £20,000 x 26.5% (Corporation Tax) = £5,300

Period to 31 March 2025 – cashed in for £230,000

- Profit = £30,000 (£10,000 + £20,000)
- Profit grossed up (as underlying fund has effectively been taxed at 20% whilst in the bond): £30,000 x 100/80 = £37,500
- From that grossed up gain, we can deduct £10,000 and £20,000 as those amounts have already been taxed in the periods ended 31 March 2023 & 2024. That leaves a figure of just £7,500.
- £7,500 profit tax at 26.5% = £1,987
- Available for current year offset = (£7,500) – this is same 'basic rate credit' as in the historic cost accounting example.

The £1,987 Corporation Tax due in the period ended 31 March 2025 is covered by the £7,500 'basic rate credit', with the remaining £5,513 available to offset against any other tax liability in the accounting period. If the £5,513 exceeds the company's remaining tax liability then the excess is not repayable and neither can it be set off against any prior or future accounting periods.

Impact on tax reliefs

There are two tax reliefs we'll look at in relation to a private company investing in a bond. These are:

- Business Property Relief (BPR)
- Capital Gains Tax (CGT) Business Asset Disposal Relief

Inheritance tax BPR

If a shareholder in a private company dies, then three conditions need to be satisfied to obtain 100% relief:

1. The ownership test
2. The investment test
3. The excepted asset test

Each company's circumstances will differ and therefore, will need to be evaluated individually. However, the key points are covered in this table:

In Autumn Budget 2024, the Chancellor announced that from 6 April 2026 the 100% rate of relief will continue for the first £1m of combined agricultural and business property and 50% thereafter. If the total value of the qualifying property to which 100% relief applies is more than £1m, the allowance will be applied proportionately across the qualifying property. Note also that the government will also reduce the rate of BPR available from 100% to 50% in all circumstances for shares designated as "not listed" on the markets of recognized stock exchanges such as AIM.

<table>
<tr><th colspan="3">IHT Business Property Relief (BPR)</th></tr>
<tr><th>Ownership test</th><th>Investment business test</th><th>Excepted assets test</th></tr>
<tr><td>Must have owned business for at least two years before death

Bond has no impact on this</td><td>No relief where the business consists wholly or mainly (i.e. 50% or more) of investment activities</td><td>Excepted assets must be excluded for BPR purposes

Needs to pass test for it NOT to be treated as an excepted asset – see below</td></tr>
<tr><td colspan="3">In order for an asset of the business NOT to be treated as 'excepted', it must pass one of two tests:

1. It has been used wholly or mainly for business purposes in the last two years, or
2. Must be required at the time of transfer of value for future use for the purposes of the business in question</td></tr>
</table>

Surplus funds held for no identifiable business purpose are likely to be treated as an 'excepted asset' whether in cash or whether invested – so switching from cash to bond (or vice versa) should have no impact on the availability of BPR.

CGT Business Asset Disposal Relief

For lifetime gains up to £1m, Business Asset Disposal Relief delivers a CGT rate of 10% in 2024/25 but the rates rise to 14% from 6 April 2025 and match the main lower rate of 18% from 6 April 2026. HMRC apply a 20% benchmark and therefore any investment activities must be kept within this to qualify for relief.

There is no single indicator when considering this 20% test. Instead the test should be applied 'in the round' – this means that there could be other indicators to consider when establishing if it's a non-trading activity. You can find out more details on the HMRC website: **gov.uk/hmrc-internal-manuals/capital-gains-manual/cg64090**

In the case of surplus cash or an investment of those funds into an investment bond, it would seem logical to primarily focus on the asset base of the company when considering the 20% test. This might simply involve spending or extracting some of those surplus funds. In the Capital Gains Tax manual signposted above, HMRC state that "Whether or not making and holding investments are part of a company's or group's trading activities is a question of fact that can be determined by reference to all the relevant circumstances.

Paying for advice

The best course of action is to speak to the company accountant to agree the most appropriate way. Companies are used to directly paying professional fees so that may be a simpler approach than the insurance company facilitating the advice charge.

Summary – things to consider for your corporate clients

When speaking to a client about corporate investing, some of the things to consider as part of your full fact find with them include:

- Is there surplus cash to invest?
- Is inflation and market volatility a concern?
- Would the possibility of smoothed returns be attractive?
- What accounting method is used and what impact this has on the amount of tax to pay?
- What is the potential impact of surplus cash on any tax reliefs available?
- What would be the preferred way to pay for the advice you give?

To find out more about any of this, or what investment options are available from Prudential, please get in touch with a Prudential Account Manager.

Prudential is a trading name of Prudential Distribution Limited. Prudential Distribution Limited is registered in Scotland. Registered Office at 5 Central Way, Kildean Business Park, Stirling FK8 1FT. Registered number SC212640. Authorised and regulated by the Financial Conduct Authority.

GENM417904 04/2025_WEB