

WING TIPS

EIS shares and Inheritance Tax (“IHT”)

Most investors are probably aware of the income tax and capital gains tax benefits they can enjoy when they subscribe for shares in an Enterprise Investment Scheme (“EIS”) company or when they acquire units in a Venture Capital Trust (“VCT”). But do they realise that there are also very attractive inheritance tax (“IHT”) benefits associated with EIS shares?

First, let’s quickly remind ourselves of the income tax and Capital Gains Tax (“CGT”) benefits available in 2006/07 -

Income Tax

- Tax relief at 20% on up to £400,000 invested in EIS shares
- Tax relief at 30% on up to £200,000 invested in a VCT
- Dividends from a VCT are tax free
- Any capital loss on the disposal of EIS shares can be set against capital gains or against income of the year.

CGT

- Exemption from CGT on the disposal of share in an EIS company or units in a VCT, provided income tax relief was given in respect of those shares/units and has not been clawed back. (“disposal relief”).
- The hold-over of CGT in respect of gains on disposals to the extent that the gains are used to subscribe for shares in an EIS-qualifying company (but with no monetary limits). The held-over CGT becomes payable on the sale of the EIS shares.

There are various conditions that must be satisfied in order to secure these reliefs for the investors but they are not unduly onerous - which is why hundreds of million of pounds have been invested on EIS companies in VCT’s.

The IHT benefits come in the form of Business Property Relief (“BPR”). This effectively provides a complete exemption from IHT for the value of shares in an unquoted trading company, provided those shares have been held for at least two years prior to the chargeable lifetime gifts or the transfer on death. For these purposes shares in a company traded on Aim are “unquoted” and therefore qualify for EIS relief. If shares in a company qualify for EIS relief they will also qualify for BPR - but remember that the conditions that must be satisfied in order to qualify for EIS relief need only be satisfied for three years, so an EIS company may change and become one that does not qualify for BPR.

If the EIS shares continue to qualify for BPR, the benefits are very attractive. IHT is charged at a flat rate of 40% on the value transferred to the extent that it exceeds £300,000 (from 6th April 2007) but the value of EIS shares is excluded. Therefore if an individual dies owning a portfolio of EIS shares which are worth £1million and which still qualify for BPR, that value will attract no IHT charge. By contrast, £1million in a bank or building society, a £1million portfolio of quoted shares or an investment property worth £1million would give rise to an IHT charge of £490,000 (assuming that the value of the home exceeds £300,000 - or £600,000 in the case of a couple).

The other advantage of shares that qualify for BPR is that they can be transferred into a trust with no IHT entry charge. A transfer of assets worth over £300,000 not qualifying for BPR would result in an immediate IHT charge, as would a transfer of cash over £300,000. Even though the BPR-qualifying share might be sold for cash soon afterwards, there would be no adjustment to that zero IHT entry cost (provided there was not a binding contract for sale at the time of transfer).

Until last year wealthy individuals could make substantial lifetime gifts into a trust, say for the benefit of children or grandchildren, without any tax charge. If that individual survived for seven years after the gift there would be no IHT liability at any time for that him/her. It is now only relatively small gifts (usually up to £300,000) or gifts attracting special reliefs, like BPR-qualifying shares that can be transferred into trust with no IHT entry charge.

Therefore, the message is: don't look upon EIS shares as investments that have short-term or medium-term income tax and CGT advantages - there can also be substantial IHT benefits!

For further information on EIS shares and inheritance Tax please contact Brian Williams @ Vantis plc, on 020 7417 0417 or visit www.vantisplc.com