Hello and welcome to this short video entitled “Investing Corporate Surplus cash in an insurance bond” This concerns the investment of lazy cash held by companies, surplus to working capital requirements, which often languishes in bank accounts generating a very poor rate of return. We have an accompanying video entitled “Investing Corporate Surplus cash in OEICs”

The video is based on our understanding as at the date you can see in the important information section on the screen.

I’m Graeme Robb, and I’m a Senior Technical Manager in the technical team within Prudential. I’ll take you through the video considering the investment, in insurance bonds, of surplus cash balances held by companies. My focus will be on accounting and corporation tax implications.

We have excellent resources that you can access online within our Knowledge Library section in Pruadviser. There is an article entirely focused on the corporation tax implications of company owned bonds together with an adviser guide to corporate investing which is more wide ranging and covers extracting company profits, investing retained profits in bonds and OEICs, together with information on the potential implications of IHT Business Property Relief and Entrepreneurs' Relief or Business Asset Disposal Relief as it is now known.

Remember that companies come in all shapes and sizes. And so the potential investment could be millions but could equally be just £20,000.

Here we've got a big company on the left. You might be dealing with the finance director acting as a custodian for the shareholders money. He or she will probably be looking for a "peace of mind" investment and the prospect of less volatile and more stable returns may be appealing.

In the middle, we've got a small business for example an IT contractor who has earned good money but acted prudently and not fully extracted profits. This is your type of case which might just be £20,000. The contractor might approach the investment with the same mindset as if those funds were simply sitting in his or her own personal bank account.

What about the company on the right hand side? That might be a company which has ceased trading and is now an investment company. Pretty common in our experience. Rather than just surplus cash to invest, the whole balance sheet will be invested in a range of investments.

Just like individuals and trustees, companies invest in OEICs and insurance bonds. They’re at polar opposites of the investment spectrum of course since an OEIC must distribute income but a bond is non income producing. Our focus in this video is on Insurance Bonds.

Bond wise, the company can be the owner of an onshore or offshore life assurance bond or an offshore capital redemption bond. Speak to your account manager to discuss these options.

If a company invests in a life assurance bond then it will be set up with the company as owner and directors as lives assured. This should satisfy insurable interest requirements for trading companies. For an investment company, a capital redemption bond with no lives assured is likely to be a better fit.

At this point, you might wish to press pause to absorb the different options available.

How are company owned bonds taxed?
The chargeable event regime and the 5% rule does not apply to companies. Instead, bonds are taxed under what's called the 'loan relationship' rules, the remit of which extends well beyond insurance bonds.
Under these rules, the tax treatment of the item in question (in this case an insurance bond) follows the accounting treatment. So what is the accounting treatment?

Accountants must use generally accepted accounting practice, and within that framework, you'll encounter two regimes depending on the size of the company. That might be a particularly small company called a micro entity or a larger company. Your account manager can provide you with further information regarding which Financial Reporting Standard is likely to apply to the company you're dealing with.

For a micro entity, Historic cost accounting can be used which means that if the bond grows in value then that growth isn’t reflected in the accounts, and the bond isn’t revalued but instead continues to be shown at its historic cost, in other words, at its original premium. If there is no annual accounting profit, then there is no taxable profit and the company will get tax deferral until there is a full or part disposal.

Those companies which are bigger than micro entities will record the bond under fair value accounting rules.
Under these rules, the Balance Sheet at the end of the accounting period will include the bond at its surrender value at that date.
That annual accounting movement has corporation tax consequences with the increase in value subject to corporation tax. Incidentally, any decrease is potentially relievable for corporation tax purposes.

As we know, with a UK bond, the underlying bond fund will be taxed meaning that the company will enjoy a 20% credit on a full or part disposal. That 20% credit mores than wipes out any 19% corporation tax liability. Where the company is using fair value accounting, the 20% credit doesn't apply on the annual increases that I previously mentioned, but only on a subsequent disposal when the 20% credit is offsettable against the company's overall corporation tax liability for the accounting period in question. Directors should be aware that double taxation effectively occurs on those annual increases i.e. life fund tax suffered and corporation tax paid by the investing company on that net return. The benefit of the 'tax credit' on disposal rectifies that but iff then there is no overall tax liability then the benefit of that tax credit might be lost. Therefore, for those 'fair value' companies concerned about 'fluctuating' results and potentially wasting a tax credit in the accounting period of disposal, then an offshore bond may be the solution.

Where a fair value company holds an offshore bond it'll simply pay tax annually on the gross return with no tax credit on disposal. Any decrease over the accounting period will be relievable for tax purposes. If a micro entity invests in an offshore bond, then as with a UK bond, no annual gain (or loss) is recognised in the company accounts, meaning no corporation tax consequences arise. When the company makes a full or part disposal and a profit arises, then that profit is simply at the prevailing corporation tax rates.

The decision to go onshore or offshore will depend on the circumstances of your case. Your account manager can help.

That’s the end of this short video and I hope it’s been of use to you. If you have any queries or wish to discuss matters further, then please do not hesitate to contact your prudential account manager who can assist you. Remember also that can also access our Knowledge Library within Pruadviser for the articles and resources I mentioned earlier.
Thanks very much for your time.