FINANCE UPDATES

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CAMPBELL & McCONNACHIE

chartered financial planners

Harbour House 1 Shore Street Lossiemouth
Moray IV31 6PD

INVESTING IN SMALL COMPANIES

The three main tax schemes to help you invest.

By their nature, small and relatively new companies tend to be considered a higher-risk investment than buying shares in larger, better-established businesses.

At the same time, they can come with greater potential for growth, more opportunities for mergers and acquisitions, and a less crowded investment market.

Fortunately for investors who are comfortable with the extra risk involved, there are additional rewards for investing in small companies, in the form of three main tax schemes.

Venture capital trusts (VCTs), the enterprise investment scheme (EIS), and the seed enterprise investment scheme (SEIS) all aim to encourage investment in the UK's 5.7 million small firms.

Both the EIS and VCTs have proved popular with investors, as the market doubled in size over the last 10 years.

While investors have been taking advantage of their tax benefits and potential for high returns, the Government hopes the schemes make money for the Treasury and cement the UK's reputation as the world's entrepreneurial capital.

Planned reforms to the EIS show the Government's continued interest in using these schemes to support innovation, which can promote productivity, create jobs and boost the economy.

The Government would love to see a new Dyson or Arm Holdings emerge, which is why from April 2020, HMRC will require at least 80% of funds raised through the EIS to be invested in knowledge-intensive companies.

VENTURE CAPITAL TRUSTS

A VCT is a listed company that makes certain qualifying investments, mainly in smaller companies that are not quoted on stock exchanges.

According to HMRC's most recent statistics in December 2018, VCTs raised £745m in 2017/18 – the highest since 2005/06.

You can invest up to £200,000 and qualify for income tax relief at 30%, provided the investment is held for at least five years.

Profits on the sale of a VCT investment are exempt from capital gains tax (CGT), and no income tax is payable on dividends.

ENTERPRISE INVESTMENT SCHEME

Since the EIS was launched in 1993/94, 29,770 individual companies have received investment through the scheme, raising £20 billion in funds.

With the EIS, you can invest in companies that employ less than 250 members of staff, with gross assets of less than £15m prior to the investment. After the investment, they must have less than £16m in gross assets.

To qualify for the EIS, you need to retain the shares for at least three years from the date of issue. If you sell them or cease to qualify within three years, your tax relief may be withdrawn.

If you invest through the EIS, you can qualify for income tax relief at 30% on up to £1m of annual investments. If at least £1m is invested in knowledge-intensive companies, the allowance doubles to £2m.

You can also defer paying CGT on gains from these investments if you use some or all of your gain to invest in an EIS company. This must be done within one year prior, or three years after the gain was accrued.

Investors get relief against CGT, and in some cases income tax, for any losses which occurred after the sale of the EIS shares.

On top of this, it provides 100% exemption from inheritance tax as it qualifies for business property relief, making it worth considering as part of an estate planning strategy.

The EIS might be a good option for investors who want to take a more hands-on approach, as they allow you to participate in running the business and be paid to do so.

SEED ENTERPRISE INVESTMENT SCHEME

The SEIS is designed to help companies raise finance when they are starting to trade. It's intended to complement the EIS, and in some ways the rules are similar.

This scheme is available for investors with a shareholding that does not exceed 30%, and can include directors investing in their companies. As with the EIS, you must retain the shares for at least three years to qualify for the relief.

You can claim income tax relief of 50% on up to £100,000 of investments a year, and you have the option to have all or part of the shares treated as if they were acquired in the last tax year.

This is applied in the form of a reduced tax liability, as long as you have the tax liability to set it against.

You can also receive CGT relief on 50% of the investment, up to £100,000. The maximum amount you can get is £50,000.

WHICH SCHEME IS BEST FOR YOU?

These schemes are almost exclusively used for tax planning purposes, so it may be worth considering one or more of them after fully utilising other tax-efficient investment options, such as pension contributions and ISAs.

The schemes should be part of a mixed portfolio of investments, and should only be used by individuals who understand the increased risks that this type of investment may be exposed to.

You'll also need to be prepared to keep your money invested for at least three to five years, as early withdrawal may not be possible – and even if it is, penalties will be incurred.

As with any investment, it's important to remember the value can both rise and fall, and it is essential to seek professional advice before committing to any investment decision.

For a general overview of the similarities and differences between each scheme, see the table below.

Speak to us about creating an effective investment strategy.

	VCT	EIS	SEIS
Maximum annual investment	£200,000	£1m (or £2m in knowledge-intensive companies)	£100,000
Income tax relief	30%	30%	50%
Investment must be held for	Five years	Three years	Three years
Reinvestment relief period before gain made	n/a	One year	n/a
Reinvestment relief period after gain made	n/a	Three years	n/a
Tax-free dividends	Yes	No	No
Tax-free capital gains	Yes	Yes, after three years	Yes, after three years
Tax relief for losses	No	Yes, after three years	Yes, after three years
Inheritance tax business property relief	No	Yes	Yes

IMPORTANT INFORMATION

The way in which tax charges (or tax relief, as appropriate) are applied depends on individual circumstances and may be subject to future changes.

Certain investments, such as the EIS and VCTs, can be high risk and are not suitable for all investors. Specialist advice is essential to establish both eligibility and suitability for such schemes.

While the EIS and VCTs may have significant tax benefits, the value of investments can fall as well as rise and you may not get back all, or even any, of the amount you originally invested. This document is solely for information purposes and nothing in it is intended to constitute advice or a recommendation. You should not make any investment decisions based on its content.

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