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# Enter the Dragon

***The TV programme Dragons Den has put investing into small businesses (known as Private Equity) into the spotlight. Chris Budd examines how your pension fund can be used to make such an investment.***

The global economy is driven by big business. However, most big businesses started life as small businesses. The government therefore recognises that small, privately owned companies, run by people taking risk and with energy and enthusiasm, are not only the seed from which the future growth of the economy begins, but are also a hotbed for invention and innovation.

As such, a number of incentives are available for individuals to invest in such 'private equity'. The most commonly used of these is the Enterprise Investment Scheme (EIS).

Since 6th April 2006, however, (known in the industry as A Day), private pension funds have also had the potential of investing in private equity.

**Self Invested Personal Pension (SIPP)**

Standard pensions are taken out in the form of a policy with an investment company, and any new policy will probably be a Stakeholder. This means low charges, but inflexibility with regard to investment.

At the other end of the spectrum lies the SIPP. This is typically run by independent trustees, who charge a fee, however there should be no restriction of the funds that can be used, timing of contributions, transfer values etc. As such, the SIPP is the most flexible form of pension planning.

Since A Day, SIPPs have also been allowed to invest in the shares of private limited companies. However, the following criteria must apply:

- The owner of the SIPP (known as the 'member'), must not own more than 50% of the shares (this includes shares owned by the member, the SIPP itself, and any other connected parties, including family members etc)
- The member (or connected party) must not be a controlling director (20% or more of the shares)
- The member must not be able to use any assets of the company (this criteria particularly has in mind any residential property)
- Must be a trading company (not an investment company)

Assuming these criteria are met, the SIPP is able to invest in a private limited company, even up to using the whole of the money in the SIPP to do so.

Of course, investing in private equity is a highly risky business, many such companies go bust. One would therefore not recommend any individual pension fund investing a large amount into one such company.

**SIPP or EIS?**

SIPPs and EIS both offer advantages and restrictions. A summary can be found in the table below.

| | **SIPP** | **EIS** |
|---|---|---|
| Tax relief? | Up to 40% (on contribution to pension) | 20% |
| Minimum period? | None | 3 years |
| Capital gains tax? | None (other than small amount of withholding tax on dividends) | None |
| Loss relief? | No | Yes (against personal income or capital gains tax) |
| Restriction on investment? | 100% earnings per annum, max £1.5m total | £400k per annum |
| Exit route from investment? | No restriction | Trade sale, floatation or liquidation |

In addition to the above, it must be remembered that EIS is relief given to funds held personally, whereas any money within the SIPP can only be accessed at age 55 (possibly earlier although currently age 50 or over), and then in the form of 25% tax free cash sum, with the remainder paying an income (although please note that it is no longer compulsory to purchase an annuity). Levels and basis of, and relief(s) from Taxation are subject to change.

## Conclusion

If you are considering making a private equity investment, it may be worth considering the SIPP route, in order to generate significant tax relief for the amount invested. Alternatively, you may wish to look at your existing pension fund arrangements, as it may be possible to unlock significant funds for additional private equity investment.

In practice, sensible planning would mean a spread around a number of private equity shares, as well as different types of equity and different types of investment. It could also mean a combination of EIS and SIPP money. Clearly, professional advice in this area should be sought on any investment and structure that is being established.

*This article is for general information only and you should seek professional advice in respect of your own circumstances.*

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****The FSA does not currently regulate all aspects of SIPP planning.***

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