

INVESTMENT

VENTURE CAPITAL TRUSTS,
ENTERPRISE INVESTMENT
SCHEMES, & BUSINESS RELIEF





Independent Financial Advisers - Financial Life Planners



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Introduction

For those of you looking for more adventurous investments or highly tax efficient areas – or both – there are some enticing options available to you.

These include Venture Capital Trusts (known simply as VCTs), Enterprise Investment Schemes (EISs) and Business Relief qualifying investments.

Stand alone or combined, in the right circumstances these options can produce attractive and dynamic investment possibilities, financial planning outcomes and tax efficiency.

Our aim in this guide is to provide an outline of how each works, to identify where or when they may be used and to include some simple examples of their application.

However, a word of warning from the start, these are investments or areas for more experienced investors, they are often considered high risk and should only be pursued once expert and appropriate regulated advice has been taken.

ATTRACTIVE AND
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Venture Capital Trusts (VCTs)

VCTs are listed companies. Their purpose, however, is to act like a fund, in the sense that they invest in other companies, smaller businesses that need investment.

You invest into a VCT, which in turn invests into a pool of smaller companies, which are either unquoted or listed on AIM. This stands for Alternative Investment Market and this is a sub-market of the London Stock Exchange.

This means these 'underlying' companies and their shares, which are acquired by the VCT, are sometimes referred to as being illiquid. This makes them higher risk and in adverse circumstances could be difficult to buy and sell.

To encourage investors to back smaller companies in this way, the Government offers a series of tax benefits to investors who invest into VCTs:

- **Income tax relief of up to 30% on the invested sum**
- **Tax free dividends paid to investors, from any profit generated**
- **Exemption from Capital Gains Tax**

VCTs do not offer any Inheritance Tax exemption, the value of a VCT will be included in an Estate on death. These tax advantages can complement other financial planning strategies including pensions and Individual Savings Accounts (ISAs).

Enterprise Investment Schemes (EISs)

As with the VCTs, the concept behind the EIS is to allow investors to support smaller companies at their inception or early growth stages and in return receive, as an incentive for the risks involved, generous tax breaks.

VCTs will always be 'pooled' investments, investing into a pool of underlying companies.

EIS can be either made through a fund, a similar idea, where the fund invests into a pool of companies, or it can be into a single company. That is a difference to the VCT option.

In addition, the EIS has a further part to it known as the Seed Enterprise Investment Scheme (SEIS) which is specifically to back very new companies or 'Start-Ups'. The SEIS offers enhanced tax benefits.

To encourage investors to support investment via the EIS/SEIS there are tax benefits, and these are different to the ones available via VCTs:

- **Income tax relief of up to 30% on the sum invested (50% for SEIS)**
- **Exemption from Capital Gains Tax**
- **If losses are incurred, these can be offset against income tax – this is known as Loss Relief**
- **Freedom from Inheritance Tax after two years via Business Relief**
- **Deferral of Capital Gains Tax (CGT) incurred on disposal of other investments**

Business Relief (BR)

Business Relief (BR) is a tax relief given under the Inheritance Tax (IHT) legislation.

It was originally introduced to allow business owners to pass on businesses to their beneficiaries free of any Inheritance Tax. The reason was to prevent businesses from having to be sold on the death of an owner to meet an IHT liability.

There is no cap on how valuable a business may be, so even a business worth many millions would be Nil Rated for Inheritance Tax.

Today it is more widely available to private investors and this means any qualifying investment held for at least two years, will have 100% relief from Inheritance Tax.

An investor can buy shares in a Company, which meets the qualifying criteria, and the value of those shares on death will be free of IHT. Provided they have been held for two years.

Shares in AIM listed companies and unquoted shares can also meet the qualifying criteria.

EIS Investments can also qualify for Business Relief due to the investor buying shares directly in the company. VCT's being collective, fund like investments do not qualify for Business Relief.

Tax planning and tax efficiency

You will note from the basic outline of each of these three different investment options and the tax positions relating to each, that there are a host and variety of favourable tax breaks.

How to use these in your situation will be influenced by your own tax position and your long-term financial planning goals.

It is worth highlighting an additional point:

The two most mainstream tax-efficient investments are generally considered to be Pensions and ISAs. Both have attractive tax breaks attached, but both have limitations which can sometimes cause difficulties.

For example, pensions have limits on how much can be paid into them (contribution limits) and a maximum amount that can be accumulated before a charge is imposed on the excess (lifetime allowance).

When these restrictions become relevant then the alternatives of a VCT or EIS can become very

attractive, as both allow for much greater annual investments to be made, but still with 30% income tax relief applied.

An ISA, whilst allowing for sums to be accumulated inside a tax-free account, will become part of an Estate on death. The option of an EIS or BR qualifying investment, where there is no IHT becomes very attractive in comparison.

The ISA rules now include AIM ISAs, this means such ISAs will qualify – after two years – for freedom from Inheritance Tax.

How the schemes compare

Maximum investment amounts

VCT - the maximum annual investment for VCTs is £200,000

EIS - the maximum investment is £1 million per year, which is raised to £2m if at least £1m is invested in knowledge-intensive companies

Holding Periods

Both VCTs and EISs provide 30% income tax relief.

VCT - the investment must be held for a minimum of five years, to be eligible for tax relief

EIS - the investment must be held for a minimum of three years to be eligible for tax relief

Dividends and Capital Gains

VCT - dividends and capital gains are free of tax, there is no minimum holding period relating to these reliefs

EIS - dividends from an EIS investment are taxable; there is no tax on capital gains (the investment must be held for a minimum of three years to get the freedom from Capital Gains Tax) PLUS, if the investment incurs a loss, 'loss relief' is available. This means the value of the loss can be offset against other taxes

Capital Gains Tax (CGT) Deferral

VCT - CGT Deferral is NOT available

EIS - CGT deferral is available. This is NOT limited to £1 million; it can be higher. Capital gains from three years before or one year after can be invested into the EIS. The deferral means the tax that would otherwise be payable on disposal of an asset, is held over until such time as the EIS itself is cashed in. This means investors with large gains can shelter those gains for many years.



Inheritance Tax (IHT)

VCT – The value of a VCT will be included in an Estate for IHT purposes

EIS – An EIS will NOT be assessed for IHT on death, if held for a period of more than two years

There are many other technical aspects which we are not detailing within these pages, for example the ability in some cases to carry forward and back investments made between tax years or the different qualifying conditions for different types of business assets for BR, such details may be incredibly important to decisions you make in the future. These details can be explored when your personal position is assessed with a professional adviser.

Examples of how investors use the schemes

The use of VCTs and EISs is very much dependent on a mix of an individual's financial situation, including their tax position and their long-term goals. How to integrate this with the use of Business Relief is likewise circumstantial.

Here are some basic ideas and examples of where the schemes can be particularly attractive:

Pension Planning - Rarely is a VCT or EIS a good substitute for a pension. However, where annual pension contributions are being maximised or the lifetime limit for pensions is a factor, then supplementing with a VCT makes perfect sense.

Retirement Income Planning – VCTs offer tax free dividends and many VCT funds use this to actively pursue a strategy of making regular pay-outs. This means investors can make an investment into a VCT, obtain 30% income tax relief, and then receive a tax-free annual income. This can be very attractive to those investors looking for an income from invested capital in retirement.

Offsetting a Large Capital Gain – Take the example of an individual making a £100,000 capital gain and this attracts a Capital Gains Tax (CGT) of £28,000. The individual can use an EIS investment to defer that tax. They don't need to pay it, or they can get it back if previously paid. They will also be entitled, if they have enough income, to income tax relief of £30,000, reducing the cost of the EIS investment to £70,000. Or £42,000 if the deferred gain is considered. They have £100,000 in the EIS to – hopefully – grow. The £28,000 tax is payable later when the EIS is disposed of.

Selling a Business – BR should be a significant consideration for people selling a Business. The irony is that shares in a limited company often, but not always, automatically qualify for BR, but once disposed of the cash value achieved immediately becomes liable to Inheritance Tax. For example, if Bob sells his Business for £1 Million, he now has £1 Million and this would be subject to Inheritance Tax. If Bob reinvests his sale proceeds into a BR qualifying investment he continues to enjoy the freedom from IHT and will still have access to the funds.

Inheritance Tax Planning – A couple in their late 80s have significant assets and now need less income than earlier in retirement, they have not made outright gifts through their retirement as

they were unsure how much money they would need. But they have reached a stage where they can comfortably make gifts from their Estate – but realise that doing so may involve living 7 years for the gifts to be free of IHT. They can consider instead using a Business Relief qualifying fund which brings freedom from IHT after just two years. Also, if circumstances change the BR investment is still available for them to access in the event of an unexpected need for cash (e.g. for healthcare).

Risks involved and other considerations

In simple terms, VCTs are operating in the same way as a fund, whereby you invest into a VCT which in turn invests into a reasonable number of small companies.

An EIS, on the other hand, is an investment into a single company. However, it is possible to invest with an EIS manager who runs an EIS portfolio which invests your money into many different single company investments. Thereby, creating the effect of an EIS fund or portfolio.

In both cases, the VCT 'fund' and the EIS 'portfolio' you can diversify the money you allocate into a reasonable number of companies. This diversification is important in terms of risk.

The nature of the companies that qualify for VCT/EIS investment is that they are smaller, early stage and/or growth companies, which makes them riskier than, say, a large established Company listed on the main Stock Exchange.

This is high risk investing. The ability to diversify offsets this to some degree. The risk can be defined in a couple of ways.

One is that the share price of any company could fall, even to zero (a total loss) and prices in such companies are likely to be more volatile than most other investments.

The other risk is that the market for the shares may be 'illiquid' – there is no guarantee of a buyer and whereas with mainstream shareholdings, on a major exchange, one would expect, always, to find a buyer, with these smaller companies shares this may not be the case, especially in difficult times.

Therefore, the more you can spread across a basket of smaller company shares, the less chance of outright loss.

Taking advice

The risks and complexities of VCTs, EISs and BR are such that seeking professional advice is of paramount importance.

In this guide we have outlined the main points for anyone to consider, but the full extent of the technical factors involved, some of which we have not covered, make this an area of financial and tax planning where it is easy to trip up.

Moreover, any individual will have various options available to them, which could be a straight choice between a VCT and an EIS or a combination of both including the use of Business Relief.

You will also have various options towards different VCT or EIS 'fund managers' and will need to select which ones to work with, again specialist advice could make a big difference in this regard.

Maximising the position favourably and even the question of whether these are suitable options needs the help of an expert. We are well-placed to deliver such help and advice to you.

History, structure, and expertise

Interface Financial Planning started providing independent financial advice in 1992. From the beginning it had the aim of providing professional advice and quality service to people with modest income and wealth.

Its key value was putting people before profit, and contribution before reward. This mission statement has been our torch to light the path ahead and has been the reason that we have endured for over 24 years.

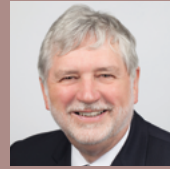
Alan has lead the company with his personal values of: Integrity, Compassion, Respect, & Loyalty, and he is proud that over the years he has worked with clients who share similar values. Like him they want to help others and make the world a little better.

Client care and service is important and he is proud that his first two clients from January 1990 remain his clients today.

We believe that every client should have access to highly qualified advice and expertise.

Technology is used to the full to maximise efficiency and engage expertise from throughout the UK. The business has been paperless for 10 years and for over 5 years has been 'cloud' based. This structure reduces costs and allows support staff to operate anywhere - from Colchester to Honiton to Leicester and elsewhere.

Clients are encouraged to access their online account where they can exchange messages and documents securely. They can view their investments and reports, and they have immediate access to their paper file. Clients love the transparency and openness of being able to view and print paperwork going back for years and many clients use it as a source of reference.



ALAN MORAN
Owner, Director
Interface Financial Planning

Alan Moran is one of the most highly qualified advisers in the UK. He became a Certified Financial Planner in 1995 and he was one of the first Chartered Financial Planners in 2005.

He is a Chartered FCSI, a holder of the IMC certificate and member of CFA UK. His expertise has been called upon by The CII, The IFP, The Kinder Institute, and others, where he has trained and examined other financial advisers.

Alan Moran B.Sc. M.Soc.Sc. Cert.Ed. FPFS FSWW IMC CFP^{CM} RLP[®]

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Compliance

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The information contained in this guide is based on legislation as of the date of preparation and this may be subject to change.

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CONTACT US

Alan Moran

0121 554 4444

enquiries@interface-ifa.co.uk

To book an appointment, schedule a call by telephone/Skype or arrange an online meeting, visit:

www.interfacefinancialplanning.co.uk