A Guide to Tax Efficient Investments

HARGREAVEHALE

contemporary thinking with traditional values

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Introduction

If you save or invest money, you'll generally have to pay tax on the interest or income you receive. This guide will look at some possible ways to help reduce the amount of tax you pay, making your investment portfolio more tax efficient.

There are a number of different types of tax efficient investments and investment strategies that we can give you advice on and recommend the most appropriate one's for you.

Here are a few of the main concepts, products and strategies that will be explained in this guide:

- Tax allowances
- Individual Savings Accounts
- Venture Capital Trust
- Inheritance Tax Portfolios
- Self Invested Pension Plans
- Enterprise Investment Schemes
- Pensions
- Junior ISA

Disclaimer

This document contains our understanding of current tax rules (tax year April 2012). It should not be taken as professional tax advice. Tax benefits referred to within depend on the individual circumstances and may be subject to future changes.

Individual Savings Accounts

Individual Savings Accounts (often referred to as ISAs) were introduced in 1999, replacing a similar scheme called PEPs that ran from 1987 to 1999.

An ISA is a tax-free wrapper which allows savers and investors the opportunity to protect all or part of their finances from the tax man. ISAs can be a tax-efficient way to manage your savings and investments and are particularly attractive to higher rate tax payers.

Why would I need an ISA?

ISAs allow you to build a portfolio of investments within a tax free wrapper. Investments within a Stocks and Shares ISA are free of all Capital Gains Tax (CGT) upon disposals and there no further taxes to pay on dividends received. If you hold cash in a Cash ISA then you will benefit from interest that is tax-free.

The Hargreave Hale Managed ISA means you can invest automatically into one of the funds run by Giles Hargreave and his team of investment managers, as well as the investment adviser of the Marlborough Extra Income Fund, with no ISA administration charges to pay.

If you would like a more flexible option, we also offer a Self-Select ISA which allows you to invest in a wider range of investments including any UK or foreign company listed on a recognised stock exchange, or any fund or investment trust, which meets the Revenue's ISA rules.

If you're in our Discretionary or Investment Managed Accounts your portfolio manager would look after your ISA needs.

What types of ISAs are available?

There are two types of ISA.

Cash ISA

A Cash ISA is designed to hold cash deposits up to the maximum annual subscription limit, currently £5640 (2012/13 tax year). Each investor may only open one cash ISA per tax year. The cash in the ISA will earn tax-free interest. Any UK resident 16 years or older can have a Cash ISA.

Stocks and Shares ISA

A Stocks and Shares ISA allows up to the maximum annual subscription limit, currently £11280 (2012/13) to be invested into stocks and shares. Only one Stocks and Shares ISA may be opened each year by an individual. Capital gains within the ISA are tax free and no further income tax is payable on any dividends or interest paid on investments within the ISA. There is also no income tax on any income taken from the ISA. Interest paid on cash balances held within a Stocks and Shares ISA is subject to a 20% charge by HMRC. Any UK resident 18 years or older may open a Stocks and Shares ISA.

How much can I invest?

The ISA annual investment allowance is £11280 (tax year 2012/13). You can invest the whole allowance into a Stocks and Shares ISA or £5640 into a Cash ISA and £5640 into a Stocks and Shares ISA.

If you have ISAs which are not currently managed by Hargreave Hale, we offer a free ISA transfer service to help you keep all your ISAs in one place.

Tax benefits depend on individual circumstances and may be subject to future change. You are able to withdraw cash or securities from your ISA at any time, but these cannot be put back into your ISA if doing so would take you over the annual subscription limit.

Junior ISA (JISA)?

A Junior ISA is a tax efficient savings and investments account which allows parents, other family members and friends to contribute, save and invest on behalf of a child. There are two alternative types of Junior ISA either in a "cash" or "stocks and shares" Junior ISA. A child will be able to hold one of each of these accounts as long as the amount contributed stays within the annual limit set by HMRC (£3600 in tax year 2012/13). However, the child cannot gain access to these accounts until they are 18 years of age, and no money can be withdrawn from the account until this time.

The tax benefits are as with a normal ISA, and we offer both the Managed and Self select options with the JISA.

What if I decide to close my ISA plan?

Should you decide to close your ISA and withdraw your investments, the tax benefits will cease at that point.

Self Invested Personal Pensions (SIPPs)

A Self-Invested Personal Pension (or SIPP) is a form of personal pension that allows you to save for your retirement by building an investment portfolio that you choose and manage yourself. A SIPP is a more flexible, hands-on version of a personal pension plan, which means you have more investment choices available to you and more control of your retirement.

Your contributions into a SIPP will generate direct tax savings and contributions will qualify for tax relief at the highest rate of tax you pay.

There is no limit on the amount of contributions that can be paid into a SIPP, but there are limits on the amount of tax relief these contributions will attract. Your member contribution will receive tax relief up to the higher of £3,600 and 100% of UK earnings in the tax year of payment.

The Lifetime Allowance applies to the total amount in your pension pot regardless of whether this is a single scheme or spread over multiple policies. The Lifetime Allowance threshold is expected to rise over the years to allow for the impact of inflation. Any value over the Lifetime Allowance limit will be subject to Lifetime Tax Charge at a rate of 55%.

The Hargreave Hale SIPP

The Hargreave Hale SIPP is ideal for investors who prefer to be in the driver's seat. We offer a low-cost, efficient service that allows you to control your pension investments effectively.

The Hargreave Hale SIPP:

- low cost to help you maximise portfolio returns
- wide range of qualifying investments, including stocks and shares (UK and international), investment trusts and unit trusts, OEICS, contracts for difference and hedge funds
- you choose how to control your SIPP – discretionary service, advisory service or execution only
- access to our experts – make the most Hargreave Hale's skilled and experienced investment teams
- tax benefits - investments within the SIPP are exempt from capital gains tax and investment income will be tax-free (with the exception of dividend payments on UK equities)

How can it be free?

Whether you're a discretionary, advisory or execution-only client, a SIPP could offer you the flexibility, choice and control you're looking for.

Within a SIPP there may be dealing charges or commissions on the transactions you make. We offset the annual fee against any dealing charges and for many people this will mean the SIPP will be free of any administration fees.

Inheritance Tax Portfolios

With property values remaining relatively high, more and more people have found that the value of their estate is higher than the Inheritance Tax (IHT) exempt threshold.

IHT may be mitigated by giving money away or putting it into trust. The principal drawback of these solutions is that access to the capital is lost - a very high price to pay. A more flexible way of mitigating IHT and maintaining access to capital is by using Business Property Relief (BPR).

The value of assets that qualify for Business Property Relief is disregarded for Inheritance Tax purposes, so long as they have been held for at least two years before death. The advantage is that, broadly speaking, AIM listed stocks qualify for Business Property Relief. Investing in a portfolio of AIM listed shares (securities) can quickly mitigate Inheritance Tax. As clients' assets develop progressively over time, pushing them over the exempt threshold, skilled IHT planning becomes more important to the success of investment portfolios.

How does it work?

The securities are included in the deceased's estate for probate purposes and revalued as at the date of death. However, if 100% Business Property Relief is available, the value of the securities will not attract death duties - no Inheritance Tax will be payable on their value at the time of death.

Hargreave Hale will construct a directly invested, diversified portfolio of securities, all of which potentially qualify for Business Property Relief. Composition will depend on the individual client's preference for risk and desire for income. Portfolios are designated as either growth, balanced or higher income from the onset. The number of individual securities purchased will range from 15-25, again dependent on the risk profile selected.

The investment risk related to companies that can potentially qualify for the IHT benefits varies from company to company.

In order to reduce the amount of risk, we employ a strict 'value' based discipline approach to stock selection. This process involves detailed analysis of the universe of stocks available. The securities selected will display some or all of the following characteristics:

- focus on organic rather than acquisition led growth
- the business has passed the test of time, i.e. has been through one or more business cycles
- a consistent trend of generating cash rather than just profit
- a clear commitment and track record of paying dividends
- a stable management team
- market value supported by tangible assets or yield

For more growth-orientated clients with a higher appetite for risk, a different approach would be adopted. Close attention is still paid to the management team, the cash flow characteristics of the business and also the 'quality' of the earnings.

Investment Risk

The Inheritance Tax Portfolios, Venture Capital Trusts and Enterprise Investment Schemes all invest in smaller companies. Shares of smaller companies carry higher risks as there can be liquidity issues, smaller management and shorter trading histories. Shares in smaller companies are also more sensitive to price movements. Due to the greater risks involved in smaller company investments, investors have the potential of receiving greater rewards.

Venture Capital Trusts

A Venture Capital Trust is a company, broadly similar to an investment trust, which has been approved by HMRC and which subscribes for shares in, (or lends money to), small unquoted companies, including those quoted on AIM or Plus markets. Under the VCT scheme, VCTs and their investors enjoy certain tax reliefs. The VCT scheme is designed to encourage individuals to invest indirectly in a range of small high-risk unquoted companies. The VCT invests in a spread of small unquoted companies, enabling investors to spread their risk, just as they do by holding shares in an ordinary investment trust.

Enterprise Investment Schemes

The Enterprise Investment Scheme (EIS) is designed to help smaller higher-risk trading companies to raise finance by offering a range of tax reliefs to investors who purchase new shares in those companies.

We have provided a breakdown below showing some of the main similarities and differences between these investment.

How do I benefit from investing in VCTs and EISs?

To encourage investment in small, growth-oriented companies, and as compensation for taking on some additional risk, investors in VCTs are eligible to receive a number of tax breaks:

1. Individuals who subscribe for new ordinary shares in VCTs and EISs at issue can invest up to £200,000 in VCTs for each tax year and £500,000 in EISs for each tax year. By doing this a VCT investor will qualify for 30% income tax relief and an EIS investor will qualify for 30% income tax relief.
2. The above relief will be withdrawn if shares are sold within five years for a VCT and within three years for an EIS.
3. Any gains accumulated on the sale of VCT shares will be free from Capital Gains Tax. This applies whether or not the shares were purchased at issue or via the secondary market. In the case of an EIS, Capital Gains Tax exemption only applies after shares have been held for three years.
4. Dividends are also received tax free for a VCT but not for an EIS. All investors in a VCT will receive tax free dividends whether investing from initial issue or via the secondary market.

A comparison of Venture Capital Trusts and Enterprise Investment Schemes

	Venture Capital Trusts	Enterprise Investment Schemes
Annual investment limit	£200,000	£500,000
Income tax relief	30%	30%
Clawback if held less than	5 years	3 years
Capital Gains Tax Deferral Relief	no	Yes if investment made up to 1 year before or 3 years after the gain made.
Tax free dividends	Yes	No
Tax free capital gains	Yes	Yes (after 3 years)
Tax relief for losses	No	Yes (after 3 years)*
IHT business property relief	No	Yes

* If a loss is realised on disposal, the investor can elect that the loss, less any income tax relief given, can be set against income of the year in which they were disposed of, or any income of the previous year.

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Risk Warning: Hargreave Hale services may not be suitable for everyone. Before investing in the stock market, please bear in mind that the value of investments and the income generated from them can fall as well as rise. Investing in the stock market should be done for the medium or longer term, and should be a part of personal financial planning which may also involve considering levels of debt and cash resources as well as pension provision and tax planning.

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