schedule, should be completed by my GP, but he was on extended compassionate leave.

Square, London E98 1ST, giving a daytime phone number. We cannot send personal replies or deal with every letter. Please do not send original documents. Advice is offered without legal responsibility. questionofmoney@sunday-times.co.uk

Investors think small to

The government is making it easier to back start-ups, but it could be risky, says Ali Hussain

INVESTORS have more opportunities to back smaller firms and pocket generous tax breaks amid tentative signs of an economic recovery.

The number of businesses looking to raise funds under government schemes designed to encourage investment has soared 90% in the past year, according to HM Revenue & Customs' figures obtained by Rockpool Investments, the adviser.

In 2012-13, there were 4,075 applications from companies for funds under the Enterprise Investment Scheme (EIS) and Seed Enterprise Investment Scheme (SEIS), compared with 2,147 the previous year.

The news comes as the Treasury announces plans to allow shares in smaller companies that are listed on the AIM market to be included in Isas this autumn.

All income and gains can be tax free and is in addition to the inheritance tax (IHT) exemption offered by AIM shares after two years.

Advisers said smaller companies offer a way to profit from economic recovery and can provide impressive returns long-term. But backing minnows can be risky.

Nicola Horlick, chairman at Rockpool, said: "This is great news for small and medium-sized enterprises looking to raise the finance they need to drive a recovery in the UK economy.

"Tax incentives supporting investment in small businesses is an important step towards delivering economic growth."

The proportion of companies in the services industry reporting rising exports increased to a record high in the second quarter, according to the British Chambers of Commerce. Meanwhile, a boost in orders helped manufacturing activity rise at its fastest pace for more than two years in June. Capital Economics, the analyst, increased its economic growth forecast for 2013 last week from 0.2% to 0.8%.

Smaller firms tend to outperform larger rivals during an economic upturn, advisers point out. Paul Parker at Canaccord Genuity Wealth Management, said: "A recovery in the UK is good for small caps. Unlike Tesco, an oil tanker of a company, which may take a while to turn around, smaller companies are more nimble, so can cut costs and react to their environment quicker."

They also tend to perform better for long-term investors. Analysis by Bestinvest, the adviser, shows that over the past 10 years, the Numis Smaller Companies (excluding investment trusts) Index, which represents the smallest 10% of companies, returned 281%. This compares with a 133% return on the FTSE 100.

However, because of the risk that smaller firms will fail, advisers caution investors to limit exposure. Patrick Connolly at Chase de Vere suggests holding no more than 10% in smaller companies.

AIM

Shares on AIM are attractive for those planning to mitigate IHT liabilities. This is because investments are outside your estate for IHT purposes after two years. Not all AIM shares qualify, so always check.

Parker at Canaccord tips firms that have a good record of growth in periods of volatility. These include Nichols, the soft drinks firm, and Majestic Wine, whose shares are up more than fivefold since 2008. Iomart, the technology firm, is up more than ninefold.

Jason Hollands at Bestinvest prefers to invest though a fund. He likes Marlborough UK Micro Cap Growth, which has about 80% in AIM shares.

To take advantage of the IHT benefits without buying an individual company, you can invest in an "IHT portfolio" of shares that qualify for relief. These are offered by the likes of Rathbones and Canaccord Genuity.

VCT

You can also buy into AIM shares with venture capital trusts (VCTs). These are listed funds that give investors access to a portfolio of small UK enterprises. Investments attract 30% income tax relief if the shares

EIS offers 13% return

Investors could net annual returns of 9% over 20 years by investing in a community energy scheme that uses the government's renewable heat incentive.

The John Cleveland College Community Woodheat Co-op hopes to raise £1m to provide energy to the college in Hinckley, near Leicester. The project is applying to be part of the Enterprise Investment Scheme, which would push returns to 13% a year, it said.