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Using a VCT to extract profits from a business tax efficiently

Scenario

Tina is an independent IT consultant with an established limited company, which has accrued a significant cash balance of £70,000.

As a limited company owner, Tina pays herself an annual salary of £12,570, and has an annual tax-free dividend allowance of £2,000.

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 of £13,175, which would reduce the amount taken from her business to just £56,825.

Solution

Tina explains her situation to her financial adviser, who makes an assessment based on her attitude towards investment risk, her investment time horizon, and her approach towards investing in smaller companies.

As Tina's priority is to extract the surplus cash in her business as tax-efficiently as possible, her adviser suggests she consider using the proceeds to invest into a Venture Capital Trust (VCT).

The adviser highlights the tax benefits associated with a VCT, 30% income tax relief, and the potential for tax free income and growth. These tax benefits can help to offset the risk of investing in small, growing firms, provided the investment is held for at least five years.

Steps

Tina's adviser suggests that she pay herself an additional £70,000 dividend. From this amount, she will invest £43,916.67 into a VCT, and the remaining £26,083.33 will be available in cash.

Tina can then claim Income Tax relief of 30% on the amount invested (£13,175) through her self-assessment form, which offsets the Income Tax due on her additional dividend.

As well as having a considerable cash sum to add to her salary, Tina also has £43,916.67 invested in a VCT, which offers the potential for tax-free growth and tax-free dividends. There will also be no Capital Gains Tax to pay when Tina decides to sell her VCT shares.

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.*

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 at around 5-years.

Solutions for Investors and Support for Advisers

Blackfinch is a tax-efficient investment specialist working in partnership with advisers to meet clients' requirements. To find out more please speak to one of our team on **01452 717070** or email **enquiries@blackfinch.com**.

IMPORTANT INFORMATION

Capital at risk. Please refer to the product literature for all risk warnings applicable to the Blackfinch Spring VCT. This article is issued by Blackfinch Investments Limited (Blackfinch), which is authorised and regulated by the Financial Conduct Authority (FCA number 153860). Registered address: 1350-1360 Montpellier Court, Gloucester Business Park, Gloucester, GL3 4AH. Registered in England and Wales company number 02705948. This article is for intermediary information only and does not form any offer or invitation to invest. All information correct at June 2021.