The Red House

Tasty tax savings; but do you have the investment and risk appetite?

The recent weekend financial pages have been dusting down those old tax wrapper favourites, Venture Capital Trusts (VCTs), Enterprise Investment Schemes (EISs) and its younger sister Seed Enterprise Investment Schemes (SEISs). And who can blame them? They have space to fill and the headline tax incentives are certainly eye catching:

	VCTs	EISs	SEISs
Annual investment limit	£200,000	£1,000,000	£100,000
Income tax relief	30%	30%	50%
Tax free dividends	Yes	No	No
CGT relief	Tax free capital gains but no CGT deferral	If income tax relief is claimed tax free capital gains after 3 years and unlimited CGT deferral	If income tax relief is claimed tax free capital gains after 3 years. CGT deferral is available in 12/13
IHT benefits	None	Investment should qualify for Business Property Relief (BPR) after 2 years	Investment should qualify for Business Property Relief (BPR) after 2 years
Minimum holding period	5 years	3 years	3 years
Loss Relief	None available	Losses can be offset against income or capital gains tax	Losses can be offset against income or capital gains tax

So far so good. But let's have a closer look at the nature of the underlying investments. One of the prime roles we play at TRH for our clients is that of risk management. The table below reviews the investment characteristics of these structures against TRH's Investment Committee risk management criteria:

Risk management criteria	VCTs	EISs	SEISs
Liquidity	Needs to be held for 5 years to maintain tax reliefs. Listed but difficult to sell at net asset value as limited open market.	Needs to be held for 3 years to maintain tax reliefs. Limited ability to sell the holding.	Needs to be held for 3 years to maintain tax reliefs. Limited ability to sell the holding.
Diversification – number of holdings	Generally up to 30 or so stocks held	Single company only	Single company only – maximum gross assets of company £200,000 and less than 2 years old
Diversification – geography	Needs to have a permanent UK base. Generally little if any overseas diversification	UK only	UK only
Fees and costs	Typically 2% plus initially and in excess of 1.5% a year	Typically 2% plus initially and in excess of 1.5% a year	Typically 2% plus initially and in excess of 1.5% a year
Active fund management?	Yes	Yes	Yes

So what are our conclusions?

The features of VCTs and EISs do not meet with our carefully considered risk management principles. The underlying investments are poorly diversified, high-risk, illiquid and focus on specialised markets or sectors. If they were attractive they wouldn't require a tax incentive. As a principle we would advise clients never to invest just to avoid or defer tax. For these reasons the schemes will not form part of our core offering to our clients.

However, we recognise that the tax incentives offered by these structures are very alluring if used sparingly and if they do not form part of a client's mainstream investment portfolio. If one has spare cash sometimes a bet can be exciting!

In summary, our view is that these structures may be suitable as a high risk, illiquid investment to add 'tax alpha' (or in lay man's terms, a return based on tax incentives, not necessarily the investment performance) at the fringes of an individual's carefully structured investment portfolio. Not quite akin to Gareth's horseracing tips but heading in that direction!

We would like to gauge interest amongst our clients for these investments. If you feel that the tax reliefs are attractive to you, given the risks we highlight, please do let us know and we will provide you with a more detailed report tailored to your personal situation.

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Notes and risk warnings

This article is distributed for educational purposes and should not be considered investment advice or an offer of any security for sale. This article does not represent a recommendation of any particular security, strategy or investment product. Information contained herein has been obtained from sources believed to be reliable but is not guaranteed.

Past performance is not indicative of future results and no representation is made that the stated results will be replicated.

VCTs are high risk investments and there may be no market for the shares should you wish to dispose of them. You may lose your capital.

Enterprise Investment Schemes (EISs) and Seed Enterprise Investment Schemes (SEIS) are very high-risk investments. An EIS/SEIS investment is usually concentrated in one single unquoted trading company. Often there is no market for the shares and it may therefore be very difficult to make a disposal. There is a strong possibility of the chosen company failing.