



FEATURE ARTICLE

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VCTs and Pension Planning - The Odd Couple?

I am sure that many of you are already aware that according to estimates from the Office of National Statistics, centenarians are the fastest-growing section of the population. Apparently the major contributor to the increasing number of centenarians is increased survival between age 80 and 100 due to improved hygiene and sanitation, improving food, housing and living standards and medical treatment.

Why is this important, well because it is just another example of ever growing statistical evidence showing that we are all living longer. Of course increased longevity is to be welcomed but from a financial planning perspective improving longevity poses a tricky question - how best to pay for an even longer period in retirement?

There are of course various alternatives in response to this challenge with much of the debate focusing on ISAs and pension schemes. To be frank there's rarely a right and wrong answer here, most people will have both and depending on individual circumstances each has its advantages and disadvantages but in this short article I want to consider another tax efficient savings vehicle as part of potential pension planning - VCTs

VCTs are, at their most basic, designed to attract UK private investors to invest in a diversified portfolio of unquoted and AiM-traded companies whose trading activities are predominately based in the UK.

There are, as we all know, a host of rules surrounding VCTs covering areas such as the type and size of companies they can invest in and the level of investment that is permitted in one company from one VCT but in simple terms, as listed companies, investors either buy newly issued VCT shares or buy them on the secondary market.



For initial offerings of ordinary VCT shares, assuming the investor then holds the shares for 5 years, an investor currently receives income tax relief of 30% (provided they have paid sufficient tax to cover this rebate) on investments up to £200,000 together with exemption from income tax on dividends and exemption from capital gains tax on disposal of shares in VCTs. (For second-hand shares, the reliefs are the same apart from the fact that the initial tax relief is not available.)

All of this means that under current legislation an investor making a £20,000 investment into new shares in a VCT, assuming as I have already said that they have paid enough income tax, will receive tax relief of £6,000 making a net investment of £14,000. They will pay no tax on any dividends they receive and they retain the ability to sell, or indeed their investment may wind up (after five years to keep the tax incentives), without paying tax on any gains they might have made.

From a pension planning perspective if an investor does encash their holding or receive their investment back because the VCT has wound up then the capital they receive back will be theirs to do with as they like, it is not controlled in the way that a pension pot is. It is also perhaps worth noting that there is no cap on the number of VCT shares an investor can own and investors can build up a significant holding over the years which can potentially produce a reasonable tax free income.

VCTs are potentially attractive to income seekers, such as those in retirement, given they combine ISA-like tax benefits on dividend payments and the added ability to distribute capital gains made within the underlying portfolios, in the form of special dividends. This is distinct from income payments made on OEICs and investment trusts, for example, which simply reflect underlying yield accumulated from the portfolio.

Which VCT is suitable?

VCTs are often considered to be too risky for the majority of investors and therefore get overlooked by people who might benefit from using them. There are however a number of "lower risk" VCTs now available and indeed over the last couple of years the most popular VCT investment class has been the so called "Limited Life" VCTs and these might be suitable as a first port of call for those using VCTs for pension planning – although each VCT opportunity should be carefully examined on its individual merits.

Conclusion

Of course VCT investments are not suitable for everybody and pension planning needs to be considered extremely carefully and an appropriate range of investments opportunities reviewed for each client.



Ultimately the best solution for the majority of investors is probably a balance between ISAs and pensions initially, using a pension for the initial tax relief and savings discipline, and an Isa for the flexibility and tax benefit on income. Once however these have been utilised other tax efficient investment opportunities such as VCTs can and indeed should be considered on a case by case basis.

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