



ADVISER GUIDE
FINANCIAL PLANNING WITH
SMALL AND MEDIUM-SIZED
ENTERPRISES

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The information in this guide is based on our understanding of current taxation, legislation and HM Revenue & Customs (HMRC) practice, all of which are liable to change without notice. The impact of taxation (and any tax reliefs) depends on individual circumstances.

Foreword from ICAEW

As Head of Personal Financial Planning at ICAEW, following the highly successful publication, *Technical Guide to Freedom and Choice in Pensions*, I am delighted that corporate partner, M&G Wealth, has extended its range of technical guides to help professional advisers in the corporate financial advice market. I hope that as a professional adviser you will find M&G Wealth's guide useful.

Business owners need a clear roadmap for how best to park surplus cash that needs to be retained in the business. This is particularly the case for owners of small and medium sized entities where the boundaries between business and personal financial planning advice often merge.

In this sector of the advice market, professional advisers therefore need to be able to deliver corporate planning advice that is also aligned to helping business owners and their families achieve their personal financial planning objectives. Of course, whether it makes sense to extract profits as dividends or salary, or to divert hard-won wealth into some form of pension scheme, will depend on a range of issues, both quantitative and qualitative in nature. Likewise, cash within a smaller business may well be "earmarked" for retirement with the thought of future dividend extraction. It is all about meeting the specific individual needs of clients in an efficient manner.

Professional advisers need to be able to explain the pros and cons of the different options that are available so that clients can understand the rationale for why their trusted adviser is recommending a particular course of action. M&G Wealth has designed this guide to help professional advisers go through that process and help demonstrate the value they deliver to their clients.

In an increasingly complex world clients need to have access to integrated advice. This technical guide is just one part of M&G Wealth's suite of support material that is available to professional advisers, which has been designed to help advisers from different professional disciplines better serve the needs of their clients.

I also thought you would be interested to know that ICAEW has established a Personal Financial Planning (PFP) Community that has a range of material and information on events designed to help support the professional advice community to deliver integrated advice outcomes and to thereby build a better business. Our PFP Community is open to both accountants and financial advisers. You can join the ICAEW PFP Community without charge at: [icaew.com/pfp](https://www.icaew.com/pfp)

John Gaskell

ICAEW Head of Personal Financial Planning

Welcome from M&G Wealth

Being a small to medium-size business owner requires multi-tasking in the extreme, a fact known extremely well by many professional advisers, who themselves may be in the same position and/or have many business owners as clients. Even with good people around them, to be successful the business owner needs to have a grasp of so many aspects of running a business. And this needs to be combined with an energy and appetite for success that many in the employed world might find daunting. However, there is a danger their business can become all-absorbing, so much so that sometimes the business owner can forget the very person that they started the business for... themselves.

Financial advisers can help facilitate the process of business owners considering how they can best help themselves. They can do this by being the subject matter expert and helping them to identify, understand and act on the business benefits that can be achieved through areas such as corporate investment. If an adviser looks after investing a business owner's personal cash why would they not look to them to look after any corporate holdings they may have? For many business owners they will consider it their cash too.

For a variety of reasons, it's common for a company to hold cash on its Balance Sheet surplus to working capital requirements. But, with interest rates at low levels, companies have increasingly invested surplus cash with the aim of enjoying a better return. With current high inflation levels not being matched by rising interest rates, there is perhaps more reason than ever to invest any surplus cash.

Is advising on corporate cash different to individuals cash? Should investments be held directly and where do insurance bonds play a part? Are international investments most suited? And where should you actually begin looking to invest in this low interest environment?

For certain companies who have already invested in certain assets, forthcoming corporation tax increases mean that consideration should now be given, in certain situations, to crystallise and accelerate investment gains to take advantage of the current tax regime before it's too late.

That's a long-winded way of saying that early encashment (and reinvestment) might be tax efficient and sensible where appropriate!

In this guide we explore the above subjects – information that many small to medium sized business owners could benefit from.

Les Cameron

Head of Technical

Les Cameron is Head of Technical at M&G Wealth, based in Edinburgh. Les covers most areas of financial planning, specialising in the pensions technical arena. Les joined Prudential in 1997 and has held various pensions technical and management roles throughout his career. Les is a Fellow of the Personal Finance Society and has a BA in Financial Studies.

Corporate investing

Why should companies invest surplus cash?

Conventional wisdom suggests that companies holding surplus cash should distribute this by way of dividend because shareholders are better placed to make investment decisions than the directors.

There are also return on capital employed (ROCE) issues to consider. Deploying cash in the company's business would be expected to generate a better return for shareholders than having cash on deposit.

However, there may be situations in which a company has surplus funds that it doesn't necessarily want to distribute, and which are not set-aside to be reinvested in the business.

In such circumstances the company could consider investing those surplus funds in a way that could generate a better return (net of tax and expenses) than that achievable on bank deposits.

This section looks at two possible investment options: company owned life assurance contracts; and company owned capital redemption contracts.

A life assurance contract must have the following elements:

- a. The contract must provide that the insured will become entitled to something on the death of the life assured.
- b. The insured must have an insurable interest in the life assured.

The contract will usually contain additional elements including the right to surrender the value of the contract at any time. It is the ability to surrender which makes this type of contract an 'investment'.

A capital redemption contract is one which, in return for one or more fixed payments, a sum or series of sums of a specified amount (based on actuarial calculations) become(s) payable at a specified time.

It is widely accepted that investment decisions should not be based solely on tax factors.

With an insurance bond 'wrapper', stakeholders have an opportunity to enjoy multi-asset investments with a smoothing process to help protect against market volatility. This type of arrangement can offer the benefits of upside of any stock market rises, with some protection against downside and volatility. This smoothing process can be invaluable.

Tax considerations

Corporation tax – changes

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 2020, 1 April 2021 and 1 April 2022.
2. From 1 April 2023, the headline (ie main) corporation tax rate will be increased to 25% applying to profits over £250,000.
3. Small companies, ie 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 rate relief meaning their actual rate of corporation tax will increase gradually from 19% to something between the small profits rate and the main rate.

The SPR will not apply to close investment-holding companies. An example would be a company controlled by a small number of people which doesn't exist wholly or mainly for the purpose of trading commercially or investing in land for (unconnected) letting. A Family Investment Company might therefore be an example of a company not eligible for the SPR.

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 rate as profits increase from £50,000 until the 25% rate kicks in. The marginal relief fraction is 3/200 and works as follows.

Note in the examples above of ABC Ltd and DEF Ltd, taxable profits are £51,000 and £100,000 respectively. If 'augmented' profits are higher, that higher figure should be used in the calculation. Broadly, augmented profits are taxable profits plus any exempt distributions received (excluding dividends from 51% subsidiaries).

ABC Ltd – year to 31 March 2024

Taxable profits	£51,000
Corporation tax @ 25%	£12,750
Marginal relief	$3/200 \times £250,000$ less £51,000 (£2,985)
Tax due	£9,765
Effective rate	£9,765/£51,000 19.15%

DEF Ltd – year to 31 March 2024

Taxable profits	£100,000
Corporation tax @ 25%	£25,000
Marginal relief	$3/200 \times £250,000$ less £100,000 (£2,250)
Tax due	£22,750
Effective rate	£22,750/£100,000 22.75%

The corporation tax liability of DEF Ltd is £12,985 more than the corporation tax liability of ABC Ltd. Given that the taxable profits of DEF Ltd are £49,000 more than ABC Ltd, then we can calculate that each £1 of profit between £50,000 and £250,000 is taxed at an effective marginal rate of 26.5% ($£12,985/£49,000 \times 100$). Both these companies could consider employer pension contributions to reduce taxable profits to £50,000 and potentially benefit from 26.5% corporation tax relief.

Take DEF Ltd. In simple terms its corporation tax liability of £22,750 comprises £50,000 @ 19% plus £50,000 @ 26.5%.

The lower and upper limits will be proportionately reduced for short accounting periods and where there are associated companies (broadly where one company controls another or both companies have the same controller). For example if a company has one associated company the upper profits limit is £125,000 and the lower profits limit is £25,000.

The corporation tax changes are applicable from 1 April 2023, ie Financial Year 2023 which ends on 31 March 2024. A company however pays tax on the profits for an accounting period and if the accounting period spans 1 April 2023, then profits will be apportioned between those falling within the financial year 2022, (taxed at 19%), and those falling within the financial year 2023.

**Example – Accounting period to 31 December 2023.
Taxable profits £1,000,000**

Accounting period	Profits	Rate
01/01/23 – 31/03/23	$90/365 \times £1,000,000 = £246,575$	19%
01/04/23 – 31/12/23	$275/365 \times £1,000,000 = £753,425$	25%

How are company owned life assurance policies (and capital redemption policies) taxed?

Finance Act 2008 brought investment-style life insurance contracts within the 'loan relationship' regime. Note also that 'interest' OEIC funds are also taxed under the loan relationship rules.

This requires that:

“... amounts to be brought into account by a company as credits and debits for any period... are those that are recognised in determining the company's profit or loss for the period in accordance with generally accepted accounting practice.”

If a company uses historic cost accounting it will be taxable on the profit made on part surrenders, full surrenders, assignments for value and death of the last life assured.

If a company uses fair value accounting it will be taxable on the profit made on part surrenders, full surrenders, assignments for value and death of the last life assured and/or on the increase in value of the bond each year.

Over the life of the bond the company will pay tax on the actual profit it has made regardless of the accounting basis used.

In general, micro-entities will be able to use historic cost accounting; other companies must use fair value accounting. To be a micro-entity a company must fulfil at least two of the following conditions:

- turnover must be not more than £632,000
- the balance sheet total must not be more than £316,000
- the average number of employees must not be more than 10.

Inheritance Tax (IHT)

Will investment in a life assurance/capital redemption contract impact on the availability of IHT business relief?

Business relief, or business property relief (BPR) as it is often called, gives a substantial relief from tax.

The legislation, Inheritance Tax Act 1984 sections 103 to 114, is 'designed' to prevent taxpayers from getting the benefit of business relief for private assets. The legislation achieves this by confining business relief to assets needed for the business.

Business relief is not due where the business, or the business carried on by the company, consists wholly or mainly of:

1. dealing in securities, stocks and shares
2. dealing in land or buildings, or
3. making or holding of investments.

However, where a business is trading, consideration must also be given to "excepted assets". These are covered under IHTA s.112 (1) and broadly means that if there are any assets within the business that are not deemed necessary for the business then the value of that asset will be excluded from receiving relief. For an asset to qualify for relief it must pass one of two tests:

1. Firstly, it has been used wholly or mainly for business purposes throughout the last two years.
2. Or, secondly, the business must need the asset for use in the future.

This second condition is obviously subjective but HMRC quote a case in their guidance which helps us understand what this means.

The case in question was Barclays Bank Trust Co Ltd vs CIR SpC 158.

The facts of the case were that a lady died holding half the shares in a company. Her husband held the other half. The company's trade was the sale of bathroom and kitchen fittings, mainly to 'trade' customers.

The company's turnover at the time of the lady's death was approximately £600,000. It held £450,000 in 'cash' invested for periods of up to 30 days. HMRC accepted that the company needed £150,000 but determined that £300,000 was an 'excepted' asset.

The case in question was Barclays Bank Trust Co Ltd vs CIR SpC 158 and the key passage from the decision was at para 10. The special commissioner's comment is quoted in full at IHTM25352 and is reproduced below.

"Was the £300,000 cash held by the company required on 23 November 1990 for future use for the purposes of the business? This is a question of fact and on the evidence before me I cannot find that it was so required. I do not accept that "future" means at any time in the future nor that "was required" includes the possibility that the money might be required should an opportunity arise to make use of the money in two, three or seven years' time for the purposes of the business. In my opinion and I so hold that "required" implies some imperative that the money will fall to be used upon a given project or for some palpable business purpose.

Whether this test is satisfied is a question of evidence in the circumstances of the particular case.

Three points should be made:

1. Only the value of excepted assets is left out – the remaining value (assets) get BPR (assuming the conditions are satisfied).
2. Cash is as much an 'excepted asset' as a bond – so switching from cash to a bond (or vice versa) should have no effect on availability of BPR.
3. The availability of BPR is only 'tested' on a transfer including a transfer on death. Spouse exemption might be available.

A bond could thus remain a suitable investment 'home' in the medium to long term. The bond could be distributed, perhaps by way of dividend, before an IHT 'event' occurs.

The following on cash holdings and BPR were sent to HMRC by the Chartered Institute of Taxation (CIOT) and the Society of Trust and Estate Practitioners (STEP) in late 2013.

"Where a company holds an amount of cash which is in excess of the amount which it 'normally holds' and there is no evidence of any given project upon which the funds will be expended, then BRP relief will be denied as the excess will be treated as an excepted asset.

Members are aware of the HMRC guidance in IHTM25352, IHTM25342 and SVM111220 and this guidance has proved sufficient in demonstrating the position of HMRC. It clarifies that cash balances should be viewed in light of the business's trading cycle and that businesses should keep evidence of discussions surrounding the intended use of cash balances.

However, in the light of the current economic climate and in order to weather the financial adversity faced by many businesses within the UK, it is widely recognised that businesses are retaining increased cash buffers in case of any further downturn in their trade. This is a widely accepted tactic in surviving a recession to ensure that businesses succeed and reverts to the cliché that 'cash is king'.

In this regard, confirmation from HMRC that they are aware of this change in mindset of business owners and company directors, and look favourably on surplus cash held in this regard, would be extremely useful to our members."

The HMRC response was:

"We understand that due to the financial circumstances in which businesses find themselves, they may choose to hold more cash in case of a potential downturn in trade. We can also confirm that in recent times we have seen this on a more frequent basis where businesses hold cash in excess of what they would traditionally require.

However, our guidance remains the same, and unless there is evidence which directs us to the fact that the cash is held for an identifiable future purpose, then it is likely it will be treated as an excepted asset. Therefore the holding of funds as an 'excess buffer' to weather the economic climate is not a sufficient reason for it not to be classed as an excepted asset."

Capital Gains Tax (CGT)

Will investment in a life assurance/capital redemption contract impact on the availability of capital gains tax Business Asset Disposal Relief?

Business Asset Disposal Relief is due, subject to meeting certain conditions, in respect of capital gains arising on 'material disposals of business assets'. These 'business assets' include: a disposal of shares in a company which is either:

- a trading company, or
- a holding company of a trading group, where the individual making the disposal satisfies certain conditions.

The relevant legislation defines a 'trading company' as a company which carries on trading activities and does not carry on other activities to a substantial extent.

Clearly, all companies will have some activities that are not trading activities but a company remains trading if non trading activities are not substantial.

In the opinion of HMRC 'substantial' in this context means more than 20%.

How should a company's non-trading activities be measured to assess whether they are substantial?

It's not straightforward. Questions to be asked of the business include:

- How much non trading income is received in relation to the total income?
- What is the balance sheet mix of trading assets against investment assets?
- How much time is spent and costs incurred on investment activities?

What has the company actually been doing from its inception until the present time? The answers to the above will give an indication whether the company's non-trading activities are substantial. It's not simply a case of "were any of these things over 20%?" The whole picture is looked at in the round and a decision made. For example, it's not inconceivable that a company's trading income could fall for a few years and their investment income comprise a substantial portion of their income but that should not in isolation be enough to consider a company to be non-trading.

The existence of 'goodwill' may need to be considered when applying the 20% test.

In the context of a company holding a bond, the 'asset base' test (alone) might be conclusive.

The holding of an investment can, in certain circumstances, be regarded as part of a company's trading activity.

Circumstances would dictate whether investment activities were trading activities. For example, a company may have retained large sums of cash that they are going to be using at some future point and feel the need to place this on deposit. Alternatively, the investment may need to be held for the purposes of the trade, such as travel agents needing to hold a certain amount of cash on deposit.

Where earnings from trading are held for long periods of time then a conclusion on whether the investments constituted trading activities must be reached.

Considerations may include whether the earnings are needed for cashflow, the nature of the investments, eg are they speculative or the intended use of the funds?

HMRC's point is succinctly made (and a fuller explanation given) in their Capital Gains Tax Manual at CG64060:

"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 only by reference to all the relevant circumstances."

For disposals made on or after 6 April 2019, the period throughout which the qualifying conditions must be satisfied is two years.

Transfers to employees or shareholders

The directors may want to consider transferring the bond to an employee or to a shareholder. This will be a taxable event and the company will suffer tax on the profit made at the time of the transfer.

If the transfer is made to an employee or director it will constitute employment income for the recipient individual. However, if the transfer is made to a shareholder it will rank as a distribution (dividend).

If the transfer is a reward for services there will be national insurance liabilities.

If the transfer is being made as a reward for services then the transfer value will qualify as a trading expense for the company and be deductible in arriving at its corporation tax profit.

If the transfer is a distribution of profits there will be no corporation tax deduction.

There will be no credit given to the individual on subsequent encashment for any tax paid while in the company. It would seem that as the investment was recommended for the company it may be more appropriate to encash within the company and pay cash to the individual who can then work with his financial adviser to identify the most appropriate investments and tax wrappers for their personal circumstances.

Adviser charging

Advice in relation to the investment will have to be paid for. This could come from the bond or simply as a payment from the company bank account. The latter is likely to be the simplest. If the payment comes in the form of a withdrawal from the bond there will be an 'event' and the profit (or loss) on the bond will have to be calculated.

Is the advice fee tax deductible in arriving at the company's taxable profit?

The test for deductibility is whether the expenditure has been incurred:

- a. wholly and exclusively for the purposes of carrying on the trade, and
- b. is income, as opposed to capital, in nature.

Adviser charging in respect of a bond will usually fail (b) and will therefore not be tax deductible.

The HMRC Business Income Manual (BIM) supports this view at BIM 46415.

Insurable interest

If the company is investing in a life assurance contract, it is necessary it can demonstrate insurable interest in the selected lives assured. The usual lives assured would be directors whose death would cause financial detriment to the company.

'Non-trading companies' are unlikely to be able to demonstrate insurable interest.

Capital redemption contracts could be used as an investment vehicle where no insurable interest exists.

The law relating to insurable interest is currently being reviewed by the Law Commission.

Basic credit rate

UK life companies pay tax on any income and gains received on investments within their insurance bonds. To allow for this taxation an “onshore bond tax credit” equal to the rate of basic rate tax in England and Wales is granted. Companies can use this to offset their corporation tax liability where part of the insurance bond they hold is cashed in (a related transaction).

Historic cost accounting

The proceeds from any bond encashment are grossed up using the following formula:

$$\text{NTC} \times \text{AR} / (100 - \text{AR})$$

where

NTC = the non-trading credit (NTC) on the related transaction

AR = the appropriate percentage (currently 20%)

The amount by which the NTC is increased is the amount of tax treated as paid.

For the avoidance of doubt, the corporation tax measures covered earlier do not impact the 20% ‘onshore bond tax credit’. In other words, life assurance fund taxation is not impacted though plans to reduce the basic rate of income tax in England and Wales in future could affect the level.

Fair value accounting

Slightly different rules apply where fair value accounting is used.

The NTC that arises annually does not ‘allow’ any tax to be treated as paid. However, where some or all the bond is encashed tax is allowed to be treated as paid and relief is given for the earlier credits.

The grossing up formula is:

$$(\text{PC}) \times \text{AR} / (100 - \text{AR})$$

where

PC = contract profit

AR = the appropriate percentage

Which gives the amount added to the NTC and treated as tax paid. Where there is a full disposal of all the investment bond the profit from the contract is:

- the amount payable on the related transaction, less
- the fair value of the contract on the later of
 - the date that the contract was made, and
 - the start of the company’s first accounting period to begin on or after 1 April 2008.

Where only part of the investment is encashed values are proportioned.

The tax treated as paid can only be set against the corporation tax liability for the accounting period when the investment is encashed. Where the corporation tax liability is lower than the tax treated as paid there is no reclaim possible.

Let’s look at an example.

Alpha Ltd

Alpha Ltd (a micro-entity) has an accounting date of 31 December.

It took out a life assurance contract on 1 May 2019. The premium was £10,000. It surrendered 25% of the contract on 1 September 2022 receiving £4,000.

There is a non-trading credit on the disposal calculated:

Proceeds	£4,000
Cost	£2,500 (25% x £10,000)
'Profit'	£1,500

This is grossed up by $£1,500 \times 20\% / (100 - 20\%) = £375$ and the non-trading credit of £1,875 is brought into Alpha's corporation tax computation.

Tax treated as paid of £375 can be offset against the company's corporation tax liability for this period.

Beta Ltd

Beta Ltd has an accounting date of 31 March. It uses fair value accounting.

Assume that in each accounting period the company has taxable profits of £100,000 before any bond gains are included.

The company uses fair value accounting, and it invested in a life assurance bond in September 2021. The premium was £200,000. Beta Ltd surrendered 50% of the contract in October 2023 receiving £120,000.

The fair value of the contract on the company's accounting dates was:

31 March 2022	£220,000
31 March 2023	£215,000
31 March 2024	£127,500

The fair value immediately before the part-surrender in October 2023 was £240,000.

The relevant parts of the corporation tax computation will be:

Accounting period year ended 31 March 2022

Non-trading credit £20,000 taxed at 19% (being growth in value to accounting date)

No tax is treated as paid as there hasn't been a disposal of contract rights.

Accounting period year ended 31 March 2023

Non-trading debit £5,000 (being fall in value over the accounting year)

Accounting period year ended 31 March 2024

A two part computation is needed:

- There is a non-trading credit in respect of the growth on the retained element of the contract
 $£127,500 - £107,500 = £20,000$
- There is a non-trading credit in respect of the profit on the surrendered element of the contract.
 $£120,000 - £107,500 = £12,500$

As there has been a disposal of contract rights tax will have been treated as paid.

PC (the contract profit) will be $£120,000 - £100,000 = £20,000$

The uplift in the non-trading credit is:

$£20,000 \times 20\% / (100 - 20) = £5,000$

This is also the tax treated as being paid.

The 'complete' impact for the accounting period is:

Non-trading credits	£37,500 taxed at 26.5% effective rate
Tax treated as paid	£5,000 (available for set-off)

Companies investing in Authorised Investment Funds

Introduction

Authorised Investment Funds (AIFs)

AIFs are authorised and regulated under the terms of the Financial Services and Markets Act 2000 (FSMA). AIFs include authorised unit trusts (AUTs) and open-ended investment companies (OEICs).

AUTs and OEICs are collective investment schemes.

A collective investment scheme is a form of investment fund that enables several investors to 'pool' their assets and invest in a professionally managed portfolio of investments, typically gilts, bonds and quoted equities. Some investments, however, may be in unquoted investments or property. In effect, investors in such schemes can spread or reduce the risk that is associated with investment in such assets as well as gain the benefits of professional management. Standard investment theory tells us holding multiple investments within and across asset classes reduces risk.

Definition – FSMA 235. A collective investment scheme is defined as:

“... any arrangements with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income.”

Investors cannot have day to day control over the investments (whether or not they have the right to be consulted or to give directions). Investors must have their contributions, profits and income pooled and the property managed by the operator of the scheme.

Taxation of OEICs

OEICs do not pay UK tax on dividend income and capital gains made by OEICs are not taxable.

Company-owned OEIC – corporation tax

General principles

Dividends received by UK companies are not subject to corporation tax.

Interest will be received gross and is taxable.

Company investing in OEIC

Where an 'equity' fund pays a dividend to a company, the distribution is divided ("streamed") into that part which relates to dividend income of the fund and that part which relates to other income. The part relating to dividend income is not subject to corporation tax, and the other part is taxable. (The OEIC provider will issue a tax voucher to corporate investors showing the split).

If the company uses historic cost accounting, the OEIC investment will not be revalued at the end of each accounting period. When the fund is disposed of, the gain on an 'equity' fund after any indexation will be subject to corporation tax. If there is a loss, indexation will not enhance that loss. Note that indexation allowance was changed several years ago so that any indexation allowance is only calculated up to 31 December 2017 when computing the chargeable gain for gains arising on or after 1 January 2018.

If it is a 'debt' fund then no indexation is available to reduce the gain.

If the company uses fair value accounting, the fund will be revalued at the end of each accounting period.

There are no tax implications for an 'equity' fund but increases in a 'debt' fund will give rise to loan relationship non trading credits which will be subject to corporation tax.

When the fund is disposed of, the gain on an 'equity' fund after indexation will be subject to corporation tax. Please see above comments regarding gains made on or after 1 January 2018.

If there is a loss, indexation will not enhance that loss.

If it is a 'debt' fund then no indexation is available to reduce the gain.

Appendix 1: Investment Advice considerations for the SME

Companies often hold cash on the balance sheet that is surplus to working capital requirements. This can arise when the company's stakeholders have decided not to fully extract profits by way of dividend, remuneration or employer pension contributions. This surplus may be earmarked to fund a future business project or it may simply be a cash buffer to help weather the economic climate.

With interest rates at low levels, and higher inflation generating negative real returns company stakeholders are increasingly seeking a better return for that surplus cash.

If an accountant has prepared the accounts reflecting those surplus funds, and does not have the required regulatory authorisations to make personal recommendations on investment products, then an independent regulated financial adviser can help advise on how those surplus funds could be invested.

Insurance Bonds and OEICs offer an investment vehicle for corporate money.

Is investment advice for companies different to advising individuals?

Yes and No.

The advice impacts the corporate entity not an individual, and clearly there are different taxation issues to consider.

Clearly companies and individuals will have complex requirements when it comes to all their needs and objectives however, when distilled down to investment advice, most companies will be relatively straightforward, ie attracting a higher return for "lazy cash".

The key issue is perhaps around attitude to risk and capacity for loss, two crucial aspects for personal advice.

Attitude to risk is broadly the amount of investment risk you are willing to take. Capacity for loss is the amount of risk you can absorb before it materially detracts your standard of living.

These concepts do not fit neatly into corporate investments, companies come in all shapes and sizes.

Larger company/multiple shareholders

Those making the investment decisions are essentially custodians of others money, ie the shareholders. The attitude to risk of the decision makers is irrelevant. It is perhaps more useful to follow a trustee code of investment as per Trustee Act 2000. Broadly this means to invest in a way that is suitable for the circumstances, taking account of the standard investment criteria such as the need for diversification and ongoing monitoring, and without taking undue risk, ie exercising reasonable commercial prudence.

Capacity for loss wise, it is perhaps unlikely that poor investment performance from the invested cash would lead to business failure. The directors attitude to how much they might lose will obviously be key. Will they be looking for a "peace of mind" investment on behalf of the shareholders, with the prospect of low volatility and stable returns?

Single shareholder

For example, an IT or medical contractor who has earned good money in recent years but has acted prudently and not fully extracted those profits. The contractor will be the company owner and director. They might view the potential investment in the same manner as if they were investing personal money. After all, it will probably be needed by them in a personal capacity at some point, eg withdrawing dividends to supplement retirement income.

In such cases, advice should almost certainly be given along personal advice principles, it is essentially their money and how much risk they are willing to take and how much loss they can absorb is personal to them.

Investment companies

These exist to make investments, perhaps speculative in nature. That is their purpose. The concept of attitude to risk, capacity for loss and whether the investments should follow personal or trustee guidelines does not appear to be of relevance.

Protection

Like individuals, company stakeholders will be interested in the levels of protection available for any investments they may make as well as the deposits they hold.

The Financial Services Compensations Scheme (FSCS) provides compensation or some other form of resolution where an authorised financial services provider gets into financial difficulties and becomes unable, or unlikely to be able, to pay any claims. Investors should be aware that they may not always be able to make a claim under the FSCS, and there are also limitations in the amount of compensation. Any compensation will depend on eligibility, the type of financial product or service involved, the investment funds selected (if applicable) and the circumstances of the claim.

The FSCS can only apply if the firm was authorised by the Prudential Regulation Authority or the Financial Conduct Authority and if the investment was a regulated product. If an FCA search shows the firm's status as authorised, the FSCS may be able to provide compensation if the firm fails. With regard to limited company investors, this FSCS webpage explains the need to meet certain eligibility criteria to claim compensation with the FSCS.

With respect to the reference to "Insurance claims", please note that insurance bonds are long term insurance policies where the FSCS may pay the entire claim if the provider fails. Note also that "All firms are generally eligible for long-term insurance contract claims, regardless of size..." But, in contrast, for investment (eg OEIC) claims, the company must qualify as a 'small company'.

With regard to a new non-UK bond investment, there will be no FSCS protection but there may be similar schemes based on the jurisdiction or other factors that could help if the worst happened and a provider was 'in default'. For example, a provider based in Dublin is bound by both EU and Irish regulations designed to ensure the company remains financially strong and holds sufficient assets to meet policyholder liabilities. This would bring into play Solvency II measures which harmonise capital requirements across EU member states.

In short, potential compensation matters can be complex and should be addressed on a case by case basis before investing. The financial adviser can advise on this.

Are bonds or OEICs best?

Just like individuals and trustees, companies invest in OEICs and insurance bonds. They're at polar opposites of the investment spectrum since an OEIC must distribute income but a bond is non income producing.

Given the respective tax treatments discussed in the main body of the guide then there is no real tax benefit from holding a bond over an OEIC. A UK bond wrapper just creates an, albeit specialised, corporation tax treatment for investments and then a tax credit of 20%. It is inconceivable that dividend producing investments would be placed in a non-UK bond wrapper as what would otherwise be received exempt by the company would be rolled up and potentially taxed at up to 25%.

OEICs must have their unit prices set according to their "net asset value". Within insurance funds the same restrictions do not apply. So, 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 that protect the fund value from short term movements in volatility.

Where “smoothed funds” are used, a company’s investment will not benefit from the full upside of any stock market rises, but crucially they will not suffer from the full effects of any downsides. For directors acting as custodians of shareholder funds, this peace of mind can be invaluable. For owner directors investing their “own money” this peace of mind may or may not be valued.

The old adage about the tax tail wagging the investment dog is true with company investments as in any other – the choice of bond or OEIC should be investment led not tax led.

Are non-UK bonds better for companies than UK bonds?

The question of whether to use UK or non-UK bonds always comes up when dealing with individual investment and trustee investments. Likewise, it will often crop up when evaluating bond investments made by companies.

If a company is using fair value accounting the annual increase in value is taxed regardless of the bond held. If that company invests in a UK bond then that gives rise at that time to double tax (ie the fund pays tax then the company pays tax on that net growth). That position is then rectified on disposal assuming the company has a sufficient tax liability in accounting period of encashment to absorb the tax credit. If the credit exceeds the company’s tax liability then the excess is not repayable and neither can it be set off against any prior or future accounting periods. Therefore for a company which encashes the bond in an accounting period in which there are no other profits and no corporation tax liability, then the benefit of that tax credit will 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 a non-UK bond may be appealing. The company simply pays tax annually on a gross return (ie gross roll-up within the fund) with no ‘tax credit’ on disposal. But loses out on the benefit of a basic rate credit from a fund which pays tax at less than basic rate.

If it’s a micro company using historic cost accounting, then a UK bond was perhaps most common in the past due to the simplicity – no annual tax and no tax on encashment due to the 20% tax credit on encashment. As we move into accounting periods that may see corporation tax rates over 20%, there is still that element of simplicity with no annual tax but for some there will still be some tax to pay on encashment.

For companies with volatile results then a non-UK bond might be appealing if there is likely to be losses which gains can be offset against. Prima facie if a loss in the year of encashment was likely to reduce or eliminate the tax on any gain then it would seem counterintuitive to suffer the taxation within the UK bond fund without the benefit of the tax credit offset where tax free accumulation and withdrawal could be achieved in a non-UK bond. Using the same principles, accruing expenditure in the accounting period to offset the gain may be an option. Perhaps one for the company accountant to consider.

For applications with insurable interest difficulties then using a non-UK bond due to the Capital Redemption Option may be considered.

So the answer? Sometimes!

What impact do the corporation tax changes have on company investments?

The new corporation tax regime begins from 1 April 2023.

The chancellor has stated that around 70% of companies (1.4 million businesses) will be completely unaffected, and just 10% will pay the full higher rate. For the 30% that are impacted then these looming corporation tax increases will focus minds, and might influence behaviours.

Assume a company draws up accounts to 31 December each year. If so, the accounting period 1 January 2022 to 31 December 2022 will be the last one that isn't impacted by the new regime. Corporation tax planning may now involve, if possible, accelerating income or gains to accounting periods ending before 1 April 2023 instead of those amounts being taxed under the less favourable Financial year 2023 regime (see comments below relating to crystallising bond or OEIC gains in certain circumstances). Less beneficial, but still worthy of consideration, would be accelerating income or gains to an accounting period straddling 1 April 2023 so that if, for example the accounting period was 1 January 2023 to 31 December 2023 then at least 90/365 (ie 3/12) of the profits would benefit from the current 19% corporation tax regime.

In addition to accelerating income or gains, directors might consider delaying tax allowable expenditure so that it falls under the forthcoming regime.

Regarding corporate owned bonds, as set out elsewhere, a 'micro entity' uses historic cost accounting for an insurance bond. The company achieves tax deferral until there is a disposal event such as full surrender, and assuming a gain arises, that profit is taxed at the prevailing corporation tax rates. If it's a UK bond then the company enjoys a 20% tax credit which more than wipes out 19% corporation tax currently due on the bond gain. Regardless of bond location "micro entities" may wish to consider crystallising the gain while the 19% rate applies and reinvesting those proceeds. It does not make sense to defer the tax on accumulated profits to a period where the tax rates are higher. This can save between 6% and 7.5% of the accumulated gross gain.

For those bigger companies using fair value accounting, then tax on growth is paid on an annual basis and so, on an ongoing basis, annual investment gains will automatically attract those 19% rates until April 2023, then the rates under the new regime apply.

For those holding non-UK bonds there would therefore be no need to crystallise any deferred gains to protect them from higher tax as the gains have been taxed as they go along.

There is however a quirk with fair value companies holding a UK bond. Annual gains on the bond are taxed on a net basis and these will have been taxed at 19%. However, when a surrender happens the net gain is grossed up due to the 20% tax credit. This means that the difference between the current gross gain and net gains that have already been taxed could be deferred into a higher taxpaying regime, in a similar way to the whole gains for micro entities above. The additional tax payable on deferral will be between 6% and 7.5% of 25% of the accumulated net gains. Like those smaller companies consideration should be given to crystallising those gains and reinvesting to prevent profit being deferred into a higher tax regime.

For both types of company when looking at crystallisation and reinvestment, consideration should be given to whether the costs of doing so will be higher than the tax savings – a "self-defeating transaction".

Note that these corporation tax measures do not impact the 20% 'tax credit' on UK bonds available to individuals, trustees and corporate investors. In other words, life assurance fund taxation is not impacted.

With regard to existing OEICs, whether "equity or interest funds", held by a micro entity, gains are taxed at time of disposal (not annually) and so again directors might expedite the disposal of shares in OEIC funds to crystallise the gain while subject to potentially lower corporation tax rates.

For non-micro companies, 'equity funds' (see later) are also taxed on disposal and therefore again the disposal might be brought forward to crystallise the gain at lower corporation tax rates. Note however 'interest funds' held by non-micro companies are accounted for under fair value rules meaning they are revalued and taxed annually. On an ongoing basis, gains therefore automatically attract those 19% rates until April 2023.

Case study 1

XYZ Ltd prepares accounts on a historic cost basis, the company year matches the financial year. It usually has profits around £100,000.

It holds a UK investment bond that currently has an £100,000 gain.

2022/23	
Existing bond gain	£100,000
Grossed up gain	£125,000
Corporation tax at 19%	£23,750
Tax credit	£25,000
Potential CY offset	(£1,250)

2023/24	
Existing bond gain	£100,000
Grossed up gain	£125,000
Corporation tax at 26.5%*	£33,125
Tax credit	£25,000
CY due	£8,125

*effective rate

By realising the profit already made on the bond, reinvesting, and carrying a rebased cost into the new corporation tax regime the company saves corporation tax of £9,375, or 7.5% of the grossed up gain. The same percentage saving would apply to a non-UK investment.

Case study 2

ABC Ltd prepares accounts on a fair value basis, the company year matches the financial year. It usually has profits of around £100,000. It holds a UK investment bond that currently has a £100,000 gain.

The bond is continued into 2023/24 before surrendering at £110,000.

	Surrender 2023/24	Rebased in 2022/23	Surrendered 2023/24
Bond profit	£110,000	£100,000	£10,000
Grossed up	£137,500	£125,000	£12,500
Bond profit (already taxed)	£100,000	£100,000	£0
Previous tax paid	£19,000	£19,000	N/A
Bond profit (still to be taxed)	£37,500	£25,000	£12,500
Corporation tax	26.5%	19%	26.5%
Tax due	£9,937.50	£4,750	£3,312.50
Tax credit	£27,500	£25,000	£2,500
Total tax less credit	£1,437.50	-£1,250	£812.50

The overall CY offset available by rebasing in 2022/33 is £1,875 higher than if the gain is allowed to carry over to 2023/24. This equates to 7.5% of the gross profit that was carried over ($£125,000 - £100,000 = £25,000$).

As non-UK investments are taxed on the net profit without grossing up similar savings cannot be made.

Would you not be better extracting profits and investing personally?

Planning with the new corporation tax regime in mind might lead to directors considering the option of not retaining and investing surplus cash within the company, but instead extracting the surplus funds and perhaps directors/shareholders then investing personally. Bear in mind however that although it's possible to accurately calculate the tax cost of extracting funds for personal benefit at a particular point in time, it is then not possible to accurately calculate whether a corporate investment or a personal investment ultimately yields the better return as future corporation tax and personal tax changes will influence matters. An educated estimate is the best that can be achieved.

These thoughts however spring to mind.

Advantages of investing surplus cash remaining within the company?

- The accountant and the company stakeholders may have taken the conscious decision to keep these surplus funds inside the business as a nest egg or because the funds are earmarked for a particular business purpose in the medium term.
- It may be desirable to keep funds in the company to maintain a strong Balance Sheet.
- It is possible that excess funds inside the company are sheltered from IHT if they are required for a palpable business purpose but fall into the IHT net once personally owned.
- Dividends paid out from after tax profits might be more tax efficient than remuneration paid, but that can lead to complications if multiple shareholders are involved. Is it desirable that all shareholders receive a dividend? If not dividend waivers are an option but anti-avoidance legislation can apply in certain situations.
- A company which is planning to cease trading may wish to invest within the company and then gradually extract funds tax efficiently over several years.
- If taxable investment growth arises within the company, the accountant may be able to mitigate the corporation tax impact by careful timing of tax allowable expenditure charged through the accounts. Paid employer pension contributions perhaps.
- The gross amount of surplus cash can be invested within the company as corporation tax has already been suffered. If the surplus cash is extracted by way of remuneration or dividend, then the recipient's personal tax liability on that sum will mean that only the net amount is available for personal investment.
- The tax on interest, dividends and gains may be lower within the corporate entity than if held personally.

- Where the company cash will be used as a future income stream, the money may be extracted at a lower tax rate in future than that payable now.

Advantages of extracting the funds and then investing personally?

- The director/shareholder can use the funds to carry out IHT planning (eg implement a bond in trust solution).
- If the director/shareholder has a spouse or civil partner, then it may be possible to gift funds to the other partner to enjoy two lots of rates, bands and allowances applying to the investment returns.
- If the company invests, then a gain in a particular accounting period will increase taxable profits and could lead to an increased corporation tax rate applying to all the profits in that period, ie not just on the investment gain.
- Certain directors/shareholders might have particular reasons why they would prefer to receive extracted funds now rather in the future, eg family circumstances, purchase of new property, etc.
- For some, cash in hand is preferable to cash in the company.
- The personal taxation on any investments could be lower than that which would be suffered in the company.

It comes down to an adviser and accountant working together to deliver the best overall outcome for their mutual client. There is no one size fits all answer.



Appendix 2: Corporate investing in a low interest rate environment

A company's surplus cash can be defined in terms of cash with no identified business need, ie is not earmarked for some future purpose and is over and above any working capital/liquidity needs. Where not required in the short to medium term investment could be considered.

Many companies keep 'rainy day' money in case of emergencies. But what if there's more money than the company needs? This surplus cash could be kept in the company bank account, which is safe and easy to access, but it wouldn't grow much with today's low interest rates. Even worse, some banks have been known to charge companies for keeping cash on deposit. In this section we'll explore investing surplus corporate cash, why some companies invest, things to consider, and what a financial adviser can do to help. Please remember that investments do rise and fall and you may not receive as much back as what you put in.

Keeping surplus cash in a bank account can erode value

Money kept in the bank is safe and easy to access, but it won't grow much based on today's low interest rates. And if the bank interest rate is much lower than inflation and stays low for an extended period, the spending power of your company's money will decline in value even more, which means you might not have adequate funds for future needs.

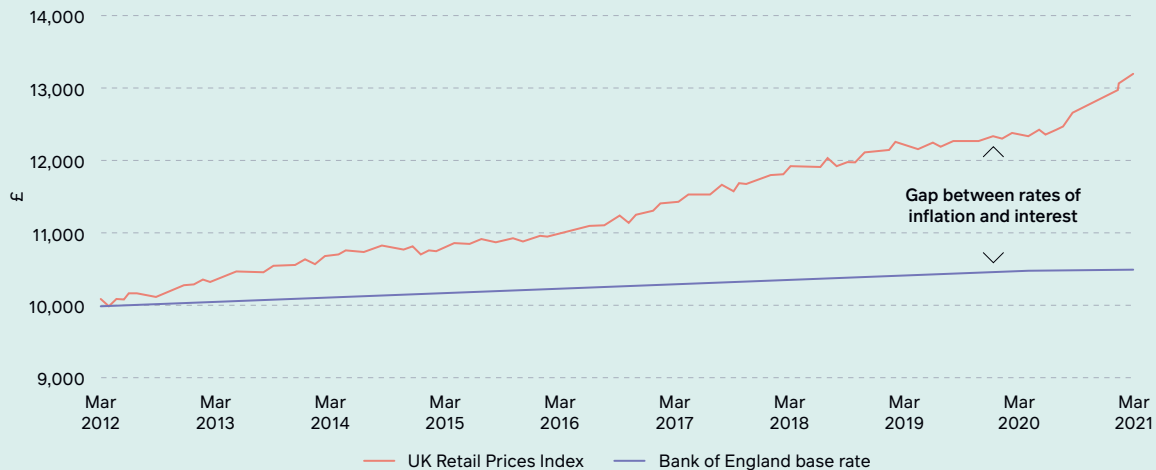
How inflation erodes the value of money in a bank account

This diagram shows the relationship between low interest rates and inflation. If your business kept £10,000 in the bank for 10 years, from 30 December 2011 to 31 December 2021, there would be little growth in the value of your money because of the low rate of interest paid by the bank during that time period. The purple line, which represents the Bank of England base rate, shows the change in the value. However, inflation represented here by the green line, has increased significantly in the same time frame. What's most important here is to notice the gap between the green and purple lines. That is the gap between the interest rate and the inflation rate and what it shows is just how much your money's buying power would've declined during this 10-year period. And will continue to decline as long as interest rates remain below inflation.

But if there is excess cash in corporate bank account where else could it be invested?

Below is the view from M&G Wealth as at the date of publication.

Mind the gap – why money in a bank account could be losing value



This graph shows the gross returns from 31 March 2011 to 21 March 2021.

Source: FE fundinfo. Past performance is not a reliable indicator of the future performance.

History has tended to show that investing in real assets helps investments to keep pace and even exceed inflation over the longer term. Here we consider the main asset classes and their historic relationship with inflation.

Property

Investments in commercial property have tended to benefit from a stable source of contractual income, currently offering an attractive real yield. Historically, through normal economic cycles, property has been effective in hedging inflation caused by economic activity. In some cases, rental income can be linked to inflation through annual uplifts in rent.

Equities

Also known as stocks and shares, when you invest in equities you buy a small stake in a company with the aim of capital growth, dividend income, or a blend of the two. Generally equities offer poor short-term inflation protection since many businesses are not able to fully pass on higher input costs. However, over long-term, historically produce positive real returns that keep pace, or exceed inflation.

Commodities

A commodity is a basic good, like steel or oil that is most often used in the production of other goods or services. Generally commodities do not produce a homogenous level of risk/return. They have a strong inflation sensitivity over short-term due to higher real rates of inflation, leading to higher carry costs and discount rates for future extraction. They can produce attractive returns in the right circumstances however.

Infrastructure

Infrastructure investment spans all of the physical assets, services and facilities that help societies develop and grow. Examples of infrastructure include roads, railways, airports, power generators, telecommunications, utilities, schools and hospitals. These are generally difficult or unavailable for individuals or companies to invest in, but specialist or multi asset funds can hold these investments. Each infrastructure asset is unique and needs to be looked at individually. However they often have long-term inflation linked cashflows and possibly capital appreciation.

Fixed Income Bonds

These are bonds issued by governments or corporations where you loan money to them in return for a fixed rate of interest. UK government bonds are referred to as gilts.

Fixed Income Bonds have various maturity and face value amounts. It is often considered that these offer the worst inflation hedge. Fixed rate bonds fall in value as inflation expectations and discount rates rise. If an investor holds the bond to maturity, there are no nominal losses but the purchasing power of the bond's cashflows will have fallen.

Index-Linked Gilts and Treasury Inflation-Protected Securities (TIPS)

These are bonds issued by governments with borrowing rates and principal payments linked to changes in the inflation rate. Though it seems counterintuitive the level of inflation hedge is not always consistent over all time horizons. Historically when inflation consistently surprised on the upside, interest rate increases were less than the increase in inflation. This resulted in a partial inflation hedge only.

So where to invest?

The benefit of diversification

Generally companies are not only looking to maintain the buying power of their capital but also ideally achieve a return over inflation. Financial advisers will often recommend spreading an investment across a variety of asset types which tends to lead to a more consistent investment performance. This can be achieved by investing in a range of different assets, funds or in a 'multi-asset' fund which invests across a variety of asset classes.

By investing in a multi-asset fund, your investment is spread over a range of investment asset types bringing the benefits of diversification. The mix of assets is determined by the objectives of each fund. Some multi-asset funds will offer higher risk opportunities for companies more comfortable with taking higher risks, whereas other funds will offer lower risks for those with a lower risk appetite. In order to consider these types of investment surplus corporate cash will typically need to be tied up for a minimum of five years, and some degree of risk to the value of the capital will need to be accepted. An investment adviser will be able to provide advice specific to the individual company.

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