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Tax-efficient investments and the tax year end

The tax year end provides a great opportunity for advisers to review their clients' portfolios and ensure they are making the most of the tax-efficient investment options available to them. In this factsheet, we consider a range of planning points in relation to tax wrappers and tax-efficient investments.

If you only read one thing…

- Use of investment bonds may be an attractive way to defer an income tax liability, particularly for those paying tax at higher marginal rates. Those looking to withdraw in excess of the 5% allowance from their investment bond should consider this in the context of their overall income profile and marginal rates to determine which side of tax year end they would be better off doing so, bearing in mind the potential availability of top-slicing relief.
- Consider the IHT efficiency of clients' investment portfolios and the potential to secure Business property relief (BPR) on shares in some Aim-listed companies.
- Those with a greater appetite for risk may want to consider EIS, SEIS or VCT investments (see text below). To carry back an EIS subscription for income tax relief in 2018-19, it must be made before 6 April 2020.
- VCT investments within the £200,000 annual limit that are then held for at least five years qualify for an immediate 30% income tax reducer worth up to £60,000, tax-free dividends from the VCT shares and tax-free capital gains on eventual disposal of the shares.

Investment bonds

Investment bonds (structured as single premium life assurance policies) offer investors the opportunity to defer an income tax liability until the point withdrawals are made or a bond is surrendered. This may be attractive to those who are currently higher or additional rate taxpayers but who may expect to pay income tax at a lower marginal rate in future years.

Investments within onshore bonds are subject to the corporation tax regime applicable to life assurance companies. Investors benefit from a 20% tax credit in relation to any chargeable event gains arising on withdrawal or surrender. Offshore bonds benefit from gross roll-up of investments due to no internal tax charges. However, there is no basic rate tax credit for the investor when a chargeable event gain is triggered.

Remember that, for the first 20 years, up to 5% of the value of the initial premium can be withdrawn each policy year without triggering an income tax liability. Clients considering making withdrawals in excess of this amount, or surrendering segments of their bonds, will want to consider this in the context of their overall income profile and marginal rates of income tax to determine which side of the tax year end they would be better off doing so. Basic rate taxpayers pushed into the higher rate band by chargeable event gains on bonds may benefit from top-slicing relief. Depending on the number of years the bond has been held, this may reduce or eliminate any additional tax payable on a bond withdrawal or surrender.

Inheritance tax-efficient investments (IHT-efficient)

Assets that secure full IHT relief because they qualify for business property relief (BPR) after two years of ownership are attractive for those undertaking later-life inheritance tax planning. Shareholdings in companies quoted on the Alternative investment market (Aim) are considered 'unlisted' for this purpose only and therefore potentially qualify for BPR. Care must be taken to check the qualifying status of each Aim investment – there are a number of Aim-listed property businesses and investment funds that do not meet the requirements. It is also important to monitor for secondary listings on recognised stock exchanges in other jurisdictions, which would be detrimental to the availability of BPR.

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Venture capital trusts (VCT)

VCTs are investment companies that are listed on the London Stock Exchange and set up to invest in small, unquoted, UK businesses that meet certain criteria. An investor's acquisitions of VCT shares are capped at £200,000 per tax year.

The government offers generous tax benefits for VCT investing, reflecting the higher-risk nature of the companies they invest in:

- Income tax relief – an income tax reducer equal to 30% of the value of VCT shares acquired, provided the shares are retained for five years.
- Tax-free dividends – no income tax to pay on dividends from VCT shares.
- CGT relief – the client won't be liable to CGT when they sell their VCT shares.

None of the above tax advantages accrue on investments in excess of the £200,000 cap.

Enterprise investment scheme (EIS) and Seed enterprise investment scheme (SEIS)

EIS and SEIS involve investment in smaller unquoted trading companies. These investments are not suitable for everyone as they represent greater risk with limited liquidity. However, for sophisticated investors, the potential to realise significant returns relative to their initial investment and secure reduced tax liabilities may be attractive.

EIS

EIS is intended to attract private investments in early stage UK businesses. It offers tax reliefs designed to incentivise investors who are comfortable with the risk of subscribing for new shares in younger companies with growth potential. There are numerous qualifying conditions, both for issuing companies and investors.

For 2019-20 and subsequent tax years the maximum value of EIS-qualifying shares that can be subscribed for in each year is £2 million, provided any subscriptions in excess of £1 million are in knowledge-intensive companies. For previous tax years, the limit was £1 million. Qualifying subscriptions potentially benefit from the following tax advantages:

- Income tax relief – an income tax reducer equal to 30% of the value subscribed for new shares. Shares must be held for three years to avoid a clawback of this relief. It is possible to carry back an EIS investment to the previous tax year and claim the income tax reducer in that year, provided the overall limit for that year is not exceeded.
- CGT relief – there will be no CGT charged on any gain on EIS shares as long as the shares are held for at least three years.
- CGT deferral – clients can reinvest proceeds from any chargeable gain into EIS shares and thereby defer the gains for CGT purposes, usually until the EIS shares are subsequently sold.
- Capital losses – losses realised on disposal of EIS shares are allowable for CGT purposes. Similarly to losses on shares subscribed for in other unquoted trading companies, losses on EIS shares can also be utilised against income.
- Inheritance tax relief – most investments in EIS shares will qualify for BPR after two years.

SEIS

SEIS incentivises investors to place capital in start-ups seeking vital early stage funding. The maximum value of EIS-qualifying shares that can be subscribed for in each year is £100,000. Qualifying subscriptions potentially benefit from slightly more generous tax advantages than EIS that reflect the higher risk nature of investments in companies in their very early stages.

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