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News letter
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Venture Capital Trusts

What are Venture Capital Trusts (VCTs)?

The Venture Capital Trust scheme was introduced on 6th April 1995. It was designed to encourage individuals to invest into smaller companies whose shares and securities are not listed on the main stock exchange.

VCTs are themselves listed on the London Stock Exchange and provide capital finance for small, expanding companies with the aim of making capital returns for investors. They are a tax efficient way to invest into smaller companies.

Money raised from individual investors is pooled by the VCT to acquire a number of different investments with the aim of spreading risk across the VCTôs portfolio. Tax relief is received up front by individuals who subscribe to the issue of new VCT shares, and these shares need to be held for five years in order to retain the initial tax reliefs (VCT shares issued in earlier years had to be held for only three years).

To retain Government approval as a VCT, 70% of its investments (by value) must be held in óqualifying holdingsô ï that is shares or securities in companies that meet the conditions of the scheme.

Investors with large income tax liabilities can invest up to £200,000 and receive tax relief on the investment. The minimum investment can be as low as £5,000, which means that VCTs are available to most investors.

A VCT is listed on the London Stock Exchange. It invests in small businesses which themselves are not listed on a major exchange. In order to qualify for tax relief, the VCT manager must invest at least 70% of proceeds in óqualifying holdingsô within three years. These are defined as shares or securities, including loans of at least five years duration, in unquoted companies and those whose shares are traded on the Alternative Investment Market (AIM) and PLUS Markets. These companies must carry out a qualifying trade wholly or mainly in the UK. The balance of 30% can remain invested in other ónon qualifyingô holdings.

Each VCT may invest into multiple qualifying companies, but each individual investment cannot make up more than 15% of that VCTôs assets. Qualifying investee companies can receive up to a maximum of £5m of funding from VCT investors in any twelve month period.
The gross assets of each of the companies into which the VCT invests must not exceed £15m at the time of investment, or £16m following the investment, and they must have fewer than 250 full-time employees at the time of the investment.
If an investment is held in a company that subsequently becomes quoted on the London Stock Exchange then it can continue to be treated as a qualifying VCT investment for up to five years.

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Tax and VCTs

Tax reliefs are only available to individuals aged 18 years or over and not to trustees or companies that invest in VCTs.
You have to hold a new VCT investment for a minimum of five years to benefit from the tax reliefs:

- Income tax relief at the rate of 30% on the amount subscribed for the shares, available on investments up to £200,000 in a tax year
- Exemption from income tax on dividends paid by the VCT
- Exemption from CGT on disposal of the shares

Second-hand VCT shares, acquired through the Stock Exchange for example, still provide tax free growth and tax free income, but income tax relief cannot be claimed on these shares. The purchase of second-hand VCT shares has to be within the same purchase limit of £200,000 per tax year.
It is important to note that tax reliefs are based on individual circumstances and may be subject to change in the future.

Different types of VCTs

VCTs can be categorised depending on the type of companies in which they invest, the investment focus of the VCT and the lifespan of the VCT.

What type of company does the VCT invest in?

AIM or Unquoted
AIM VCTs invest in new shares in companies that are admitted to trading on the Alternative Investment Market (AIM) or PLUS markets. Both AIM and PLUS are exchanges on which smaller companiesô shares are traded.
Only new shares can be bought by VCTs, and only the smaller AIM-listed companies are likely to fall within the maximum size of enterprise that VCTs are permitted to subscribe to.
Unquoted VCTs focus on investing in companies that are not quoted on any exchange.

What is the investment focus of the VCT?

Specialist or Generalist
Specialist VCTs invest in companies focused in specific sectors, such as technology or healthcare, where the VCT manager has an expertise.
Specialist VCTs are perceived to be at the riskier end of the spectrum, but can potentially offer higher returns.

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Generalist VCTs will not focus on specific sectors and so will have a broader portfolio of companies. This gives some risk mitigation but also could limit the upside of being focussed on the sector that outperforms the market during the period.

What is the lifespan of the VCT?

Evergreen or Limited Life VCT

Until fairly recently all VCTs were evergreen funds, and many new funds still are. These expect to exist forever and provide a long-term stream of tax free dividends. If an investor wants to sell the VCT then there is a market for VCTs that have demonstrated a good dividend track record.

Limited Life VCTs aim to wind-up and repay capital back to investors as soon as possible after the minimum five year holding period. This usually demands a different investment strategy to evergreen VCTs. Long term investment return isnôt as significant an objective, and the initial tax rebate is a more significant part of the overall benefit to the investor.
A VCT could therefore be described as an unquoted specialist limited life VCT, while all combinations are possible.

Who would find a VCT useful?

This investment may be suitable for investors who are looking to:

- Take advantage of income tax relief
- Harness the potential for significant capital growth in todayôs financial markets
- Diversify their existing investment portfolio
- Find a complementary solution to pensions or ISAs
- Potentially diversify their investment portfolio by including a fund which typically does not follow stock market cycles

What should I consider when choosing a VCT?

- Always consult a financial adviser if unsure of where to invest.
- Consider what you want out of the investment
  - higher capital growth potential;
  - maximum tax free income distributions;
  - or income tax relief and preservation of your original capital.
- Decide how much risk you want to take. All VCTs have risks attached but the net potential returns can be better than investing in most individual shares, whilst a level of diversification is created by the VCTs investing in multiple underlying companies.
- Understand what the VCT is going to invest in. VCTs that invest in new ventures or specialist sectors may have higher risks (and potentially higher returns) than VCTs investing in more established companies or companies focused on capital preservation.
- The experience of the manager in investing in smaller companies is very important.
- Consider the charges and compare with other VCTs.

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What if I have already invested the maximum allowance in my ISA?
Even if you have invested the full tax allowance in your ISA you can still gain tax benefits on the full £200,000 allowance into a VCT, as the tax reliefs are unrelated.

Who is eligible?
Any UK taxpayer over the age of 18 is eligible for the tax breaks. The initial tax relief is limited to the amount of income tax the individual pays in that tax year.

What are the risks?
As with any investment there are risk attached:

- Rates of tax, tax benefits and allowances may change from time to time and are not guaranteed.
- Tax treatment is dependent on individual circumstances and may be subject to change in the future.
- Past performance is not a guide to future performance and may not be repeated.
- The value of shares can go down as well as up and you may not get back the full amount invested.
- You should consider an investment in a VCT as a long-term investment.
- Investment in unquoted companies involves a higher degree of risk than investment in a quoted portfolio.

However, some factors could be viewed to address some of the risks:

- The downside risks of VCTs are buffered by the combination of tax reliefs and tax free dividends and capital gains tax.
- Risk may be further reduced, depending in the investment manager, as up to 30% of the gross investment can be invested in non-qualifying assets including cash.

When can I sell?
VCT shares can be sold or bought at any time, but initial income tax relief is only available on the new issue of shares and must be kept for five years to retain the relief. Secondary purchases of shares, created from existing shareholders exiting, lose their right to initial income tax relief however these investors can still enjoy tax-free income and growth.

VCT shares must be companies quoted on the London Stock Exchange so that when investors wish to sell they can do so. It should be noted, though, that the secondary market in VCT shares is limited, and investors can expect to dispose of their holdings on the open market only at a, sometimes substantial, discount to the underlying net asset value.

For this reason, many VCTs have a policy of buying back their own shares so as to control the extent to which their shares are discounted. The operation depends on the VCT having generated sufficient liquid returns from its investments, and they are only able to do so for certain periods during the year.

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How do I invest and receive the tax breaks?

It is always advisable to consult a financial adviser who will complete all transactions on your behalf, although it is also possible to go through a stockbroker or invest directly.
When you buy a new issue VCT, you receive the shares certificate and a tax certificate. It is this tax certificate that you send to H.M. Revenue & Customs to claim your income tax relief.

Those investors paying tax under PAYE can choose to have their tax code adjusted immediately and so pay less tax or can apply for an immediate tax repayment if they are investing at the end of the tax year.

If the investor dies, even within the first five years, the income tax is not reclaimed.

Full use of these tax advantages will depend on individual circumstances and if youqre unsure of your own potential tax liabilities, you should seek professional advice from a qualified tax adviser. Please remember that tax rules and regulations are subject to change.
The value of an investment may go down as well as up and an investor may not get back the full amount invested. Please note that past performance is no guide to future performance. An investment may only be made on the basis of the information set out in the prospectus, product brochure and terms and conditions document.

Venture Capital Trusts should be regarded as higher risk investments. They are only suitable for UK resident taxpayers who are over 18 and can tolerate higher risk and have a time horizon greater than five years. Nothing in this guide should be regarded as investment advice.

At Seven Financial we are here to help.
Please contact the team.