Hello and welcome to this short video entitled “Investing corporate surplus cash in an OEIC”. 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 also have an accompanying video entitled “Investing corporate surplus cash in an Insurance Bond.

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 companies investing surplus cash into OEIC shares. 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. For comparison purposes you may wish to consider an article entirely focused on the corporation tax implications of company owned insurance bonds.
We also have 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.

Incidentally we also have an article focusing on OEICs and unit trusts for individuals which contains some useful background information on OEICs.

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.

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 OEICs.

As many of you will know, an OEIC fund will distribute dividends or interest. It can only pay interest if it satisfies what's called the qualifying investments test. If not, then dividends will be paid instead. It satisfies the test if the market value of its qualifying investments exceeds 60% of all its investments. Qualifying investments are effectively money market type investments.

On the left we have a fund which is 39% equity & 61% fixed interest. That fund will pay interest.

In contrast, the fund on the right which is only 45% invested in money market investments will simply pay a dividend as it fails the 60% test.

Where a company receives dividends, they are tax free but interest is taxable.

Special treatment however applies to tax free OEIC dividends received by corporate investors. This is designed to prevent companies reducing their tax bill by investing in funds which fail the 60% test so pay tax free dividends but in fact some of that return is due to interest that would otherwise be taxable.

Therefore the OEIC provider when it pays out the dividend must inform the corporate investor that in fact X% of that dividend is tax free dividend but Y% is taxable interest.

So that’s how income from the OEIC is taxed, but what about capital growth?

In some cases, a company's investment in an OEIC is taxed under what's called the 'loan relationship' rules. These rules apply to money market type investments outside of an OEIC and so it makes sense that if a company purchases an OEIC primarily invested in money market investments then the rules apply to that.

So, the rules advise us that if the OEIC fund has money market type investments with a market value over 60% of its total assets then the loan relationship rules apply, and if not they don't apply.

Where the OEIC fund does not have money market type investments exceeding the 60% test then the loan relationship rules don't apply.

If they don't apply, regardless of the size of the company, growth will only be taxed when there is a disposal of shares. Prior to disposal, larger companies may reflect growth in the accounts, but the tax point will be at disposal.

Where the OEIC does have money market type investments passing the 60% test then the loan relationship rules apply.

The remit of these rules extend well beyond OEIC investments.

In broad terms, these rules require the tax treatment of the item in question (in this case the OEIC fund) to follow the accounting treatment.

We know that accountants must use generally accepted accounting practice. Within that framework, you will encounter two regimes depending on the size of the company you're advising.

If you're advising a particularly small company called a micro entity then the accountant will prepare the accounts using Financial Reporting Standard 105. These companies enjoy simplified accounting rules.

If you're advising a company which doesn't qualify as a micro entity, then the accountant will prepare the accounts using Financial Reporting Standard 102.

Your account manager can help you determine which regime applies to a given company.

So let's see what these different standards mean for a company investing in OEICs

Micro entities can use historic cost accounting.

Historic cost means that if the OEIC fund grows in value then that growth isn't reflected in the accounts, and the investment isn't revalued but instead continues to be shown at historic cost, in other words, at it original investment

Why is that important?

It means that there is no annual growth accounted for which means that there is no annual tax due. Therefore the company will get tax deferral on the growth – just like an individual. Essentially, you only need to consider taxing the growth when the shares are encashed.

If you’re advising a company which is too big to be a micro entity, then fair value accounting rules apply.

Under these rules, the Balance Sheet at the end of the accounting period will include the fund at its current value at that date.

That accounting movement has corporation tax consequence with the increase in value subject to corporation tax. Incidentally, any decrease is potentially relievable for corporation tax purposes.

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.