# Montpellier Guide to Tax Efficient Investments

## Enterprise Investment Schemes

Enterprise Investment Schemes (EIS) were introduced by the government to encourage individuals to invest in small start up companies, which typically involve a higher degree of risk than investments into larger companies and those traded on the main market of the London Stock Exchange. Montpellier advise on EIS investments that give investors access to qualifying investments that are structured in a way that does not expose them to the volatility and uncertainty that characterises a typical EIS investment.

### The Investments

EIS investments may take place into a range of different companies. Among the most popular at the moment are companies focussing on renewable sources of energy and technology. There are EIS's for a wide range of possible investments and investment will be into a small UK companies. This makes the level of risk significant, but there are some considerable tax advantages to investors which can make EIS's attractive.

### The Tax Advantages

There are a wide range of tax reliefs linked with an EIS that make them an attractive proposition for certain clients and they often form part of a wide strategy for financial planning.

- Income Tax Relief
- Capital Gains Tax Deferral
- Capital Gains Tax Relief
- Business Property Relief
- Loss Relief

### Income Tax

The income tax relief is only available to individual investors. You may benefit from income tax relief of up to 30% on a maximum investment of £1,000,000. This will allow tax relief up to £300,000. It should be noted that you only benefit from income tax relief if you have paid that amount in income tax! In order to benefit from the 30% relief the investment will have to be held for a minimum of three years.

### Example

£100,000 investment into an EIS will qualify for income tax relief for £30,000 which may be offset against your income tax liability for the year of investment, or it may be set against the previous tax year!


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## Capital Gains Tax

There is no Capital Gains Tax (CGT) to pay on the disposal of the EIS shares providing that they have been held for a minimum of three years.  If however the EIS shares are held for only 18 months and then sold and if there is any increase in value since inception there will be CGT to pay on the gain and also the income tax relief will be lost as the minimum holding period is three years.

## Capital Gains Tax Deferral

This is available to individuals and trustees of certain trusts. The payment of tax on a capital gain can be deferred where the gain is invested in shares of an EIS qualifying company. The gain can arise from the disposal of any kind of asset, but the investment must be made within the period one year before or three years after the gain arose.

There are no minimum or maximum amounts for deferral and it does not matter whether the investor is connected with the company or not. Unconnected investors may claim both income tax and capital gains deferral relief.

There is no minimum period for which the shares must be held; the deferred capital gain is brought back into charge whenever the shares are disposed of, or are deemed to have been disposed of under the EIS legislation.

If a recent liability to Capital Gains Tax had arisen for £50,000 resulting in a tax liability at 28% (£14,000), this gain could be deferred indefinitely by investing into the EIS.

## Business Property Relief

For some older clients who may have a possible exposure to Capital Gains Tax (CGT) whether because of investment properties or investment portfolios, an EIS investment can be a solution to unlocking the Capital Gain, but also mitigating possible Inheritance Tax (IHT). EIS Investments traditionally qualify for BPR after two years of investment which means that the value of the investment will not form part of the estate when assessing any liability to IHT. The key advantage is that during lifetime it is possible to unlock the Capital Gain which maybe deferred into the EIS, so that the CGT liability never comes into charge; further on the basis that the investment will qualify for BPR there will be no IHT to pay either.

## Loss Relief

If the shares are disposed of at a loss, you can elect that the amount of the loss, less any Income Tax relief given, can be set against income of the year in which they were disposed of, or any income of the previous year, instead of being set off against any capital gains.

## Why are there so many tax advantages?

The tax advantages have been increased over the last few years.  The Government have identified that in order to stimulate the economy they need to widen the approach of their fiscal policy and look beyond quantitive easing and interest rates!  The Government accept that small to medium sized business in the UK add significant benefits to the economy and see them as integral to the long-term development of the economy and it is for this reason that the tax advantages to an EIS investment have continued to increase.

## Venture Capital Trusts

Venture Capital Trusts are similar to an EIS as the investment will be made into small UK companies. The difference is in the structure, as a VCT is a company structure which is a pooled investment like a Unit Trust, the difference is the type of companies and the concentration of investment making the structure of a VCT slightly different to that of an EIS.

Smaller companies have been described as the 'lifeblood of the UK economy', which is why the UK government offers serious tax incentives aimed at attracting investors.

## The Tax Advantages

- Up to 30% income tax relief on the amount subscribed (up to a maximum of £200,000 per tax year and provided the shares are held for a minimum of five years)
- Tax-free dividends
- Tax-free capital gains on the disposal of shares
- Smaller companies do carry an element of risk, which is why it is important to find a VCT provider with skill and expertise in this highly specialised area. At Montpellier regularly review who is in the VCT market and into what types of investment they are making.
- Income Tax Relief - You may invest a maximum of £200,000 into a VCT in a single tax year. This means that you may benefit from income tax relief up to a maximum of £60,000 (providing that this amount of tax is chargeable).

The income tax relief may be reclaimed should the VCT be sold within 5 years of investment.

### Example

£50,000 investment into an VCT will qualify for income tax relief of £15,000 which may be offset against your income tax liability for the year of investment.

## Tax Free Dividends

Where dividends are paid on a VCT they are paid free of additional rates of tax and therefore become attractive to higher and additional rate tax payers.

## Capital Gains Tax

There is no ability to defer Capital Gains Tax into a VCT in the same way that you can with an EIS, but with a VCT there is no CGT on disposal regardless of how long the VCT has been held.

We hope that you have found this brief guide useful. If you would like to find out how this may affect you or if you would like to learn how to implement elements of this planning within your financial affairs then please contact us on the details below.

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