SAUNDERSON HOUSE

Special Briefing

Tax-Efficient Investing for High Earners

Introduction

High earners and wealthy individuals are finding it increasingly difficult to shelter their income and capital from the taxman. This is part of a deliberate policy from the government, who have made a number of tax reforms in recent years to increase tax revenue and reduce the fiscal deficit. Most notable among these are changes to pension legislation, with people earning more than £150,000 a year (including their employer pension contribution) seeing their pension annual allowance drop to £10,000 per year and, unless they hold one of the forms of Lifetime Allowance Protection, their lifetime allowance fall to £1m. Individual Savings Accounts (ISAs) remain an attractive investment vehicle, although with annual contributions restricted to £15,240 (rising to £20,000 from April 2017) they only provide a limited tax shelter. Buy-to-let investing has been a successful strategy for some, providing a steady level of income in retirement and, in many areas, strong capital growth too. However, increases in stamp duty on buy-to-let properties (and second homes) and restrictions to landlords' mortgage interest relief now make this less appealing. Finally, with asset prices having risen sharply since the 'nil rate band' was fixed at £325,000 in April 2009 (to be reviewed in April 2017), beneficiaries are increasingly left with inheritance tax bills to pay.

This changing landscape is driving investors to look at other tax-efficient investment schemes, namely Venture Capital Trusts (VCTs), Enterprise Investment Schemes (EISs), Seed Enterprise Investment Schemes (SEISs), Social Investment Tax Relief (SITR) and Business Property Relief (BPR). In this guide we look at each of these schemes in detail, showing how they help investors to mitigate or avoid future tax liabilities, recoup tax already paid and receive tax-free income and gains, depending on the product. An overview of the tax reliefs is shown in Fig. 1. It is worth noting that these options will not suit everyone and they are not substitutes to more conventional tax shelters such as pensions, ISAs, CGT allowances and gifting. However, they can be effective when used appropriately and, for high earners and wealthy individuals, should be included in wider financial planning discussions.

Fig. 1: Overview of Tax Reliefs

	Maximum investment	Income tax relief	CGT relief / deferral	Tax-free dividends	Tax-free growth	IHT free	Loss relief
VCT	£200,000	30%	No	Yes	Yes	No	No
EIS	£1,000,000	30% + carry back	Deferral	No	Yes	2 years	Yes
SEIS	£100,00	50% + carry back	50%	No	Yes	2 years	Yes
SITR	£1,000,000	30%	Yes	No	Yes	No	No
BPR	Unlimited	No	No	If in ISA	If in ISA	2 years	No

Source: HMRC

Venture Capital Trusts

VCTs were introduced in 1995 to encourage investment into small UK companies (having assets of less than £15m and no more than 250 employees at the point of investment). They are closed-ended investment companies listed on the London Stock Exchange. They pool investors' money and employ a professional manager to make qualifying investments. VCT fundraising is seasonal, with offers typically launching towards the end of the year and lasting for as long as there is capacity. This can be a matter of days for the most in-demand share issues. Offers may be open to new investors or restricted to existing ones.

VCT investors receive 30% income tax relief on their subscription, do not pay tax on dividends received and are not subject to capital gains tax (CGT) on realisations. However, VCT shares must be held for a minimum of five years in order to keep the tax breaks and, with the exception of 'Limited Life' VCTs (see below), investors should be prepared to remain invested for considerably longer.

Different VCT managers implement various investment strategies in order to achieve their goals, though their focus falls into one of four broad areas:

- **Generalist VCTs** invest in a wide range of (predominantly) unquoted companies across different sectors. They are 'evergreen' in nature – i.e. they don't have predetermined wind-up date – and tend to focus on high growth, high risk investments. They aim to deliver tax-free income and/or capital growth, with the bulk of an investor's return likely to come from the former (paid from income produced within the portfolio as well as from the sale of portfolio holdings).
- **AIM VCTs** invest in companies whose shares are traded on AIM. Like Generalist VCTs, they are diversified across different sectors, focus on rapidly growing businesses, are evergreen in nature and aim to deliver tax-free income and/or capital growth.
- **Specialist VCTs** focus on one sector, such as media or technology. Their lack of diversification may make them more risky than other VCTs, although this will depend on the investment focus. They aim to deliver tax-free income and/or capital growth.
- **Limited Life VCTs** primary goal is to return the invested capital at a modest profit (which may come in the form of dividends) at a predetermined date, typically as soon as possible after the trust has passed its five-year qualifying period. They tend to be managed more conservatively than the other VCTs, with a greater focus on capital preservation.

Since VCTs are listed, they can be bought and sold on the stock market. However, the secondary market for VCT shares is highly illiquid, meaning that even if a buyer can be found, many VCT shares trade at substantial discounts to their respective net asset values (NAVs). Further, as the price of shares bought on the secondary market is determined by supply and demand, should these not align (as is often the case), the difference between the buying and selling price (the spread) may be wide. Disposing of a VCT holding in the secondary market may therefore only be possible at a price significantly below the NAV of the shares. A large number of VCT managers do, however, offer share buy-back schemes, which they typically undertake at a c5%-15% discount to NAV.

Whilst illiquidity means that VCT share prices may not be an accurate reflection of underlying portfolio value, the fact that they are listed and report their asset values on a timely basis means that it is possible to monitor and evaluate performance. This sets them apart from the other tax-efficient schemes discussed herein, which are unquoted and only provide valuation information to existing investors, typically on an annual or biannual basis as part of a review. Moreover, although the valuation methodology for all schemes is similarly subjective (with respect to unquoted holdings), the listed nature of VCTs means that there is a 'sense check' by the market, which might caution managers against inflating valuations to enhance perceived performance (and unrealisable gains).

Our preference is for Generalist VCTs and AIM VCTs above Specialist VCTs and Limited Life VCTs, as this is where we have found the highest quality managers (in our opinion), strongest track records and it is where we consider the investment strategies to be best aligned with the spirit of the VCT rules. Moreover, since no tax is due on dividends from VCTs, the prospect of a Generalist or AIM VCT delivering a long-term income stream at an attractive yield is appealing, and differentiates the investment from the other tax-efficient schemes.

It should be noted, however, that new qualifying rules introduced on 18 November 2015 in The Finance (No.2) Act 2015 will have a material impact on the investment strategies employed by a number of Generalist and AIM VCT managers. It will specifically affect those managers who focus on established, 'later stage' businesses (bringing the age limit rule into consideration) and/or management buy-outs (now prohibited), reducing deal flow and possibly pushing up valuations as managers compete for business. While the changes only relate to new investments, existing investors will be impacted when new money is raised for existing share pools and/or holdings are sold and reinvested. Over time, this is likely to change the shape of the VCT portfolios to have greater exposure to earlier stage businesses whilst diluting exposure to MBOs. We would expect this to gradually increase the risk profile of these VCTs. However, it is worth emphasising that this will be a slow process and dependent on the level of fundraisings and realisations. We anticipate a more immediate impact is likely to be fewer and smaller fundraisings among this group of VCTs.

VCT case study - Generalist and AIM VCTs

David is a high earner and comfortable taking a higher level of investment risk. He makes full pension and ISA contributions, uses his dividend allowance and annual CGT exemption, and is looking at other tax-efficient ways to supplement his income in retirement. He plans to work for another five years and will have considerable surplus income over that period. After meeting with his financial adviser, David agrees to invest £50,000 per year for the next five years into a range of VCTs, which will reduce his income tax liability by £15,000 each year (30%).

Below we assume that the VCTs achieve their target dividend yield of 5% and there is no movement in capital values. In practice, however, dividends may be higher or lower in any given year and capital values are likely to fluctuate

When David enters his first year of retirement, he has a VCT portfolio with a NAV of £250,000 at a net cost of £175,000 (after income tax relief). He would have already received £37,500 in tax-free dividends and stands to receive a further £12,500 in tax-free dividends each year thereafter if the VCTs continue to meet their target. David must remain invested for five years to keep all of the tax breaks provided, but thereafter his VCT holdings could be sold if required without any income tax or CGT implications. David understands that any sale would be at a discount to NAV.

Enterprise Investment Scheme

The EIS was introduced in 1994 as the successor to the Business Expansion Scheme. It is designed to help small UK trading companies raise finance by offering a range of tax incentives to investors who purchase new shares in those companies. The tax treatment is generally more advantageous than that of VCTs, with both receiving 30% income tax relief on the amount invested, but EIS investors able to carry relief back to the tax year prior to when the shares are issued, defer capital gains tax, claim 'loss relief' on any realised losses (on each underlying investee company) and qualify for inheritance tax relief on the investment (provided the shares have been held for two years and are still held at the time of death). Moreover, the minimum holding period in order to keep the tax breaks is shorter, at three years. However, unlike VCTs, EIS investments do not qualify for tax-free dividends and, as they are not listed, there is no secondary market through which investors may sell their shares. This means that the only exit route is through sale of the underlying investments, with an investor's returns likely to be achieved wholly in this manner (i.e. no dividends). Investors should therefore pay close attention to the exit strategy of the EIS investment as a guide to the expected holding period, bearing in mind that the exit may be dictated by, or at least closely tied to, economic and market conditions.

There are three main types of EIS investment:

- **EIS Companies,** representing a direct investment in the eligible shares of a single EIS qualifying company. This may include a company set up by an EIS manager/adviser that qualifies for EIS tax relief. Investment horizons vary from just over 3 years to much longer holding periods. Fundraisings for EIS Companies are launched throughout the year and open for a limited period of roughly three months, closing sooner if fully subscribed.
- **EIS Managed Portfolios,** a discretionary portfolio invested in shares of a number of EIS qualifying companies (typically 6-10). These are managed by a fund manager and are generally available for investment all year round, with an investor's subscription allocated to a spread of deals typically over a 12-18 month period. The manager generally targets an investment horizon of 4-10 years, with money returned to investors sequentially as the underlying holdings are exited.
- **EIS Funds** (Approved and Unapproved), allowing money pooled from a number of investors to be subscribed for shares in a range of EIS qualifying companies selected by a fund manager. These open for a limited period, raise money and then close. The manager generally targets an investment horizon of 4-10 years, with money returned to investors sequentially as the underlying holdings are exited. Approved EIS Funds are not common in the marketplace.

Given their structure (unquoted and either single companies or a concentrated portfolio of companies) and the fact that the same restrictive qualifying criteria applies to investments as that for VCTs, we would consider EIS investments to be above VCTs in the risk spectrum. However, at this upper end, EISs range from high growth, high risk strategies to more conservative strategies that are structured with a focus on capital preservation. The high growth approach is more common for EIS Managed Portfolios (EIS case study 1) and EIS Funds, while the conservative approach is more common with EIS Companies, specifically those that are set up by an EIS manager/adviser (EIS case study 2).

Investors should be mindful that, for the purposes of claiming tax relief, the relevant date is the date when the EIS shares are issued and not the date when the investment is made1. This means that, for EIS Managed Portfolios and Unapproved EIS Funds, claiming tax relief will be lumpy, as the shares are only issued after each underlying investment is made. However, investors can take advantage of 'carry back' relief, so that shares issued over two successive tax years are treated as being received in the same period.

More importantly, investors should be aware that only the amount invested in EIS shares receives tax relief. This is not an issue for EIS Companies, where the whole subscription is in EIS shares. However, for EIS Managed Portfolios and EIS Funds, where the manager sets aside initial and annual management fees, typically only 90-95% of the subscription is invested in EIS shares and therefore receives tax relief.

Companies can apply to HMRC in advance of offering shares to check that they meet the qualifying criteria. This 'Advanced Assurance' gives investors added confidence that the company is undertaking a qualifying trade (or at least plans to) and that the shares will qualify for tax relief at the time of issuance. When considering an EIS Company for investment, we would recommend that Advanced Assurance is attained before making a subscription. This does not apply to EIS Managed Portfolios or EIS Funds since the fund manager selects the underlying companies only after the investor has invested.

As a result of the tax treatment and shorter minimum holding period, EISs can be used more tactically than VCTs from a financial planning perspective. However, liquidity is a key consideration and may limit any planning objectives, while the timing of tax relief should also be considered.

EIS case study 1 - EIS Managed Portfolio

Wendy is 40 and works in the City. She earns £400,000 per year and has an adventurous risk profile. She would like to invest in a higher risk strategy with the potential for high reward. She does not require income and is comfortable 'locking up' her capital for a number of years. Wendy agrees to invest £100,000 into an EIS Managed Portfolio. Over the next 18 months, the EIS manager invests £95,000, after fees, into six qualifying companies. Wendy receives EIS 5 certificates in respect of these holdings on which she claims £28,500 income tax relief. The net cost of her investment is £71,500. Over the next seven years, two of her investments are sold at a multiple of 2 x cost, one at 1.5 x cost, one halves in value and two are complete failures. The proceeds from these are £95,000, which is equal to the amount the EIS manager invested into the companies. However, after claiming loss relief (£11,400) and when accounting for the income tax relief received (£28,500), Wendy's total return is £134,900 on £100,000 invested. The percentage return on the net investment is 48%.

Company	**1**	**2**	**3**	**4**	**5**	**6**	**Fees**	**Total**
Amount invested	£15,833	£15,833	£15,833	£15,833	£15,833	£15,833	£5,000	£100,00
Income Tax Relief	£4,750	£4,750	£4,750	£4,750	£4,750	£4,750	n/a	£28,500
Proceeds of Sale	£31,666	£31,667	£7,917	nil	nil	n/a	n/a	£95,000
Loss Relief at 45%	nil	nil	nil	£1,425	£4,988	£4,987	n/a	£11,400
Total Return								**£134,900**

EIS case study 2 - EIS Company

Gary is a high earner and has just crystallised a £1m gain on the sale of a second property. He does not want to reinvest in the property market at this point and balks at the idea of paying the £280,000 capital gains tax charge. He also has a £300,000 income tax liability. He asks his financial adviser about EIS as a way of eliminating his income tax bill and deferring his capital gains tax bill. Gary is comfortable taking a higher level of investment risk, although would prefer some form of asset-backing and/or capital preservation to his investment. He agrees to invest £1m into an EIS Company that owns and operates infrastructure assets. The Company targets a return of £1.10 per £1 invested after four years. Gary plans to roll over the proceeds into another EIS Company and hopes to indefinitely defer his capital gains tax bill assuming the rules still allow him to do so. He plans to work for another 10 years, over which period his income tax liability will be at least £300,000 per annum. It will then drop to £50,000 per annum (although it is worth noting that he would only need an income tax liability in the year of or prior to investing).

Below we assume that a return of £1.10 is achieved in each and every four-year holding period and money is reinvested the following year. We also assume that Gary holds EIS shares on death, and that these shares are then held by his beneficiaries until the Company is wound up.

Year	Investment	Income Tax Relief	CGT Deferral	Net cost of investment	Total Return*	Proceeds paid out
0	£1m	£300,000	£280,000	£420,000	£1. 1m	£100,000
5	£1m reinvested	£300,000	n/a	£120,000	£1. 1m	£100,000
10	£1m reinvested	£300,000	n/a	(£180,000)	£1. 1m	£100,000
15	£1m reinvested	£50,000	n/a	(£230,000)	£1. 1m	£100,000
20	£1m reinvested	£50,000	n/a	(£280,000)	£1. 1m	£1. 1m
Total	**£1m**	**£1m**	**£280,000**	**(£280,000)**		**£1.5m**

**Total return on £1m invested*

Gary's CGT liability lapses on death and the investment is exempt from inheritance tax. His initial £1m investment was rolled over four times and in doing so he received £1m income tax relief whilst avoiding the £280,000 CGT bill originally due. The net cost of his investment was therefore minus £280,000 (i.e. he received more in tax relief than he invested) with proceeds paid out over the 25 years accumulating to £1.5m. Of these proceeds, £1.1m is exempt from inheritance tax (being the investment held at death) and £400,000 was received by Gary (free of CGT) whilst alive.

Seed Enterprise Investment Scheme

The SEIS was launched in 2012 to encourage investment into start-ups where access to capital is very limited. SEIS investments are structured in the same fashion as EIS investments (i.e. unquoted and can be an investment into a single company or a portfolio of companies), but have larger tax breaks to compensate for the higher risk nature of the qualifying restrictions.

Most notably, the SEIS offers 50% income tax relief on subscription, while it also offers capital gains reinvestment relief, allowing investors to roll a chargeable gain on the disposal of assets into qualifying SEIS shares, with half of the reinvestment amount exempt from CGT. SEIS investments also qualify for loss relief and IHT exemption, although capital gains deferral is not permitted (reinvestment relief supersedes this). As with the EIS, investors are taxed on any dividends received (and thus unlikely to be paid). An investor taking advantage of all the available tax reliefs would be able to mitigate losses to 17.5% of the investment amount (including 50% income tax relief, 10% capital gains reinvestment relief[2] and 22.5% loss relief for additional rate taxpayers), while the maximum downside for an EIS investment would be 38.5% and for a VCT it is 70%. Therefore, from a tax treatment perspective, SEIS investments are the most attractive proposition.

From a risk perspective, however, SEIS investments are the most speculative. This is because in order for a company to qualify for SEIS relief, its trade must be no more than two years old (and the company must not have carried on a different trade prior to this), it must have assets of less than £200,000, have fewer than 25 employees (each at the point of investment) and it is not allowed to raise more than £150,000 from government-backed schemes (SEIS or otherwise) in any tax year (versus £5m per tax year for companies under the EIS). The investment opportunity is therefore inherently very risky and this should be a key consideration when assessing its suitability.

Another consequence of the limited amount of capital that a SEIS qualifying company can raise is that the SEIS is not a viable product offering for most investment managers/advisers. Therefore, there are very few SEIS offers in the marketplace and those investment opportunities available are for shares in a single company rather than an investment in a portfolio of companies

[2]Assuming CGT at 20%, although the reinvestment relief would be 14% if the gain was from a residential property.

SEIS case study 1 - total loss

Fred is an additional rate taxpayer with taxable gains on a substantial portfolio of stocks and shares. He is willing to accept very high risks in pursuit of high tax-free gains and is aware that SEIS provides an element of downside protection through loss relief. His financial adviser recommends that he invests in a small media company that qualifies for SEIS status. Fred invests £100,000 and reclaims £50,000 upfront tax relief plus £10,000 CGT reinvestment relief. Tax reliefs therefore represent 60% of his original investment. Unfortunately, the media company has cash flow problems and goes into administration. Fred's shares are worth nothing so he claims loss relief, which reduces the net cost of his investment by another £22,500 thereby limiting his after-tax loss to £17,500.

SEIS case study 2 - unchanged share price

Martina is in a similar financial position to Fred and backs a start-up recruitment firm that qualifies for SEIS status. She invests £100,000, reclaims £50,000 upfront income tax relief and, because she has gains from a recent property sale, is able to claim £14,000 CGT reinvestment relief. Tax reliefs therefore reduce the net cost of her investment to £36,000. The recruitment firm sees rapid growth in its first two years, although the economy turns downwards and, by the end of the third year, the firm's future looks uncertain. A trade buyer offers to acquire Martina's shares for £100,000 and she accepts. Even though the value of her investment has not increased, the tax reliefs mean that she achieves a £64,000 profit (tax-free).

Social Investment Tax Relief

SITR was introduced in the Finance Act 2014 to encourage individuals to support social enterprises and help them access new sources of finance. Investments are made in organisations with a defined and regulated social purpose. Charities, community interest companies or community benefit societies carrying out a qualifying trade, with fewer than 500 employees and gross assets of no more than £15m may be eligible. Investments in companies set up to carry out a Social Impact Bond are eligible for SITR, but only if the company has received accreditation from the Cabinet Office.

SITR is modelled on the EIS, with investors able to claim 30% income tax relief on the amount invested, either for the tax year in which the investment is made or the previous tax year (the investment must be held for a minimum period of three years for the relief to be retained), CGT deferral and CGT exemption on disposal of the qualifying social investment itself, although dividends or interest received are subject to income tax.

Since most social enterprises do not have ordinary share capital, qualifying investment can be provided as either unsecured debt or equity, which is not the case for EIS. No debt instrument need be issued – a straightforward loan suffices – although funds must be sent directly to the social enterprise (an assignment of the debt from a third party does not qualify) and the debt must rank lower than other types of borrowing in the event of a winding up.

Another difference between SITR and the EIS is the trades that count as 'qualifying'. Unlike the EIS, an investment can be made in a social enterprise that leases assets, operates or manages hotels, operates or manages nursing homes or residential care homes, holds, manages or occupies woodlands, or carries out other forestry activities including timber production.

However, a notable limitation to SITR relative to the EIS is the amount of money that social enterprises can raise under the scheme. At present, a social enterprise is limited to raising €344,827 (c£250,000) in SITR investment over three years, meaning that much like the SEIS it is not a viable product offering for most investment managers. The government has said that it will apply for EU state aid clearance to increase the SITR limit to match the EIS, however, given the UK's anticipated exit from the EU, any developments look unlikely before 2019. The political backdrop is also likely to delay any progress to the proposed Social VCT scheme, which is designed to replicate many of the features of the existing VCT and SITR schemes.

We have seen very few SITR opportunities since the scheme was introduced and we do not expect this to change while fundraising limits are low.

Business Property Relief

BPR was introduced in the 1976 Finance Act and permits individuals full relief from inheritance tax on transfers of 'relevant business property'. This includes a business, an interest in a business, unlisted shares and most shares quoted on the Alternative Investment Market (AIM).

In order to qualify for BPR on death, qualifying assets must have been held for at least two of the previous five years and still held at the time of death. BPR is also available on gifts of business property provided that the property is owned by the recipient throughout the period between the gift and the death of the transferor, or the earlier death of the recipient.

Aside from IHT exemption, the appeal of BPR schemes as an estate planning solution includes:

- Efficiency, the value of the investment should be fully exempt from IHT after only two years. Other methods can take up to seven years.
- Control, the investor retains the beneficial ownership of the investment and access to funds. Other methods can require the individual to give up control of their assets.
- Simplicity, there are no complex legal structures, client underwriting or medical surveys. There is no maximum age limit.

The rules stipulating what qualifies for BPR are less restrictive than those in place for VCTs or EIS; for example, shares do not need to be newly issued and there are no gross asset restrictions. Certain conditions do apply, however, to prevent the relief being obtained where the business of the company in question is mainly comprised of dealing in securities, stocks or shares, land or buildings, or in making or holding investments. It should be noted that BPR relief is assessed by HMRC on a case-by-case basis at the time of death of the investor and, as such, is not guaranteed.

There are two main types of BPR scheme in the marketplace: one invests in the shares of an unlisted BPR-qualifying company and the other invests in a portfolio of AIM-listed stocks. The unlisted company is usually operated/advised by an investment manager and has a relatively conservative business model designed to preserve capital whilst delivering modest growth. Typical trading activities include secured lending, asset leasing, media financing (e.g. to television and film production companies) and renewable energy production. The AIM portfolio solution is managed by a professional investment manager on a discretionary basis and is designed to generate strong investment returns but taking a higher level of risk.

Since 2013, when the Government changed the rules to allow AIM-listed shares to be held in an ISA, it has been possible to transfer existing investments in an ISA into BPR-qualifying AIM investments, thereby sheltering an individual's ISA assets from inheritance tax. Of course, the AIM portfolio is likely to be higher risk than the portfolio of stocks listed on the Main Market. However, with 40% inheritance tax potentially due on the standard stocks and shares ISA portfolio (subject to the individual's wealth exceeding the inheritance tax-free allowance), the AIM ISA portfolio effectively has a big performance cushion to compensate for this risk.

When assessing a BPR scheme, liquidity should be a key consideration. This is particularly important for schemes focused on unlisted companies, as the individual will either need to sell the shares back to the company (which is the most common method) or to another investor in order to exit.

Estate Planning case study 1 – unlisted BPR-qualifying company

Graham is 78 and wants to minimise the inheritance tax bill his children will face whilst retaining control of his investment should he need it to cover long-term care if his health deteriorates. He has a large family home in his name, considerable assets in his pension and a taxable share portfolio of £800,000. After speaking with his financial adviser, he decides to sell his taxable share portfolio and invest in an unlisted BPR-qualifying company ("the Company").

The Company targets a return of 3% per annum, although has a 2% initial charge and a 1% dealing fee levied on purchase and sale of the shares.

Graham passes away five years later, over which period the Company's shares have risen by 3% per annum. His children sell his holding and receive proceeds of £890,600. This full amount is free of inheritance tax.*

**£800,000 x 0.97 = £776,000 (investment less initial fee and dealing fee for purchase) £776,000 x (1.03x1.03x1.03x1.03x1.03) = £899,597 (five years of growth at 3% per annum) £899,597 x 0.99 = £890,600 (less dealing fee for sale)*

Had Graham continued to hold his taxable share portfolio until death and, assuming the same investment return, his children would have received proceeds of £556,452 after inheritance tax.*

**£800,000 x (1.03x1.03x1.03x1.03x1.03) = £927,419 (five years of growth at 3%) £927,419 x 0.6 = £556,452 (less inheritance tax at 40%)*

Graham's taxable share portfolio would have had to grow by 13% per annum over the five years to have generated the same proceeds as the BPR solution.

Estate Planning case study 2 - AIM Inheritance Tax ISA portfolio

Susan is 74 years old. Her home and savings are valued considerably higher than the current inheritance tax-free allowance of £325,000. Included in these savings she has ISA investments worth £100,000. After meeting with her financial adviser and confirming that she's comfortable with the risks, Susan transfers her ISAs into an AIM Inheritance Tax ISA. Susan passes away some years later. Stock markets have been volatile over this period and her AIM portfolio has lost 15% in value. Her ISAs are therefore worth £85,000 on death, although with no inheritance tax liability on this (since the investments are BPR qualifying), the full amount is passed on to her beneficiaries. The investments she previously held have performed better and are up 10%. Had she remained invested in these then her ISAs would be worth £110,000. However, her beneficiaries would have 40% inheritance tax to pay on this, meaning that only £66,000 would have been passed on.

Conclusion

When assessing a BPR scheme, liquidity should be a key consideration. This is particularly important for schemes focused on unlisted companies, as the individual will either need to sell the shares back to the company (which is the most common method) or to another investor in order to exit.

In recent years it has become more difficult for high earners and wealthy people to shelter their income and capital from the taxman. The tax-efficient investment schemes discussed in this paper outline a number of ways in which investors can mitigate or avoid future tax liabilities, recoup tax already paid and receive tax-free income and gains, depending on the product.

It is important to recognise that the schemes are not suitable for all individuals and investors must understand and be comfortable with the level of investment risk inherent in the products. However, their high risk nature should not automatically be viewed as a negative, with the track records of some managers showing strong investment returns even without tax reliefs factored in.

It should be noted that HMRC has changed the rules governing the schemes in the past and may do so again in the future. However, these changes have been targeted more at the qualifying criteria than the tax allowances, with the most recent changes to tax incentives providing greater rather than less relief. VCTs, the EIS and BPR are well established schemes and we anticipate growth in these areas as investors look for additional financial planning options given restrictions to more conventional tax shelters.

We would recommend that interested investors seek information and advice from specialist financial professionals before making a subscription.

Geoffrey Challinor
Investment Analyst

D: 020 7315 6519
E: geoffrey.challinor@saundersonhouse.co.uk

Saunderson House Limited
1 Long Lane, London EC1A 9HF

T: 020 7315 6500
F: 020 7315 6650
E: shl@saundersonhouse.co.uk
www.saundersonhouse.co.uk

Registered in England. Address as above. Number 940473
Authorised and Regulated by the Financial Conduct Authority.