EQUILIBRIUM

Managing your investments

Specialist

Inside this document

An introduction from Neal Foundly

Investment Analyst at Equilibrium

The misnomer that "tax doesn't have to be taxing" has been widely derided since it was used in HM Revenue & Customs advertisements to remind people to complete their tax returns. This is never more pertinent than when we talk to our clients about some of the less well-known tax allowances and reliefs, particularly in relation to estate planning and inheritance tax.

These discussions tend to take place once more traditional planning opportunities have been fully utilised. For example, we might have already used pension allowances as part of an income tax strategy, or perhaps we have maximised gifting or trust planning as part of an estate planning strategy.

In situations like these our financial planners might wish to consider investing into a more specialist product or service to seek further tax benefits. To support this process we have developed our Specialist proposition with the aim of providing your planner with a range of fully researched and approved solutions to meet these objectives.

This booklet seeks to make everything a little less taxing by introducing our proposition and providing the background for any discussions. It is important to note that these solutions are not for everyone and must only be taken up following an in-depth review with your planner. Some of the schemes we use are very high risk and generally suitable for experienced investors only.

If there are any areas that seem unclear or if you have any questions, please feel free to contact your client manager who will be happy to help.

N. C. Foundly

Neal Foundly
Investment Analyst

Specialist investment options

The recommendation of a specialist portfolio follows the same general principles as our standard investment process, but involves different products, providers and levels of risk. This booklet contains an overview of the options included within our Specialist proposition and should be read in conjunction with our full Managing your investments booklet and Retail client agreement.

Supporting the economy

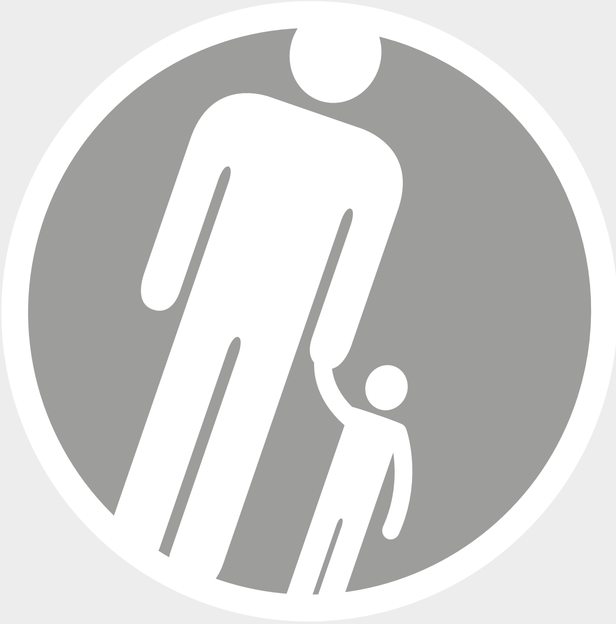
The schemes outlined in this booklet originate from the well-known and widely tested Government tax breaks offered to individuals who invest in fledgling UK companies. The payback for the Government is a strong economy with a higher contribution from small businesses, creating jobs and boosting tax revenue.

The options

Where we use the term specialist in this booklet, we are referring to schemes or products where the primary investment objective is to receive tax benefits. Investment returns are a secondary consideration. As such, we only tend to recommend our specialist investment options once traditional planning opportunities have been fully utilised. The products we use can be split into two categories:

Estate planning schemes	Tax incentivised schemes
Overview	
Products designed to utilise business relief. This is where qualifying assets are outside of an individual's estate for inheritance tax purposes after a two-year time frame as long as they are held at the time of death.	Tax efficient products designed to encourage investment into small, unquoted UK trading companies.
Suitability	
Particularly suitable for those who are looking to reduce their inheritance tax liability **and**: • can afford to give capital away, but wish to retain control of the assets; **and** • have already used other traditional planning such as gifting and trusts; **and / or** • believe they are unlikely to survive for seven years	Only suitable for experienced and knowledgeable investors with a very high-risk tolerance. Ideally, the investor should also: • have the capacity to lose up to 100% of their initial investment • have a particularly high tax liability that cannot be addressed by other means • be able to leave the investment in place for the long term (at least 5-7 years or often longer) and not need early access to the capital
The options are:	
• the Equilibrium Alternative Investment Market (AIM) portfolio • other third-party inheritance tax mitigation schemes	• Enterprise investment schemes (EIS) • Venture capital trusts (VCT)

Estate planning schemes



The Equilibrium AIM portfolio

The Alternative Investment Market (AIM) is a sub-market of the London Stock Exchange that allows smaller companies to float shares due to its more flexible regulations. Around two-thirds of AIM stocks qualify for business relief.

Launched in March 2015, our in-house AIM portfolio seeks to deliver a return above that of the FTSE AIM Index. Managed by Neal Foundly, the portfolio usually holds around 30 stocks, selected with an emphasis on sustainable dividend income and likely qualification for business relief.

We regard AIM stocks as high risk which means that they are only really suitable for investors with a high-risk tolerance, or where the portfolio is only a small part of a client's overall assets. For this reason we have identified two alternative third party schemes that also look to utilise business relief, but at a lower level of risk.

Inheritance tax mitigation schemes

The objective when researching alternative business relief strategies was to find schemes that would complement our existing AIM portfolio. Rather than investing in AIM stocks, these schemes invest in unquoted trading companies that pursue lower risk activities, such as lending or renewable energy. As such, expected returns tend to be more limited and less volatile than through an AIM portfolio.

For this reason, these products can sometimes be suitable for clients who do not have the risk tolerance required to invest in AIM stocks. However, as returns are expected to be lower, the potential tax saving can soon be eroded compared to other forms of investments if held over the long term.

Important to know

Business relief was introduced by the Government in 1976. It allows shares in qualifying businesses to be passed down the generations free from inheritance tax, subject to being held for two years **and** on the date of death.

If held on death, the proceeds will also be exempt from capital gains tax as this form of tax does not apply on death.

Tax incentivised schemes

Enterprise investment scheme (EIS)

Introduced by the Government in 1994, EIS help small companies raise finance by providing tax incentives to investors who purchase new shares in those companies. As such, an investor makes a direct investment into the unquoted trading company, which is then tied up until the company is sold at a later date.

In return, the investor will receive income tax and capital gains tax relief (the latter being exempt after 3 years), plus the investment will potentially attract business relief in the same way as the estate planning schemes outlined earlier.

When investing in an EIS, an investor can elect to carry back some or all of the income tax relief to the previous tax year. In addition, where an individual has a capital gains tax liability, an EIS investment can defer the capital gains tax to the point at which the EIS shares are disposed. A further tax benefit of EIS investment is that should a capital loss be made, the investor can elect to offset this against income, instead of being offset against capital gains.

In order to receive the tax benefits, the EIS must be held for a period of at least 3 years, although in practice the shares tend to be held much longer until the company is realised. EIS can therefore have multiple tax advantages but should be considered extremely high risk due to the profile of qualifying companies, limited diversification and illiquidity.

The maximum subscription on which tax relief can be received is £1m per tax year, rising to £2m if at least £1m is invested into knowledge intensive companies (companies with highly skilled employees and high spends on innovation and R&D).

Venture capital trusts (VCT)

Introduced by the Government in the 1995 Finance Act, VCTs are closed-end collective investment schemes listed on the London Stock Exchange. The VCT manager will select a number of unquoted companies in which to invest and then support these businesses to help them expand and become more profitable. In other words, VCTs are designed to provide private equity capital to small expanding businesses, in return for the investors receiving dividend income and/or capital growth. As well as income tax relief on the initial investment, investors also receive their dividends and capital growth free of tax.

The tax benefits of VCTs are therefore less extensive than for EIS, although the risk is usually considered ever so slightly lower due to the greater diversification from the collective approach and the fact that a secondary market exists. The actual risk will of course depend on the type of EIS or VCT purchased.

The maximum VCT subscription is £200,000 per person per tax year and the shares must be held for at least 5 years to retain the tax benefits. It should be noted that VCTs do not qualify for business relief.

Specialist scheme comparison

Feature	Inheritance tax mitigation schemes	AIM portfolio	Venture Capital Trusts	Enterprise Investment Schemes
Minimum investment amount (approved schemes)	£25,000	£10,000	£3,000	£10,000
Maximum allowable investment amount	No limit	No limit	£200,000 per person per tax year	£1m per person per tax year (£2m if at least £1m invested in knowledge-intensive companies)
Investment structure	Limited selection of directly held companies	A portfolio of individual shares	Investment into a company that then purchases the underlying investments.	Limited selection of directly held companies
Liquidity	Generally illiquid	Listed and considered generally liquid	Listed and potentially liquid	Should be considered illiquid until the company is sold
Typical investment timescale	2 to 5 years	5 years +	5 years +	7 years +
Tax benefits				
Income tax relief	✗	✗	✓ 30%	✓ 30%
Tax relief carry back	✗	✗	✗	✓
Tax free dividends	✗	✗	✓	✗
Capital gains exempt*	✗	✗	✓ immediately	✓ after 3 years
Capital gains deferral	✗	✗	✗	✓
Income tax relief for capital losses	✗	✗	✗	✓
Business relief qualifying	✓	✓	✗	✓
Shares must be held for	Two years to qualify for business relief	Two years to qualify for business relief	Five years to keep the tax rebate	Three years to keep the tax rebate – two years for business relief

* It should also be noted that capital gains tax does not apply on death

Our preferred providers

Our specialist investment services are delivered via a panel of third party providers, as well as through our own in-house Alternative Investment Market (AIM) portfolio. We may recommend any one or more of these options depending on your specific circumstances and planning requirements.

The Equilibrium AIM portfolio

Our portfolio was launched on 1 March 2015 and is held via the Nucleus Financial Services investment platform.

nucleus

Third party specialist options

We maintain and regularly update a panel of specialist providers, to cover the full range of product options including inheritance tax mitigation schemes, enterprise investment schemes and venture capital trusts. The selection process we use is detailed opposite.

These schemes are not daily valued and in some cases are only updated every six months. This means that the actual value of a holding might be different to the valuation provided at your last review, depending on how the dates fall.

Family support

Your planner will consider the relative merits of each provider before making a specific recommendation to meet your aims and objectives. If you would like any member of your family to be included in these discussions, especially when considering estate planning, we would be more than happy for you to bring them into any meetings.

Provider selection process

To be able to recommend specialist schemes with confidence, we need to be sure that the management style of the product providers we choose is consistent with our own investment ethos. To achieve this, we have developed a well-defined research and selection process.

Initial research + MICAP due diligence

Review all available products and filter on size and availability

Use independent due diligence from MI Capital research (MICAP), an investment research company that specialises in the tax advantaged investment market

Long list

Focused research

Initial meetings with asset managers on long list covering the nature of their product including:

- Risk
- Exposures of underlying investments
- Costs

Short list

Verify the details

Further meetings with short listed asset managers to cover the fine details

Verification of our due diligence with other specialist research providers

Provider decision

Focused research

Continuous monitoring of selected products and providers, considering:

- Risk
- Exposures of underlying investments
- Costs

Annual review

Charges

The charges that will apply to your investments are set out in full within our Retail client agreement.
In summary:

Estate planning schemes

Initial Equilibrium fees

Initial Equilibrium fees of 1.5% of the amount invested apply to all estate planning scheme and AIM recommendations, subject to a minimum of £750. These fees would be in addition to any implementation fees you are being charged under the terms of our Retail Client Agreement. Your planner will confirm if this applies.

Ongoing Equilibrium fees

EFP

Equilibrium Financial Planning LLP
Ongoing advice fees will be charged based on the total assets under our influence, including any business relief investments. We will also charge an additional 0.5% intermediation fee for third party specialist business relief products. This will be facilitated directly from your investments. This does not apply to investments in AIM.

EIM

Equilibrium Investment Management LLP
Ongoing investment management fees of 1% plus VAT are charged for managing our AIM portfolio. No ongoing investment management fees apply to investments in third party specialist business relief products.

Tax incentivised schemes

Initial Equilibrium fees

Initial Equilibrium fees of 1% of the amount invested apply to all VCT and EIS recommendations, subject to a minimum of £500. These fees would be in addition to any implementation fees you are being charged under the terms of our Retail Client Agreement. Your planner will confirm if this applies.

Ongoing Equilibrium fees

EFP

Equilibrium Financial Planning LLP
Ongoing advice fees will be charged based on the total assets under our influence, including any EIS or VCT investments.

EIM

Equilibrium Investment Management LLP
No ongoing investment management fees apply.

Provider fees

The Equilibrium AIM portfolio is held via Nucleus Financial Services and their standard charging structure applies.

The fees charged by the third party providers we recommend are significantly more than those for our standard range of investments:

- There are often **initial fees** on purchasing the investments usually ranging between 2% and 2.5%. We can sometimes arrange for this to be reduced, with any amount due deducted from the amount you invest.
- The **annual charges** vary by product and will typically total between 2% and 3%.
- There could also be **exit charges** or **performance fees** charged in addition in certain circumstances.

The specific fees for any recommended products will be disclosed in your suitability report.

Managing your specialist investments

When establishing (and then reviewing) a portfolio that includes specialist investments, your planner will consider a number of factors including the impact their recommendations will have on:

- overall risk levels
- expected performance
- diversification

This is explored further with some illustrative examples below.

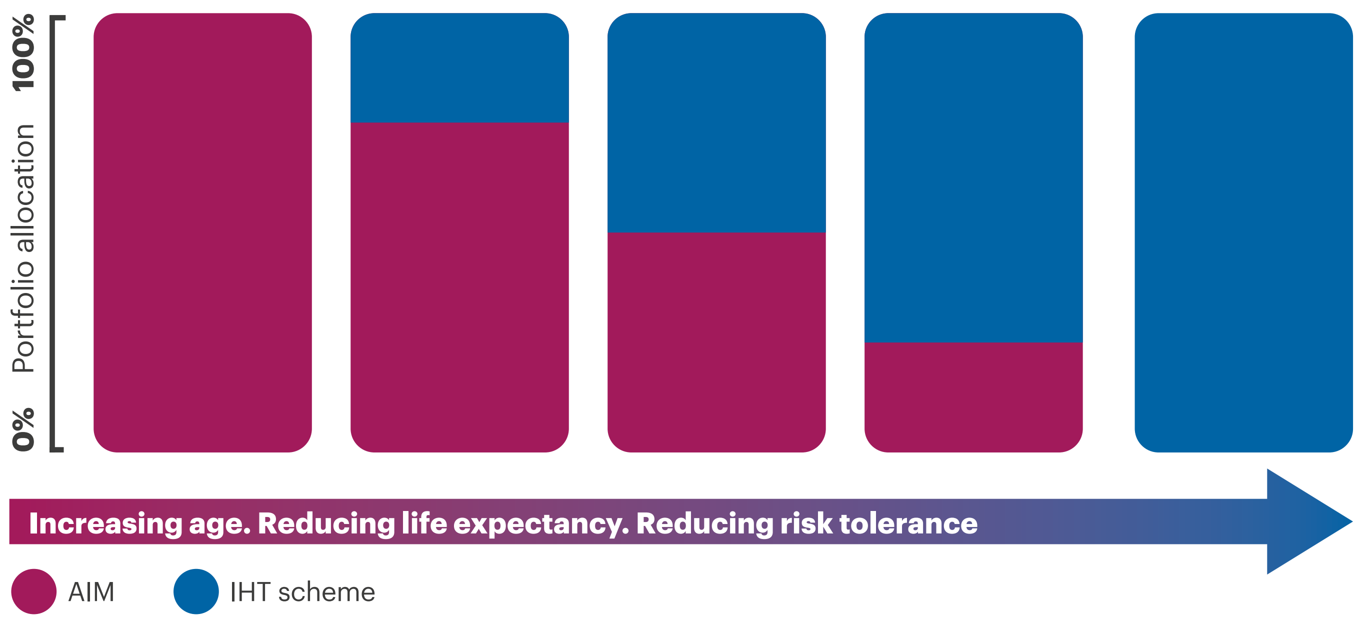
Recommending an estate planning scheme

As already explained, AIM portfolios are purely equity based and as such very high risk, but with the potential for high returns. The minimum investment timeframe should be at least five years, but IHT efficient investments are designed to be held until death.

Inheritance tax mitigation schemes are lower risk than AIM, but with significantly lower potential returns. These products are sometimes recommended for shorter investment timeframes as a result. Indeed, holding them over the longer term can mean that you end up worse off than if you invested in our standard portfolios, even after business relief is taken into account.

With this in mind, once your planner has recommended investing for business relief, they will then consider the type of products to recommend and how they fit with your existing portfolio:

- unless you have a low risk tolerance, or have a short life expectancy, business relief planning will often start with an investment into AIM. As your investment is being made, your planner might look to reduce the risk of your non-AIM portfolio if risk will increase outside of your identified tolerance.
- as time passes, your planner might then look to move further assets into the business relief portfolio or potentially reduce the risk to limit future volatility. At this stage, they might consider investing into one or more inheritance tax mitigation schemes to hold alongside the AIM portfolio, thereby creating a blended business relief portfolio.
- your business relief portfolio would then be managed over time with the percentage of higher risk AIM reduced in favour of the lower risk schemes. This could look as follows:



Your planner could start business relief planning with any of the portfolio mixes shown opposite, dependent on the likely investment timeframe and desired level of risk. This would of course be tailored to your particular circumstances, as well as those of your beneficiaries.

Recommending a tax incentivised scheme

EIS and VCTs are very high risk and potentially illiquid investments. They would generally be held as standalone investments to solve tax planning related issues, rather than as part of a diversified portfolio.

Should your planner recommend one of these products, they would consider:

- whether to reduce risk elsewhere to compensate for the higher risk nature of these products.
- whether to blend multiple specialist products together to achieve greater diversification.

These decisions would be guided by research produced by our investment team.

Risks

The standard risks of investing with Equilibrium are set out in **Managing your investments**, pages 24-25 and 34-35. The additional risks specific to the products referred to in this booklet are as follows:

Liquidity

Investments in unquoted shares can be difficult to value or sell. The process to realise investments can be slow or in some cases impossible. There are no guarantees that investments can be realised early and they should be considered generally illiquid in most cases.

If you sell a holding subject to business relief and then withdraw the funds, this could potentially result in the loss of inheritance tax relief on the amount sold.

Policy changes

The UK tax regime can be changed by Government policy resulting in the potential loss or alteration of certain tax benefits, perhaps even retrospectively. The tax reliefs set out in this booklet are based on our understanding of current legislation only, and their value depends on the individual circumstances of each investor.

Diversification

Specialist portfolios tend to be invested in fewer companies compared to our standard portfolios. The investment risk is therefore more concentrated as an issue at one company can have a material effect on the portfolio as a whole.

Performance delay

There can be a reduction in performance if the investment programme of a scheme is delayed such that cash is held for longer than expected. There are no guarantees that suitable investments will be identified to fulfill the scheme objectives.

Fund manager changes

Specialist investments can be very sensitive to changes in personnel and this could adversely impact on future performance.

Fledgling UK companies

Investing in unquoted or AIM listed companies is higher risk than our standard investment portfolios. It is possible (likely) that some parts of an investment could fail and be lost completely. You should be prepared to see significant volatility and for losses to occur.

Investor qualifying status

It is possible for an investor to lose their qualifying status by taking, or not taking certain action. For example, becoming non-UK resident can have consequences in some instances.

Investee company qualifying status

Although care is taken to select companies or investments that qualify for the various forms of tax relief, it is possible that qualifying status can be lost. This can result in tax benefits being withdrawn or reclaimed by HMRC.

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