

Inheritance tax planning with EIS

Henry is an 80-year-old widower with an estate of £4m, far above the nil-rate band, and would like to ensure he leaves as much to his three children and seven grandchildren as possible.

He believes that at his age his life expectancy is not much more than five to ten years, and is keen to get his affairs in order. Henry wishes before his death to minimise the inheritance tax (IHT) on his estate and will do this by selling down some of his portfolio, which will incur a capital gains tax (CGT) bill of at least £60k.

- Henry has a £1.5m investment portfolio and a £1m pension. Whilst he is keen to reduce inheritable tax, he does not wish to give up control, as he has reservations about his children receiving sizeable sums.
- While Henry currently has sufficient income, he would not want to see this reduced due to his concerns for the future with potential energy price hikes and rampant inflation.

Henry's adviser will review tax-efficient investments to mitigate the CGT and IHT. Henry intends to hold onto these until death for the capital gains tax to die with him.



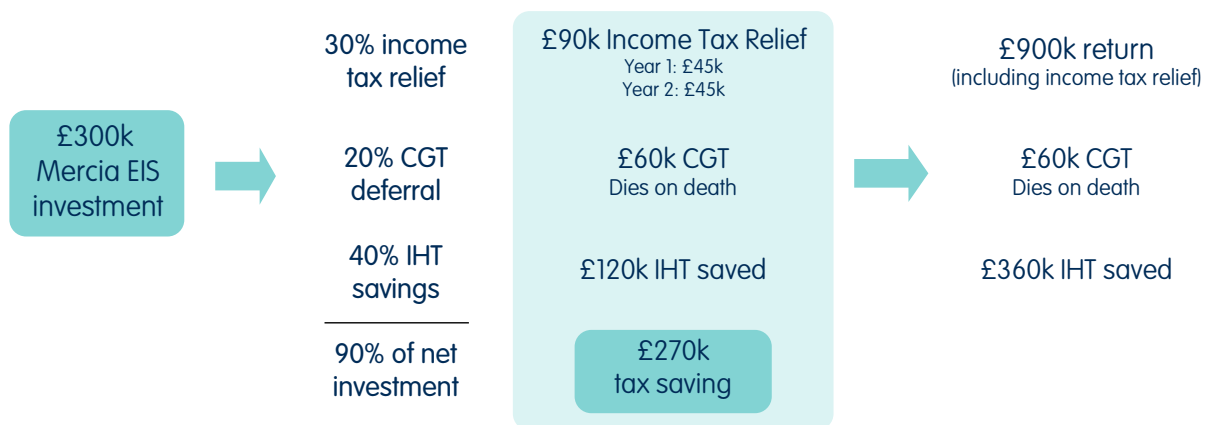
To mitigate CGT and minimise his taxable estate, Henry's financial adviser recommends an EIS of £300k that will be taxed at 0% for IHT after two years.

Using the EIS, any capital gains can be deferred and will die on Henry's death.

The investment of £300k would benefit from 30% income tax relief, equating to £90k. As this is over Henry's annual income tax liability of £50k, the adviser has recommended that the carryback across two tax years be utilised to ensure

that the full income tax relief is available.

Following any EIS exits, any reinvestment will immediately qualify for Replacement Property Relief, which applies when assets from the sale of one Business Relief qualifying asset are reinvested into another qualifying asset.



In total, Henry's EIS investment has benefited from 30% income tax relief, 20% capital gain tax deferral and 40% inheritance tax savings on his estate, making a total tax

saving of 90%. The large tax reliefs listed above strongly enhance the returns of this potentially high-growth asset class.

EIS and probate

Should the investor pass away within 2 years, before the EIS would qualify for business relief, there will be no clawback of the initial income tax relief and the CGT liability would also disappear. However, the EIS will form part of the estate and will be subject to a probate valuation.

If liquidity is demanded for probate, the value may be significantly lower than the book cost due to being small illiquid shares (c10%). Any difference may have saved the estate inheritance tax. However, the beneficiaries will inherit that asset at probate value.

Any gains will be liable to CGT for them personally, as exits take place. If there is any yet uninvested cash it will be returned and becomes part of the taxable estate.

Any CGT liability could be managed using beneficiaries' annual allowances, as exits will take place across different tax years. Beneficiaries could also elect to re-invest any gains into an EIS of their own and defer the gain and benefit from the income tax relief available.

For this reason, it may be beneficial for the will to distribute the EIS holdings across multiple beneficiaries.

* assuming 3x Mercia growth target is achieved

EIS Tax Planning with Mercia | how advisers can achieve attractive tax advantages for their clients

EIS allows investors to gain exposure to high-growth British SMEs, whilst also benefiting from very attractive tax reliefs.

EIS tax reliefs are designed to give investors an added incentive to support smaller, entrepreneurial businesses with the benefit of an asymmetrical return profile in the form of downside protection and tax-free growth.

Investors that may benefit from the below tax reliefs may wish to consider an EIS investment. If an individual can benefit from more than one relief, the rationale for an EIS investment will be even stronger.

Mercia's minimum subscription is £25,000. The maximum investment for income tax relief is £1m in any tax year or £2m if the additional investment is made into Knowledge-intensive companies.

Mercia also offers an Approved Knowledge Intensive (KI) Fund once a year, and always has a tranche of its main EIS fund open. We also offer a Business Investment Relief (BIR) service for UK resident non-domiciles.

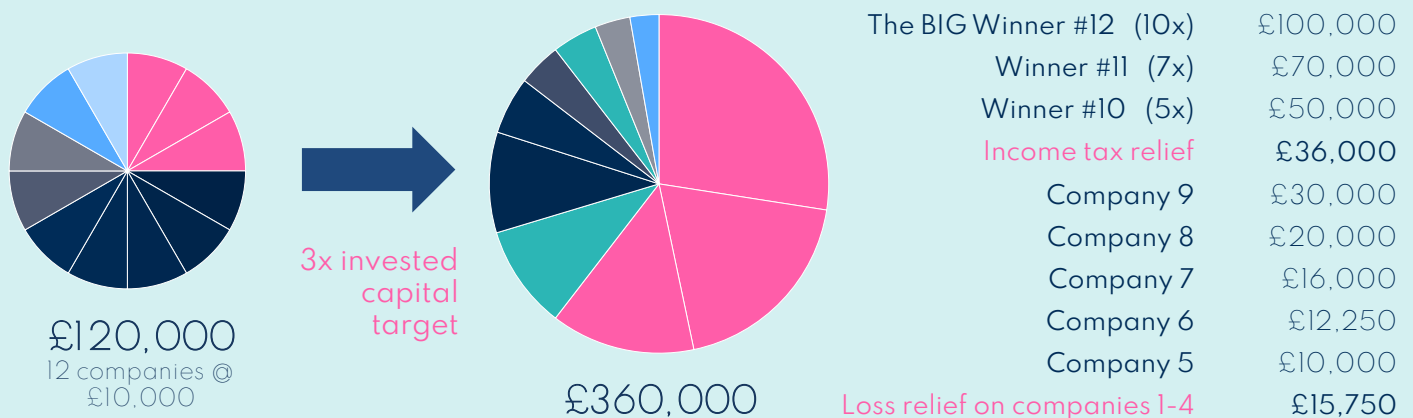
Tax incentives available

- **Income Tax Relief** - 30% income tax relief is available until the investor's income tax bill is reduced to zero.
- **Capital Gains Tax (CGT) deferral** - which can be used to manage a CGT liability. For example, when selling a business, a second home or a share portfolio.
- **Inheritance Tax Relief** - An investment into an EIS fund typically qualifies for Business Relief, reducing the inheritance tax to 0% for these assets.

Tax-free growth and downside protection

- **Tax-free gains** - if EIS shares are sold for more than was paid for them, any profits are free from capital gains tax.
- **Loss relief** - We expect a third of portfolio companies to fail (see image below) and when this happens investors can offset any loss against their income tax (or capital gains tax) liability.

Mercia EIS model portfolio*



*Please note that this model is not guaranteed and should only be used for illustrative purposes. It does not include any benefits from CGT deferral or IHT reliefs.

Risk warnings

EIS investment is restricted by the FCA rules to persons who qualify as high net worth, restricted or sophisticated, or who are acting upon advice from a suitably qualified financial adviser. Investing in early-stage businesses involves significant risks. The risks may include, but are not limited to; illiquidity, lack of income, loss of investment and dilution, and it should be done only as part of a diversified portfolio. You should not rely on any past performance as a guarantee of future investment performance. Tax relief depends on an individual's circumstances and may change in the future. In addition, the availability of tax relief depends on the company invested in maintaining its qualifying status. You may lose all the money that you invested; the investments are highly illiquid and have no ready market for disposal; there is a risk from future dilution of your shareholding.