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Client Briefing Note

Number 11 – September 2009

Could You Never Pay Income Tax Again?

Never pay income tax again? While it may sound too good to be true it is a possibility for some taxpayers who sufficient capital to invest on three-year time horizons.

Enterprise Investment Schemes (EIS) offer a novel tax planning idea that could achieve this objective. By investing capital over three consecutive years, investors are able to use EIS to set in motion a rolling series of the investments that, based on current legislation, could potentially wipe out their income tax bill every year.

How Does It Work?

First it is important to understand the tax benefits offered by Enterprise Investment Schemes. Provided clients hold their investments for three years, EIS delivers:

- 20% income tax relief on investments up to £500,000 per tax year, against their income tax bill for this or the previous tax year
- Capital Gains Tax (CGT) deferral (for gains made up to three years previously) for the life of the investment, up to the amount of the investment
- Inheritance Tax exemption after two years provided the investment is held at death
- Tax free capital growth

Concentrating initially on the income tax benefit, this means that a client investing £50,000 in protected EIS will receive income tax relief of £10,000 for the year (or the previous year).

Assuming the client opts to take the relief on this year's income tax bill, and that this bill is exactly £10,000, he can actually reclaim all of this income tax. He has, in effect, wiped out his entire income tax bill for the year.

In year 2, he could invest another £50,000 with the same results, and again in year 3 (assuming his income tax bill doesn't change, and assuming current EIS legislation doesn't change).

What Happens After Year 3?

Captain packaged EIS products are designed to protect capital and return it to the investor after it has been held for the three year qualifying period. What this means is that the year 1 investment, having reached the three year qualifying period by year 4, can be reinvested in another EIS investment to eliminate the investor's year 4 income tax bill. Similarly, the year 2 EIS investment is reinvested in year 5, year 3 in year 6 and so on...

Thus, in this example, a total investment of £150,000 eliminates the investor's income tax on an ongoing basis!

The investor can increase or decrease their investments as they invest in each new tranche if preferred, based upon changes in their level of income that they wish to offset.

Capital Gains Tax is deferred by each EIS investment, so can simply be rolled into the next investment. If held at death, the Capital Gain is eliminated, and the investments (if held for two years) are outside the investor's estate and so not subject to inheritance tax.

If you would like to explore EIS or other tax efficient investments in more detail, we would be pleased to do so upon hearing from you.

For further details please telephone 01573 224391 or email: mail@renniewelch.co.uk

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