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Deferring capital gains by investing via an EIS portfolio

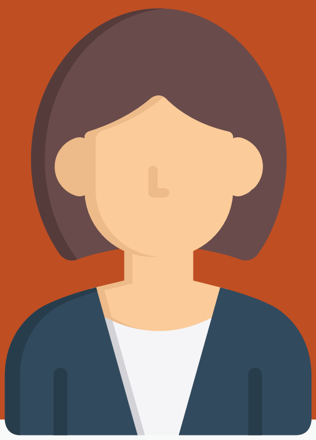
Clients who have realised a taxable gain – for example, by selling investments or a second home – can defer the Capital Gains Tax (CGT) due on the proceeds by investing into the shares of companies which qualify for the Enterprise Investment Scheme (EIS).

With careful planning, a CGT bill can be deferred until there is no CGT left to pay.

Benefits of tax-efficient investments are subject to change and personal circumstances.

Don't invest unless you're prepared to lose all the money you invest. This is a high-risk investment and you are unlikely to be protected if something goes wrong.

Take 2 minutes to learn more on page 4



Meet the client

Victoria has a buy-to-let property she no longer wants. She sells the property for £250k. The profit Victoria made after her annual Capital Gains Tax (CGT) allowance was £50k and, as a higher rate taxpayer, she was required to pay £12k in CGT within 60 days of selling the property.

Victoria asked her financial adviser if there was any way to get this tax back. She was therefore delighted when her adviser let her know that yes, there was.

Guidance given by the adviser:

Victoria's adviser explained how investing the profit from the sale of the property into an EIS portfolio could help her defer her CGT bill and reclaim the £12k in CGT already paid.

In doing this, Victoria can also claim up to 30% Income Tax relief on the value of her investment, meaning she would receive a refund from HMRC of £15k against Income Tax paid in the current or previous tax year. All profits made on her EIS investment would be completely tax free, subject to holding her EIS shares for at least three years. The investment would also be free from Inheritance Tax (IHT) after it had been held for two years and provided it was still held at the time of her death.

The adviser explained that her EIS investment allowed Victoria to defer her CGT bill, effectively transferring the CGT liability from the buy-to-let property to the portfolio. As a result, when the EIS-qualifying companies in her EIS portfolio were sold or reached an exit, the CGT bill would become payable again. However, her EIS portfolio would feature at least ten different companies, which in all likelihood would be sold or would reach an exit in different tax years. Victoria could therefore use future annual CGT allowances against the deferred gains when CGT again became due.

Even in a scenario where several EIS portfolio companies were sold in the same year over and above her annual CGT allowance, Victoria could reinvest some of the proceeds of the sales into another EIS-qualifying investment, re-defer the remaining gain, and repeating this process until there was no CGT bill left. Also, if Victoria died while still owning her EIS portfolio, any remaining CGT liability would be eliminated upon her death. The investment would also be exempt from IHT (if it had been held for 2 years).

Without an EIS investment

Profit on sale of BTL property: **£50,000**

CGT due: **£12,000**

With an EIS investment

Investing **£50,000** profit into EIS defers CGT bill

£12,000 CGT paid can be reclaimed from HMRC

Sale of EIS-qualifying portfolio companies can be offset against annual CGT allowance potentially saving the **£12,000** in CGT

Income Tax relief of up to 30%: **£15,000**

IHT exemption after two years
(provided shares still held at time of death)

Clients must be advised that this example is for illustrative purposes only and ignores initial and annual charges. Please refer to our product literature for further details.

Background

Since its introduction almost 30 years ago, the EIS has become a valuable tax-planning tool. The UK Government launched it in 1994 to encourage investment in start-ups and early stage companies.

Tax Reliefs

The EIS offers a range of valuable tax reliefs to encourage investment and reduce the risks involved. Investors must have a sufficient income tax liability to benefit from the tax reliefs available.

Supporting the UK Economy

Investing in EIS-qualifying businesses positively contributes to the UK's economic growth, enhances innovation reputation, actively supports entrepreneurial ventures, fostering job creation and economic productivity.

EIS Tax Benefits

Up to 30% Income Tax relief
in the current or previous tax year, providing investments are held for a minimum of three years.

100% (IHT) Exemption
on qualifying investments in as little as two years (and if held at time of death).

CGT deferral relief
The EIS shares you subscribe for must be issued to you in the period beginning one year before, and ending three years after, the date of the disposal for which you wish to claim relief.

Offsetting of capital losses up to 45%
Dependent on marginal rate of Income Tax at time of loss. Capital losses of one portfolio company can be claimed irrespective of the performance of other companies in the portfolio.

Growth free of CGT
if Income Tax relief has been claimed.

Carry back to previous tax year
(for Income Tax relief).

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Risks

Due to the potential for losses, the Financial Conduct Authority (FCA) considers this investment to be high risk.

What are the FCA key risks?

1 - You could lose all the money you invest
If the business you invest in fails, you are likely to lose 100% of the money you invested. Most start-up businesses fail.

2 - You are unlikely to be protected if something goes wrong
Protection from the Financial Services Compensation Scheme (FSCS), in relation to claims against failed regulated firms, does not cover poor investment performance. Try the FSCS investment protection checker. (https://www.fscs.org.uk/check/investment-protection-checker)

Protection from the Financial Ombudsman Service (FOS) does not cover poor investment performance. If you have a complaint against an FCA-regulated firm, FOS may be able to consider it. Learn more about FOS protection. (https://www.financial-ombudsman.org.uk/consumers)

3 - You won't get your money back quickly
Even if the business you invest in is successful, it may take several years to get your money back. You are unlikely to be able to sell your investment early.

The most likely way to get your money back is if the business is bought by another business or lists its shares on an exchange such as the London Stock Exchange. These events are not common.

If you are investing in a start-up business, you should not expect to get your money back through dividends. Start-up businesses rarely pay these. (https://www.financial-ombudsman.org.uk/consumers)

4 - Don't put all your eggs in one basket
Putting all your money into a single business or type of investment for example, is risky. Spreading your money across different investments makes you less dependent on any one to do well.

A good rule of thumb is not to invest more than 10% of your money in high-risk investments. (https://www.fca.org.uk/investsmart/5-questions-ask-you-invest)

5 - The value of your investment can be reduced
The percentage of the business that you own will decrease if the business issues more shares. This could mean that the value of your investment reduces, depending on how much the business grows. Most start-up businesses issue multiple rounds of shares.

These new shares could have additional rights that your shares don't have, such as the right to receive a fixed dividend, which could further reduce your chances of getting a return on your investment.

If you are interested in learning more about how to protect yourself, visit the FCA's website. (https://www.fca.org.uk/investsmart)