

GUIDE TO OFFSHORE LIFE OR CAPITAL REDEMPTION PLANS FOR UK RESIDENT COMPANIES

INTRODUCTION

The purpose of this guide is to give you information about the use of offshore plans as a potential investment vehicle for UK resident companies. This information will allow you to consider whether an offshore plan may be a suitable investment for UK resident corporate clients who are looking for assistance with effective tax planning and investment strategies.

INVESTMENT FLEXIBILITY

An offshore plan may be a suitable investment vehicle for corporate clients who require a broad investment choice. Offshore plans offer a much more expansive choice of funds in comparison to their onshore counterparts. If your corporate clients demand a choice between thousands of investment funds, including pooled funds such as unit trusts and open-ended investment companies (OEICs), institutional funds, hedge funds, cash deposit accounts and many more, then an offshore plan may be worthy of consideration.

INTERNAL TAXATION OF THE FUNDS WITHIN AN OFFSHORE PLAN

Offshore plans are designed to accumulate income and gains within their funds. They offer what is known as “gross roll-up” because no Income or Capital Gains Tax is deducted from the underlying funds, with the exception of a small amount of withholding tax deducted from certain income producing funds.



CORPORATE TAXATION

Both life assurance and capital redemption versions of offshore plans are taxed under the Loan Relationship Rules where they are owned by UK resident companies and not under the Chargeable Events legislation which applies where the plan is owned by either individuals or trustees.

WHAT ARE THE LOAN RELATIONSHIP RULES?

The Loan Relationship Rules were first introduced in 1996 to deal with the taxation of debt and

interest. A company has a “loan relationship” when it is either a creditor or a debtor for a money debt arising from a transaction to do with the lending of money. Loan relationships include bank loans, bank deposits, mortgages and gilts, as well as more complex financial instruments.

HM Revenue and Customs (HMRC) makes it clear that companies must bring into tax the profits and losses arising from their loan relationships that reflect generally accepted accounting practice and in particular, using an authorised accounting method.

ACCOUNTING STANDARDS

Based on regulations set out by the Financial Reporting Council (FRC), UK companies must adhere to ASBs (Accounting Standards Board) rules for accounting, known as Financial Reporting Standards (FRS) and there are a number of rules that a UK company might use in accounting for an insurance contract.

In January 2016, the Financial Reporting Standard for Smaller Entities (FRSSE) was withdrawn and replaced with the New 'Generally Accepted Accounting Practice' (New UK GAAP) or Financial Reporting Standard 102 (FRS102).

UK resident companies holding an offshore plan are subject to either FRS 102 or the small entities regime (Section 1A Small Entities of FRS 102). Such companies must report on a fair value accounting basis and the Loan Relationship Rules still apply.

A small entity is defined as a company that qualifies as small under sections 382 to 384 of the Companies Act 2006, providing it was incorporated under Company law. The relevant size thresholds for a small company under FRS 102 section 1A is:

- Turnover doesn't exceed £10.2m
- The balance sheet doesn't exceed a total of £5.1m
- Number of employees doesn't exceed 50 employees.

MICRO-ENTITIES

From 1 January 2016 micro-entities are subject to FRS 105 which is based on FRS 102, however the accounting rules differ slightly in that micro-entities cannot, by law,

adopt the fair value or alternative accounting rules. Instead they will be able to claim the historic cost basis providing the company meets at least two of the three following conditions:

- Turnover doesn't exceed £632,000
- The balance sheet doesn't exceed a total of £316,000
- Number of employees doesn't exceed 10 employees

ACCESS

An offshore plan can be surrendered in whole or in part at any time (subject to any exit penalties). This means that the value of the plan can be readily realised in unforeseen circumstances.

Ordinarily, UK resident plan owners have the ability to withdraw up to 5% of total payments made, each plan year on a cumulative basis without incurring an immediate tax charge. This is not a feature of the Loan Relationships Rules and as such corporate investors are unable to take advantage of this feature.

PERSONAL PORTFOLIO BONDS (PPBs)

The PPB provisions fall under the Chargeable Events Legislation. As mentioned earlier, where a plan is held by a UK resident corporate, it is not taxed under the Chargeable Events regime.

Companies can therefore access a much larger range of assets than those available to individual or trustee investors. This is the case irrespective of the accounting basis the company uses.

SUMMARY

Small companies that meet the definition for the micro-entity regime under FRS 105 are still able to claim the 'historic cost' basis, therefore tax deferral is still available, until monies are accessed from the plan..

However, companies which do not meet the criteria required to be a micro-entity will need to account for the plan on a 'fair value' basis. As such, any increase in the value of the plan year on year, will be subject to taxation.

The only exception to this rule is if the plan invests solely into cash deposits and fixed income funds and therefore meets the criteria as a 'basic financial instrument', the 'historic cost basis' can still be used.

IMPORTANT NOTES

For financial advisers only. Not to be distributed to, nor relied on by retail clients.

Finally, please note that every care has been taken to ensure that the information provided is correct and in accordance with our understanding of current law and HMRC practice as at April 2024. You should note, however, that we cannot take on the role of an individual taxation adviser and independent confirmation should be obtained before acting or refraining from acting upon the information given. The law and HMRC practice are subject to change.