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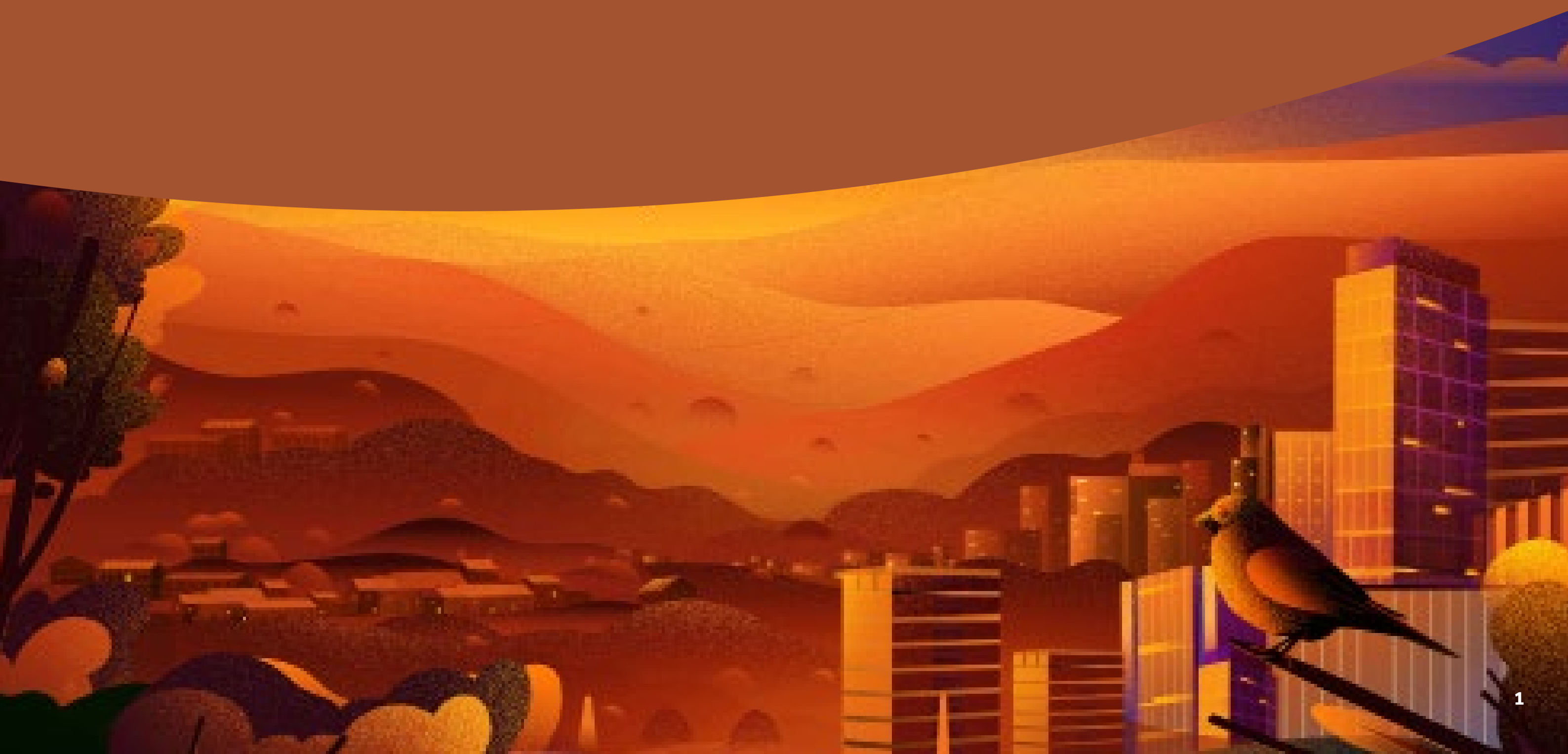
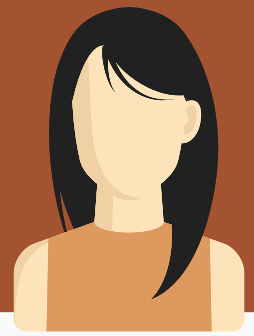
Using a Venture Capital Trust (VCT) to extract profits from a business tax efficiently

For many successful business owners, holding a high cash balance isn't an attractive thought since that money could be working harder for them as an investment. But to withdraw funds from a business could incur a tax liability, so it could feel like a no-win situation.

Benefits of tax-efficient investments are subject to change and personal circumstances.





Meet Tina

Tina is an independent IT consultant with an established limited company, which has accrued a significant cash balance of £45,000. As a limited company owner, Tina pays herself an annual salary of £12,570, and has an annual tax-free dividend allowance of £500. Tina would like to extract the cash balance from her business, but is aware that paying herself a large dividend would result in a significant tax bill.

Tina's adviser suggests that she pay herself a dividend of £45,000. From this amount, she will invest £19,063 into a VCT, and the remaining £25,938 will be available in cash.

Tina can then claim Income Tax relief of 30% on the amount invested (£5,719) through her self-assessment form, which offsets the Income Tax due on her dividend.

As well as having added an additional cash sum to add to her salary, Tina also has £19,063 invested in a VCT, which offers the potential for tax-free growth, tax-free dividends and additional diversification to her portfolio. There will be no Capital Gains Tax to pay when Tina decides to sell her VCT shares. Tina could continue to reduce her income tax bill on an annual basis by doing the same every year and then implementing a reinvestment strategy from around year 6.

Tina pays herself £45,000 dividend and places it in a savings account*

First **£500** tax free
Next **£37,200** is taxed at 8.75% **(£3,255)**
Remaining **£7,300** is taxed at 33.75% **(£2,463.75)**

Total Income Tax bill
£5,719

Net cash after taxes
£39,281

Tina opts to use a VCT to off set her Income Tax bill

£19,063 invested into a VCT
£25,937 cash

Income tax due on dividend payment
£5,719

Tina claims 30% Income Tax relief on the VCT investment
£5,719

Cash available **£25,937**
VCT Investment **£19,063**

**This potentially leaves Tina liable to future Income Tax on any interest earned over her Personal Savings Allowance*

Please note: This example is an illustration that assumes no gain or loss on the VCT investment. It also does not take into account the initial fees and ongoing charges associated with investing in a VCT. Investors should be reminded that a VCT is a high risk investment and is fundamentally different to a pension or individual savings account (ISA). When VCT shares are sold, they are usually valued at a small discount to their underlying net asset value. After selling VCT shares, investors cannot claim tax relief on new shares bought in the same VCT within six months of the initial share sale.

The Benefits of a VCT

VCTs offer a range of tax benefits to offset the risk of investing in early-stage firms. These currently are available on investments of up to £200,000 in a tax year.

- ✓ **30% income tax relief (minimum holding period five years)**
- ✓ **Gains exempt from capital gains tax when clients sell their shares**
- ✓ **No income tax on any dividends from a VCT**

The UK Government introduced VCTs in 1995 to encourage investment in new businesses and support UK entrepreneurs. VCTs themselves are companies that can be publicly traded on a stock exchange.

Uses of VCTs

VCTs are well established and popular with investors. Alongside tax mitigation, VCTs have many other uses. They can help to create a more diversified portfolio through exposure to different firms and sectors for investors. They can provide an income stream through dividends. Whichever way a client chooses to use a VCT, they can be a helpful and useful feature of financial planning.

Here to help

For more help with tax-efficient strategies, please speak with your local Business Development Manager who will be happy to help.

Send us an enquiry →

Find out more about VCTs →

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