TAXPAYER SENTIMENT REPORT 2016

IWCAPITAL
INVESTED INTEREST

IW Capital Taxpayer Sentiment Report 2016

Between the passing of the self-assessment tax deadline on 31 January 2016 and the Government's upcoming Budget announcement on 16 March, the subject of taxation finds itself under close scrutiny.

Figures published by HMRC reveal wealthy Britons pay more than a quarter of the country's entire income tax bill, with nearly 300,000 taxpayers having contributed to the equivalent of £45.9 billion in income tax between them. With an estimated £4.7 billion chalked as 'wasted' tax in 2014 and a further 74% of taxpayers admitting they had not done anything to reduce their tax waste in the last 12 months, tax-planning is quickly becoming a priority on the financial agenda of UK investors who wish to plan their finances both safely and efficiently.

Whether the objective is to preserve capital, grow investment value or benefit from tax advantages, the suite of government-backed solutions, schemes, trusts and fund management options now available to the serious saver and/or investor is steadily decreasing. With the Enterprise Investment Scheme (EIS) serving as one of the last viable products available, IW Capital's Taxpayer Sentiment Report 2016 analyses the attitudes of Britain's investment-minded population towards initiatives of this nature. The research gauges the average income tax paid by individuals who have over £40,000 in investments and evaluates these investors' perceptions of the EIS.

Key Findings

- The average income tax bill in the UK is £5,590
- The average income tax bill for the 788,000 people in the UK who earn over £100,000 – the top 2.7% of the British taxpayer population – is £81,700
- Investors with over £40,000 worth of investments pay an average £26,058 in income tax – more than four times the national average
- For the 2016/17 financial year, 54% of taxpayers with current investments valued over £40,000 would consider investing through the EIS, with over a quarter (26%) stating that they definitely would consider doing so
- For British investors, £81,950 is the average ideal investment size over the next ten years
- Two thirds (66%) of respondents whose ideal investments size over the next ten years is between £42,001 and £100,000 would consider the EIS

- On average, investors who currently have more than £100,000 worth of investments said their ideal investment size over the next ten years is £210,468
- Of those who ideally intend to invest between £100,001 and £250,000 over the next ten years, 64% would consider using the EIS
- A higher proportion of males compared to females would consider the EIS (60% vs. 44%)
- The youngest age group is more likely to consider the investment scheme compared to the older age group (91% of 18 to 34s vs. 28% of 55+)
- Over four-fifths (84%) of Londoners would consider the scheme

Britain's Tax Landscape

The UK has 29.8 million taxpayers. Just 1% of them pay the highest rate of income tax (45%) – known as the 'additional' tax rate – for those with earnings of over £150,000 a year. Despite its size, this group contributes almost 30% of HMRC's revenue. A further 15% of the taxpaying population falls into the higher rate of income tax (40%) for those who earn more than £31,780; this group contributes 37% of HMRC's revenue.

The top 1% of taxpayers contribute almost 30% of HMRC's income tax revenue

Due to the growth of an increasingly affluent middle class in the UK, those paying the higher income tax rate are shouldering more and more of Britain's tax bill. IW Capital's analysis of the latest HMRC income tax data from the 2014/15 financial year shows that the average amount of income tax paid by a taxpayer was £5,590. For those who earn over £100,000 – a group that comprises of approximately 788,000 people, which is 2.7% of the taxpaying population – the average income tax bill stood at £81,700. Moreover, the data shows that this group of high earners paid a staggering 39% of the UK's total income tax bill in 2014/15. This is a greater proportion than in 2012/13, when those earning over £100,000 paid 34% of the total income tax bill.

When considering the outlook for 2020, the significant weight of tax responsibility placed on the UK's higher earners could increase yet further. In February 2016, the Institute for Fiscal Studies (IFS) stated that George Osborne's "inflexible" Budget targets may mean the Government is forced to introduce sudden tax rises in order to achieve a forecasted surplus of 0.5% of national income by 2020. With the next Budget due to be delivered on 16 March, the IFS warned that the Chancellor's desire to fulfil this commitment in the present economic climate could result in "big tax rises … with very little notice".

Income Tax – The UK Average

As part of the Taxpayer Sentiment Report 2016, IW Capital conducted a survey to explore just how much Britain's serious investors are paying in income tax compared to the national average. The group of over 2,000 respondents – which is representative of the UK's adult population – were asked about the size of their current investment portfolio and the amount of income tax they paid in the 2014/15 financial year.

The results showed that among respondents who currently have more than £40,000 worth of investments, their average income tax bill was £26,058, over four times the national average.

Enterprise Investment Scheme

For higher rate taxpayers, particularly those who are investment-minded, the objective is to balance the pursuit of profitable and safe investment options with the challenge of efficiently managing tax expenditure. With a focus on one of the last government-backed opportunities available to investors that offers tax incentives, the Taxpayer Sentiment Report 2016 reveals the EIS as a distinctly popular product for the 2016 financial year. The statistics highlight that the majority of the investor sample – 54% of respondents who currently have investments worth £40,000 or more – said they would consider the EIS for their forthcoming tax plan.

2,795 companies raised a total of £1.56 billion under the EIS in 2013/14

The EIS is designed to help smaller businesses to raise finance by offering a range of tax reliefs to investors who purchase new shares in those companies. Since it was launched in 1994, more than 22,900 companies have received investment through the scheme and over £12.3 billion worth of funds have been raised. Moreover, according to government data released in January this year, 2,795 companies raised a total of £1.56 billion under the EIS in 2013/14, a notable rise on the year before when 2,470 companies raised £1.03 billion.

The popularity of the scheme lies in the fact that it encourages private investment into early-stage companies by offering tax relief to investors. Under the EIS, income tax relief of 30% can be claimed on investments of up to £1 million in a single tax year, giving a maximum tax reduction in any one year of £300,000. It also provides tax relief against capital gains tax and inheritance tax.

Sarah Wadham is Director General of the EIS Association (EISA), a not-for-profit organisation which exists to aid the provision of capital investment into SMEs through the EIS.

Commenting for this report, Ms Wadham stated that high earners "should be encouraged to consider EIS" because not only does it offer attractive tax reliefs to investors, but it also "contributes a huge amount to the economy". Furthermore, she said that people who do invest through the EIS often "really enjoy being involved with the companies and feeling part of supporting a growing and exciting part of the economy".

Ms Wadham added that while the high proportion of investors considering the EIS is a positive finding, it is important they "do not just consider it, but act on it". One issue she says can inhibit investment through the EIS is that people are "nervous about breaking tax laws" – as such, greater awareness of the scheme is needed so that people realise it is "a legitimate, government-sponsored form of tax planning; one that has proved vital for both investors and the economy".

A positive trend that Ms Wadham has observed over recent years is that there is now "a more varied demographic" of people investing through the EIS. Specifically, she noted that more women and older investors are now considering EIS. This is supported by the Taxpayer Sentiment survey; of the respondents who currently have more than £40,000 worth of investments, a healthy proportion of women (44%) and over 55s (28%) said they would consider the EIS.

44% of women and 28% of over 55s with investments worth over £40,000 would consider the EIS

Managing Risk

Despite its strengths, the scheme is not without risk. As with any form of investment, people can lose their money. Serving as a testament to this, Ms Wadham stated: "Sometimes it is better to just pay the full amount of income tax, rather than making investments that are not right for you."

One way of managing this risk is to invest through a fund manager. EISA's Director General offered the following advice: "I would suggest that investors considering EIS look at some of the more well-known EIS funds – this way you get a professional fund manager who not only performs due diligence in selecting the companies to invest in but also manages the investment to protect the interests of the investor. Importantly, a fund manager will work with the company to ensure it maximises its commercial potential; they mentor the CEO, put people on the board and introduce them to useful contacts."

Protecting the EIS

The long-standing evidence indicates that the EIS has gone from strength to strength since its launch 22 years ago. Despite its undoubted growth, continuously evolving government legislation poses various implications on the continued success of the scheme.

In 2015, EIS legislation was amended to ensure its compliance with new European Union regulations on State aid money. The changes, which came into effect when the Finance Act 2015 received royal assent on 30 November last year, included the introduction of a new cap. This limited the amount of EIS funding a company could receive in its lifetime at £12 million, although it was set higher for knowledge intensive companies, which can receive a total of £20 million. Further changes have also been proposed under the 2016 Finance Bill that will prevent any company involved in the generation of any form of energy from taking part in the EIS.

One of the main aims of the legislative changes is to direct money into the fast-growing industries that require it most. However, as Britain's serious investors signal their intent to consider investments through the EIS in the coming financial year, Ms Wadham has stressed that the Government must ensure new legislation does not negatively impact this "absolutely vital" initiative for early stage and high-growth SMEs in the UK.

Sarah Wadham, Director General, EISA

A lot of the changes that came in last year were a result of new EU State aid guidelines; I hope we now have a period of letting EIS settle down. I think all of us need to be conscious of the fact that schemes such as the EIS are extremely important and contribute a huge amount to the economy – they need to be protected and looked after.

Luke Davis, CEO, IW Capital

Britain's vibrant SME community plays a fundamental role in the steady recovery of the economy, propelling a staggering body of new and innovative businesses that form 99% of the UK private sector. However, the long-term success of the "SME revolution" relies on investors continuing to supply these businesses with the capital they need.

As the sentiments in this report reveal, huge numbers of investors are considering the EIS as part of their future tax strategy – the Government must ensure the scheme is protected and its undoubted success is built upon, while also remaining conscious of the tax burden being placed on the UK's investors.

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