

So EISily SIPPable –a great way to shelter those well gotten gains by Chris Lee and Brian Carter

With the Stock Market rising more than 80% over the last three years, and exceptional increases in property values over the last decade, many investors are looking at ways to lock in these gains whilst not exposing themselves to large capital gains tax bills. With the changes to the Self Invested Personal Pension (“SIPP”) rules coming into effect on 6th April 2006, and the Enterprise Investment Scheme (“EIS”) continuing to provide attractive reliefs, a combination of the two has some interesting benefits for high net worth individuals. Before we mix our heady cocktail, let’s have a quick look at the ingredients.

SIPPs Personal pensions are a particularly tax efficient form of saving for retirement and SIPPs are a “bespoke” variety of personal pension. UK residents with earned income subject to UK tax who are under 75 are eligible for SIPPs. Generous tax reliefs are granted on personal pensions, as contributions paid by an individual attract full tax relief against earned income, up to a maximum of £215,000 in 2006/07. At any time from age 50 (55 from 2010), 25% of the accumulated fund can be taken as a tax free lump sum - whether or not the individual chooses to retire. The balance of the fund must be used to provide an income which is taxed as earned income.

EIS allows certain tax reliefs for investors who subscribe for qualifying shares in qualifying companies. These include 20% upfront relief against income tax, capital gains tax deferral relief, capital gains tax exemption on sale and income tax loss relief. In essence a combination of the upfront income tax relief and further income tax relief for any loss on sale allows 40% tax payers to protect 52% of their investment.

So, how can we combine these two enticing ingredients into something alluring? Let us imagine you have built up a portfolio of equities, which has gained significantly in value over the last three years. The £50,000 you invested is now worth £90,000, and you have annual earnings of £120,000, subject to 40% income tax. From 6th April, you can transfer the portfolio into your SIPP, reducing your taxable income to £30,000 – mmm, tastes good! But, the capital gain incurred of £40,000 is not so sweet, you will have to spit out £16,000 into HMRC by way of capital gains tax. However, if you reinvest the gain of £40,000, funded substantially by the income tax saving, into an EIS qualifying investment, you can roll over the gain, and receive a further 20% income tax relief. Pour me another, please!

	Assuming no SIPP and no EIS	Assuming SIPP and no EIS	Assuming SIPP and EIS
Taxable income	120,000	120,000	120,000
Income tax payable	48,000	12,000	4,000
Capital gains tax payable	Nil	16,000	Nil
Tax paid	48,000	28,000	4,000
Assets, net of tax	162,000	182,000	206,000

The above figures assume that lower rate tax bands and annual allowances are offset against other income and gains

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