WEALTH MANAGEMENT ALERT

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LIGHTHOUSECARRWOOD

Helping businesses make their surplus cash work harder

There are many reasons why a company may choose to accumulate cash in the bank. Whatever the reason, that money isn't working as hard for your client as they worked for it. In fact, it is probably losing value in real terms. Here are some options clients could consider.

The rise in inflation in July to 2.5% puts the spotlight once again on the fact that savings held in cash deposit accounts losing money in real terms.

Even taking into account the Bank of England's base rate rising to 0.75% in early August, savings are likely to lose at least 1.75% of their value each year if base rates and inflation remain more or less static. Over time, this can have a significant negative impact (see box on page 2 for an idea of how much clients could be losing).

It is therefore important that clients who have savings in cash deposit accounts, other than for "rainy day" savings, realise that there are other ways they may be able to make their hard-earned cash work harder for them.

Here we consider options open to businesses that have accrued sizeable amounts of cash. In the box on the next page we look at just how much individuals with cash savings have lost out on over the last decade by not putting their savings into mainstream investments.

Tax-efficiency key to optimising returns for businesses

For savings, the over-riding aim is to deliver a return higher than inflation and tax efficiency can be a key factor in achieving this, especially when considering lower risk options.

ABCD company is sitting on £200,000 cash

ABCD is a small company with five employees including the director, Robert. It has an annual turnover of £500,000 and £500,000 on its balance sheet. After a successful six months, it has accumulated £200,000 in cash, which is surplus to its immediate requirements.

Robert is aware that this surplus cash has accrued thanks to a good spell and is expecting a downturn at some point. If he leaves the money in the cash deposit account, gross interest paid is liable to corporation tax.

He asks his independent financial adviser, Julie, if there is anything he can do to make better use of this cash. She says that there are a number of options open to him.

Equities: high risk

Investing directly in equities or in business relief schemes may be tax-efficient but tends to be risky. Volatility can be unnerving, especially if funds might be needed at short notice, possibly when the value of the investments has fallen. However, this could be an option for directors who know they will

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Are your clients making the most of the tax efficiency of pension contributions for directors and high earners?

Company owners have a great deal of flexibility when it comes to drawing money from their business. They can choose from a number of remuneration options and can combine them in different ways, varying the weighting of each. Their main options are salary, dividends and pension contributions. As a general rule payment becomes more restricted but more tax-efficient in the following order: salary, dividends, pension contributions.

Employer contributions are usually the most tax-efficient component and possibly the most under-utilised of an employee's remuneration. Contributions must take into account the employee's annual contributions allowance and the total amount they hold in pensions.

Given their tax benefits, employer contributions should be considered as an integral part of the remuneration package, either via regular contributions or occasional large contributions to maximise available allowances, including carry forward.

To determine the tax efficiency of different combinations of salary, dividends and pension contributions for a particular client, please get in touch. Email Phil Mason, Business Development Director, LighthouseCarrwood Limited.
phil.mason@lighthousegroup.plc.uk.

Do clients holding long-term cash in deposit accounts realise they have missed out on 120% potential growth?

Many people think that cash is the safest home for their money. What they may not realise is that over the last decade, with very low interest rates, they have actually lost money in real terms.

For instance, £10,000 placed in a cash ISA in August 2008 and paying an average of 0.5% interest throughout the last ten years and with no withdrawals made would have grown to £10,501.14. However, according to the Office for National Statistics average inflation was 2.95% during this period, which means that just to maintain its buying power, the original £10,000 would now need to be £12,958.96. For someone who has held, say, £50,000 in cash for ten years, the loss of money in real terms is significant.

Over the same period, the IA UK All Companies sector grew by an average of 120.4%, according to the Investment Association (based on data from Morningstar)*, with other sectors delivering substantially higher returns – and a few a little less. That £10,000 would have turned into £22,000. Of course, there is no guarantee that equity-based investments will continue to out-perform cash over the longer-term, but using an experienced, independent financial adviser who recommends funds that spread the risk and match your clients' needs, circumstances and objectives can help manage the risk involved and give their money a greater potential to grow.

To refer clients to us or to discuss how we could work together, email Phil Mason, Business Development Director, LighthouseCarrwood Limited. phil.mason@lighthousegroup.plc.uk

* https://www.theinvestmentassociation.org/fund-statistics/statistics-by-sector.html?what=table&show=26

always have control over when they cash in the investment and are prepared to accept the risks of equity investing – there is no guarantee that the value of their investments will increase.

The attraction of life assurance bonds

Companies can also place money in life assurance bonds which are taxed under the loan relationship rules. It is important to know what accounting standards the company use – historic cost and fair value are the most common.

This is the option Julie recommends for Robert's company – placing the cash into an onshore life assurance bond that invests in a popular smoothed fund to help manage short-term volatility. Although there is still some risk, the smoothing mechanism could help reduce some of the extreme short-term volatility.

No reporting of annual gain or loss required

ABCD follows historic cost accounting standards. Therefore the bond is simply shown on the balance sheet at the end of the company's accounting period at the original premium, regardless of the surrender value. No annual gain (or loss) is recognised in the company accounts, so corporation tax is not affected.

Taxation of any gain on surrender

Fast-forward to 2020 when Robert decides to cash in the bond, as he wants to recruit more staff and replenish stock. There have been no tax consequences whilst the bond has been in force, as the original value has been stated. Now that he is surrendering the bond, a gain will be disclosed. Let's assume that the bond has increased in value to £220,000, giving a gain of £20,000.

The gain is effectively grossed up, as HMRC treats the bond gains as net of 20% life fund taxation, which, when added in, gives a gain of £25,000 for tax purposes. Corporation tax in 2020 is expected to be 17%. So £25,000 @ 17% is £4,250.

ABCD gains £20,000 – with no corporation tax payable

However, no tax is due because of the taxation already paid within the bond. ABCD will receive £220,000 when it cashes in the bond. If this had been an offshore bond, the £4,250 would be payable, as no life fund taxation would have been paid during the life of the bond.

If Robert had simply left this cash in the bank, for example in a two-year fixed account earning 1.5%, it would of created a £3,000 gain for the company, and corporation tax would be payable on gross interest received. Assuming all interest is added at the end of the two-year term, £510 would be deducted giving a net gain of £2,490.

The value of your investments can go down as well as up, so you could get back less than you invested. A pension is a long-term investment. The fund value may fluctuate and can go down. Your eventual income may depend upon the size of the fund at retirement, future interest rates and tax legislation. Tax advice which contains no investment element is not regulated by the Financial Conduct Authority. LighthouseCarrwood Limited is an appointed representative of Lighthouse Advisory Services Limited which is authorised and regulated by the Financial Conduct Authority.

We are experienced in helping business owners and directors make surplus funds work harder. We would be happy to work with you to advise your clients about how they can do this in a tax-efficient manner. To refer clients to us or to discuss how we could work together, email Phil Mason, Business Development Director, LighthouseCarrwood Limited.
phil.mason@lighthousegroup.plc.uk.

We would like to thank Prudential for their input into this article.

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