

# An Adviser's Guide to Venture Capital Trusts

## Find inside:

- VCT landscape
- Risks and rewards
- Rules for VCTs
- Claiming the tax reliefs
- Interaction with pensions and other tax wrappers
- Charges and practicalities
- Suitability
- Research and due diligence
- Case studies

An up to date and comprehensive resource that contains the information required to make informed decisions about VCT investments

First Edition

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An Adviser’s Guide to

Venture Capital Trusts

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# Introduction

*This guide is designed as a practical and impartial resource for financial advisers, providing concise and common-sense assistance with the technical, planning and legislative aspects of using Venture Capital Trusts (VCTs). Relevant case studies, an outline of the rules and updates on rule changes give clarity on when and how VCTs can be helpful. This reference document also provides useful tips on how to assess VCT offers and providers, as well as client suitability considerations that inform advisers on making the best use of the VCT tax reliefs.*

*While the key focus of this guide is the practicalities of using VCTs, our regular VCT Industry Report is the place to go for opinions, forecasts, research and market analysis. This insightful resource includes key metrics and provider and adviser discussions, and is available free of charge from Intelligent Partnership.*



## Learning Objectives

After reading this guide, advisers will be able to:

- Apply the main rules and practicalities that govern the VCT reliefs available.
- Explain the main risks associated with VCT investments.
- Define the key aspects that need to be taken into account when considering client suitability for a VCT investment.
- Evaluate the main considerations for a VCT investment and investment provider.
- Access planning examples that can apply to real-life situations.
- Ascertain the circumstances in which VCT reliefs can be withdrawn.

## Acknowledgements

A publication like this is rarely the product of one organisation's efforts; to ensure that it is up to date, comprehensive, accurate and captures all of the key issues requires a wider input. We've had plenty of help producing this Guide and would like to thank David Brookes, Sarah McGuffick, Ian Sayers and Rhodri Whitlock, who have contributed their thoughts to this Guide. We would also like to thank our partners: Amati Global Investors, Blackfinch Ventures, GrowthInvest, NVM Private Equity, Octopus Investments and Seneca Partners. It would not be possible to produce educational material like this without their generous support and contribution towards the production, printing and distribution of the guide.



### IAN SAYERS

CHIEF EXECUTIVE  
ASSOCIATION OF INVESTMENT COMPANIES

## Opening Statement

*2018/19 was a bumper tax year for Venture Capital Trusts (VCTs) with the sector raising £731 million for investment in small businesses. This is the **highest amount ever raised** at the current 30% level of upfront tax relief and the second highest amount since VCTs were created in 1995. There is clearly a need for VCTs which offer retail investors access to small unquoted companies, with generous tax reliefs to compensate them for the higher risks involved. Though the companies VCTs invest in start small and are high-risk, they can become household names in the future, helping to create much needed growth.*

*Consistent high demand for VCTs reflects the **growing recognition of the benefits** they provide to investors. They also have a strong long-term record of delivering growth and income returns. An investment in the average VCT over 5 years is up 36% and over 10 years up 178%. The average yield for the VCT Generalist sector is 7%. In the 2017 Budget, rule changes were announced to ensure VCTs invest in the ambitious,*

*innovative companies that are the backbone of the economy. However, these younger companies will be riskier than some of the past investments and this must be considered when projecting likely income levels in the future.*

*These returns, whether in the form of dividends or capital profits, are free from any income tax or capital gains tax. Combined with the 30% up-front income tax relief available when subscribing for new shares, this makes VCTs **an attractive prospect** for tax efficient portfolio planning for those clients for whom VCTs are suitable. This is likely to be more relevant for high earners facing pension restrictions. The changes to the amount high earners can pay into pensions have prompted further interest in VCTs over recent years.*

*VCT managers have continued to find a host of opportunities. Of course, it's too early to understand the long-term impact of Brexit but usually the growth companies that attract VCT funding are global in their approach and opportunities are opening up in the US, Middle East and Asia. The key Brexit worry for VCTs has been the status of Europeans working in the UK after Brexit and whether smaller companies will be able to retain and attract talent.*

*The **government's continuing support for VCTs** is undoubtedly good news for the UK's younger companies as they will benefit from the investment and expertise they need to grow. VCT-backed businesses deliver vital economic, social and environmental benefits, with jobs more than doubling after VCT investment. And VCT investment continues to be a catalyst for change at some of the UK's fastest growing businesses.*





# The VCT landscape

## Purpose

Venture Capital Trusts (VCTs) are specialised investment companies that are listed on the London Stock Exchange (LSE) (VCTs are permitted to be listed on any European regulated market but all current VCTs are listed on the LSE). The government grants various tax reliefs to VCT investors to encourage investment into portfolios of small and medium-sized enterprises (SMEs) in the UK. SMEs are recognised as vital contributors to economic growth and job creation. They are generally deemed to be risky investments and therefore the government offers incentives to investors in VCTs in the form of tax advantages.

The VCT scheme is not a tax avoidance scheme that operates by taking advantage of legal loopholes. It is a statutory scheme that uses tax reliefs to incentivise investors to invest in a vital part of the UK economy.

## Types of VCT

VCTs commonly fall into THREE broad categories:

**GENERALIST** – investing in unquoted companies across a range of sectors;

**SPECIALIST SECTORS** – for example, technology or healthcare;

**AIM** – shares listed on the Alternative Investment Market.

Some VCTs previously operated as limited life VCTs. These aimed to invest capital and then wind up within 5-10 years. Given the new ‘risk-to-capital’ condition (explained later on) most VCTs now operate in one of the three sectors mentioned.

Despite the variety, the investment strategies employed by VCT managers do differ. We will discuss the different types in more detail in further sections.

## History and main developments

VCTs were first announced in the November 1993 Budget and, following a short consultation, introduced in the Finance Act 1995 to stimulate investment in small businesses.

Since then, over £8 billion has been raised by VCTs and today there are typically more than 30 VCTs raising funds in any given year. This is widely seen as a great success and the scheme has enjoyed the support of successive governments.



**£8bn**  
invested into VCTs

1995

2019

The majority of changes that have been introduced to the rules governing VCTs, have been made with the intention of ensuring the schemes continue to support high growth companies.

The scheme was expanded in 2011 and 2012 to allow greater levels of investment into larger companies.

## SIZE OF VCT QUALIFYING COMPANIES

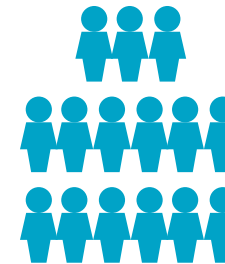
■ PRIOR TO 6 APRIL 2012

■ ON OR AFTER 6 APRIL 2012



up to 50

full-time equivalent  
employees



up to 250

full-time equivalent  
employees

Further changes to the VCT scheme were made in 2015 to ensure that the VCT reliefs continued to comply with EU State Aid rules. Overlapping with changes made to EIS qualification, these changes had the effect of restricting the types of companies that qualify for VCT investment.

In the Finance Act 2016, changes were made with regard to the permitted non-qualifying investments a VCT can make, limiting such investments to a narrower list of permitted investments required only for liquidity management purposes (including short-term deposits and shares or securities acquired on a European regulated stock market).

## Autumn Budget 2017

In addition, and in line with similar rules introduced for EIS and SEIS, it was announced

in the Autumn Budget 2017 that the 2017/18 Finance Bill would include a new ‘principles based approach’ to identify lower risk activities that should not benefit from the tax reliefs. In accordance with the Finance Act 2018, the ‘risk-to-capital condition’ applies to investments made on or after 15 March 2018.

The Autumn Budget 2017 also included a welcome boost for VCT investments into knowledge-intensive companies. Knowledge-intensive companies (explained in greater detail in later sections) are those which are carrying out significant levels of research and development (R&D); these can qualify for higher amounts of VCT (and EIS) funding than other companies.

As a result, for VCT investments in knowledge-intensive companies made from 6 April 2018:

- The 12-month investment limits are doubled (from £5 million to £10 million per company).
- Greater flexibility has been provided to knowledge-intensive companies over how the age limit is applied.

Additional measures for all VCTs include:

1. VCTs are no longer able to invest in companies under rules in place at the time funds were raised (but will have to invest under the rules currently in place); and
2. VCTs have to invest more money in qualifying holdings.

There is more detail on these changes in later sections.

None of these recent changes should be interpreted as the government changing their support of VCTs and the associated tax reliefs. However, it should be noted that some of these targeted changes will result in a greater proportion of VCTs’ funds being invested in smaller, higher risk trading companies. In meeting these requirements, VCTs will hold lower amounts of cash and liquid resources.





# Risks and rewards



Investments into unquoted small and medium-sized enterprises are deemed high risk. The value of smaller companies can rise and fall more sharply than that of more established businesses and investment returns will typically be more variable.

It is important to understand the key risks associated with VCT-qualifying investments in a general sense, and we will examine some of those risks here. However, each individual VCT will have its own unique risks and, therefore, each VCT must be individually assessed.

## Investment risks

Statistically speaking, smaller companies fail more often than larger, more established ones. The reasons for this include:

- They may be more reliant upon a small number of customers.
- They have less capital available to withstand a downturn in fortunes.
- They can take a long time to bring new initiatives to fruition and become profitable.
- Where they are listed on AIM, they can experience significant share price volatility.

These risks can be offset to some extent by measures, including: skilful stock selection and sufficient diversification; and, where

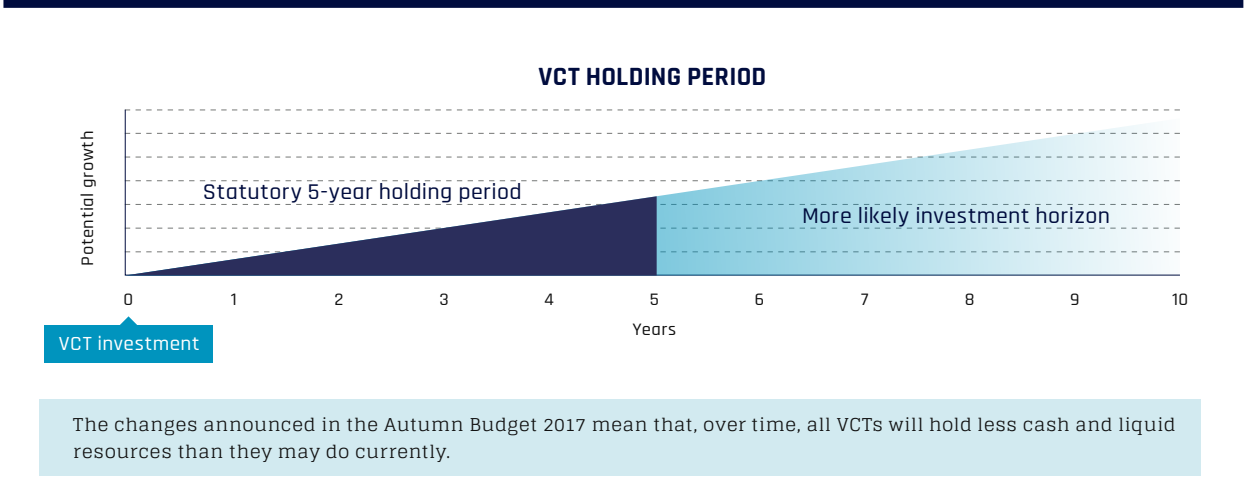
possible, investing in more mature companies with existing customers and assets (to the extent that this is permissible under the new ‘risk-to-capital’ condition), or by a combination of both of these strategies. VCTs can use gearing (borrowing money to invest), which can magnify risks (as well as returns). However, the use of gearing within VCTs is extremely rare.

## Liquidity

VCTs are investment companies and investors can sell their shares on whichever market the VCT is listed on, predominantly the LSE. In addition, up to 20% of the VCT’s assets (up to 30% for accounting periods ending before 6 April 2019) may be held in cash, or certain other liquid assets. However, liquidity can still be problematic. VCTs’ shares are not widely traded and they usually trade at a discount to their Net Asset Value (NAV).

VCT managers do often offer share buyback schemes to enable divestment, but these are usually at a discount to the underlying asset value and are not guaranteed.

Although the minimum holding period to qualify for and retain income tax relief is at least five years (note, there is no minimum holding period for Capital Gains Tax (CGT) disposal relief and tax-free dividends – although these are subject to the permitted maximum), in reality investors are likely to have to commit their funds for much longer;



most VCT investments should be viewed on a five to ten-year investment horizon.



## VCT tax reliefs in summary

VCT tax reliefs are only available to investors with a UK tax liability and are only available if the VCT maintains its qualifying status with HMRC. The amount of relief an investor will be entitled to depends on their individual circumstances. While it is important to understand the details of the tax reliefs available, tax should not be the only driver for investment in shares in a VCT.

The investment must be suitable for the client even without taking tax relief into consideration and there is likely to be a specific planning scenario involved.

There are THREE potential tax reliefs available for VCT investors, some or all of which may be available/applicable to a particular investor.

**INCOME TAX RELIEF:** Up to 30% income tax relief (subject to the permitted maximum investment amount of £200,000 p.a. and five-year minimum holding period).

**TAX-FREE DIVIDENDS:** 100% income tax relief on dividends (subject to the permitted maximum).

**TAX-FREE CAPITAL GROWTH:** Subject to the permitted maximum.

Some VCTs were previously positioned as ‘limited life’ or ‘planned exit’ and had an objective of winding up as soon after the five-year minimum holding period as possible. However this was still subject to being able to successfully dispose of the qualifying investments (without there being any arrangements in place to sell the assets from the outset, which would impede qualification for the tax reliefs).

## Tax risks

In order to qualify for the tax reliefs, VCTs must follow a number of rules. The rules govern:

- The types of investments that they make;
- How much cash they can retain within the fund;
- How quickly they have to deploy any funds they raise.

If the VCT breaches any of these rules, it may lose its approved status and investors would risk having their tax relief withdrawn and clawed back by HMRC.

The specific rules will be explained further in the ‘Rules for VCTs’ section which starts on page 15.



# The permitted maximum

Investors can purchase as many shares in VCTs as they like, in either new share issues or in the secondary market. However, there is a limit on how many of those shares will qualify for the tax reliefs. That limit is known as the permitted maximum and is currently set at £200,000 worth of VCT share purchases a year, including purchases of newly-issued shares and purchases in the secondary market.

The permitted maximum was £100,000 up to the tax year 2003-04. Therefore, this limit needs to be used when calculating the value of tax reliefs relating to VCT shares purchased prior to April 2004.

This means that it is perfectly possible to build up a portfolio of tax-advantaged VCT shares in excess of £200,000, provided that no more than £200,000 of shares were purchased in any single year.

Note: There is no income tax relief for VCT shares purchased on the secondary market.

## Rules when the permitted maximum is exceeded

If the permitted maximum has been exceeded, when calculating which shares to claim reliefs on, it is NOT possible to choose which shares will be treated as acquired in excess of the permitted maximum (and therefore do not attract any reliefs).

Instead, shares acquired earlier in the tax year count towards the permitted maximum first. The basic rules are:

- The annual limit applies to all the taxpayer's acquisitions in VCTs in the tax year concerned;
- Shares acquired earlier in the tax year count towards the permitted maximum first;
- Shares in different VCTs or different classes of ordinary share in the same VCT, acquired on the same day, are identified on a pro-rata basis.



## COMPARISON OF RISKS WITH EIS

It is worth comparing the risks of VCTs with EIS, the other major tax-advantaged venture capital scheme in the UK.

The biggest difference is that VCTs generally operate a much bigger pool of investee companies, giving increased diversification and limiting investment risk.

Secondly, as they are listed on a recognised exchange and hold more liquid assets than EIS funds (at least 20% of a VCT's funds are not required to be invested in qualifying holdings; or 30% for accounting periods ending before 6 April 2019), they have increased liquidity.

For these reasons, a VCT would usually be viewed as a less risky investment than an EIS company or fund.

## VCT Tax Reliefs

VCT TAX RELIEFS	INCOME TAX RELIEF	TAX-FREE GROWTH (DISPOSAL RELIEF)	TAX-FREE DIVIDENDS
RATE OF RELIEF	Up to 30% of the value of VCT shares subscribed for subject to permitted maximum	100% CGT exemption on disposals of VCT shares subject to permitted maximum	Dividends are not subject to income tax subject to permitted maximum
MINIMUM HOLDING PERIOD	5 years from the acquisition date of the shares in the VCT	None	None
WINDOW OF OPPORTUNITY	Relief can be claimed in the same year as the VCT shares are issued (unlike EIS, there is no carryback of a VCT subscription to a previous year)	Subject to the VCT maintaining its qualifying status, no CGT to pay upon disposal if VCT shares are sold at a gain at any time	Subject to the VCT maintaining its qualifying status, no income tax to pay on dividends paid from VCTs at any time
RELIEF ON SECONDARY MARKET PURCHASES	No	Yes	Yes
MAXIMUM LIMIT	£60,000 based on the annual permitted maximum of £200,000 worth of VCT share purchases in any tax year	Gains on the disposal of ordinary shares in a VCT are not chargeable to CGT providing individuals aged 18 or over acquire ordinary VCT shares (whether by subscription for new shares or otherwise) within the annual permitted maximum	Individuals aged 18 or over who acquire ordinary VCT shares (whether by subscription for new shares or otherwise) are exempt from income tax on dividends in respect of shares acquired within the permitted maximum
FURTHER CONSIDERATIONS	Maximum limit includes purchases of newly-issued shares and purchases in the secondary market	Losses made on disposals of shares in VCTs cannot be used to offset gains made elsewhere when calculating an investor's CGT liability	Investors who receive exempt dividends do not have to show them on their tax returns



# Income tax relief

VCT investors are potentially able to claim a reduction in their income tax bill of 30% of the cost of the VCT shares they have purchased, up to the permitted maximum of £200,000 worth of shares in any tax year. The reduction is applied to the investor’s income tax bill in the same tax year as the shares are issued. However, unlike EIS, there is no carry back of a VCT subscription to a previous year.

## POINTS TO NOTE:

An investor’s **overall income tax liability** cannot be negative (i.e. it is not possible to claim relief on tax that hasn’t been paid or isn’t due to be paid).

### Example

A client who purchased the maximum £200,000 of VCT shares would be entitled to claim up to £60,000 of income tax relief (£200,000 x 30%).

If the client only paid £30,000 of income tax , £30,000 of that potential relief would be lost (£60,000 – £30,000). Leftover income tax relief cannot be carried back or forward.

In this case the client could have invested £100,000 in VCT shares and still have reduced their income tax bill to zero.

The **minimum holding period** to retain the income tax relief is five years, starting from the date of the share issue. It ends on the fifth anniversary of the date of the share issue. If an investor disposes of their shares prior to the end of the five-year period, HMRC claws back the income tax relief.

### Example

A client subscribes for £100,000 of VCT shares and receives £30,000 income tax relief. If the client was to then sell those shares for £150,000 within five years, HMRC would claw back the full £30,000.

The only cases when it might make sense to sell shares within the five-year period, are when the sale proceeds exceed any clawback of income tax relief.

If **all shares are disposed of at a loss** within five years, the clawback will be equivalent to the sale proceeds multiplied by 30%.

### Example

Assume a client buys £100,000 of VCT shares and receives £30,000 income tax relief. If the client was to then sell those shares for £34,000 within five years, HMRC would claw back £10,200 (£34,000 x 30%).

If some of the shares are **disposed of at a loss** within five years there is a slightly more complex formula.

### Example

Assume a client buys 100,000 VCT shares for £100,000 and receives £30,000 income tax relief. If the client then sold 10,000 of those shares for £2,000 within five years, the clawback would be the smaller of:

- the relief given on shares disposed of (£30,000 x 10,000 / 100,000 = £3,000 in this example).
- the consideration received x 30% (£2,000 x 30% = £600 in this example).

In this example the relief to be withdrawn is therefore £600.

If shares are disposed of other than at arm’s length (a normal commercial transaction between two or more persons that does not favour one or other of the parties i.e. there is no collusion between the buyer and the seller) all the relief given in respect of the shares disposed of is withdrawn.

# Clawbacks

The clawback can never be more than the amount of the initial income tax relief (subject to any interest that may be due). If the shares are disposed of at a gain within five years, HMRC will claw back the full amount of the tax relief received. HMRC will claw back income tax relief by raising a special assessment for the tax year in which the relief was obtained.

Transferring the shares to a spouse or civil partner within the five-year period does NOT trigger a clawback of income tax relief, but transferring the shares to any other third party does. There is no clawback if the disposal or transfer is a result of the investor’s death.

# Brand new shares

To qualify for income tax relief the client must subscribe, pay for and be issued brand new shares in a VCT. Secondary purchases, either purchased on an exchange or arranged privately, do not qualify for income tax relief.

# Tax-free dividends

Dividends issued by VCTs are exempt from income tax and investors who receive exempt dividends do not have to show them on their tax returns. There is no minimum holding period for this relief, and it applies to both subscriptions

for newly-issued shares and purchases of shares in the secondary market. However, the exemption from income tax on dividends is subject to the permitted maximum.

### Example

A client with a £250,000 portfolio of VCTs that yielded 5% would be entitled to £12,500 tax-free income annually (provided that no more than £200,000 of VCT shares had been purchased in any single tax year).

# Tax-free growth (disposal relief)

Disposals of VCT shares are not subject to CGT as long as the company was a VCT both when the investor acquired the shares and when he or she disposed of them, and they are aged 18 or over at the date of disposal. There is no minimum holding period for this relief, and it applies to both subscriptions for newly-issued shares and purchases of shares on the secondary market. However, disposal relief is subject to the permitted maximum.

### Example

A client purchases £50,000 of VCT shares and then sells them for £75,000 six years later. Conventional shares would have attracted £5,000 CGT (ignoring any annual allowances and applying the higher CGT rate of 20%), but shares in VCTs are CGT exempt.

Losses made on disposals of VCTs cannot be used to offset gains made elsewhere when calculating an investor’s total annual CGT.



Regulatory risk

VCTs that meet all the qualifying conditions are approved by the Venture Capital Relief Team on behalf of HMRC.

VCTs are either fully approved (once established) or provisionally approved (for new VCTs) by HMRC.

Loss of VCT approval is extremely rare, but for completeness, if a VCT loses its approval:

- 1. HMRC may claw back any income tax relief if the VCT loses its approval within five years of the share issue, or at any time if the VCT was only provisionally approved;
- 2. All dividends paid by a VCT with provisional approval will be treated as if they were never exempt from income tax, and HMRC may claw back the tax due;
- 3. Any VCT shares whose disposal would ordinarily have been exempt from CGT will lose that exemption.

There is more on the various conditions that VCTs have to meet in the 'Rules for VCTs' section on page 15.

Comparison:  
EIS and VCT tax reliefs

There are some notable differences in how the tax reliefs available with VCTs compare to those available through EIS (the other major tax-advantaged venture capital scheme in the UK).

- Income tax relief is subject to a five-year minimum holding period with VCTs, compared to three years with EIS (although the investment horizon is likely to be five years or more).
- Unlike EIS, VCT investment cannot be carried back to previous tax years.
- There is no loss relief, CGT deferral relief or IHT relief with VCTs.
- VCTs can pay dividends tax-free, EIS cannot.
- Both VCTs and EIS investments are not subject to CGT on capital gains made, (subject to certain conditions).

With a VCT, income tax relief is claimed at the point at which the shares are issued by the VCT. This is also treated as the starting point for the minimum holding period. In an EIS company investment, the minimum holding period starts when the shares are subscribed for and income tax relief can be claimed as soon as the company has issued an EIS3 certificate to the investor.



VCT AND EIS COMPARISON	VCT <sup>1</sup>	EIS portfolio/fund <sup>1</sup>
INCOME TAX RELIEF	30%	30%
MINIMUM TERM	5 years	3 years
LIKELY INVESTMENT HORIZON	5 - 10 years	5 - 10 years
MAXIMUM ANNUAL INVESTMENT ELIGIBLE	£200,000	£1m plus £1m carry back*
DIVIDENDS	Tax exempt	Taxed
CAPITAL GAINS	Tax exempt	Tax exempt
CGT DEFERRAL	No	Yes
LOSS RELIEF	No	Yes
IHT RELIEF	No	100% after 2 year holding period
DIVERSIFICATION	30 - 60 companies	4 - 15 companies
LIQUIDITY	Up to 20% (for accounting periods ending on or after 6 April 2019), of the VCT's assets may be held in cash**	There is no large-scale active secondary market*** in unquoted shares
TARGET DEPLOYMENT TIMELINE FOR FULL INVESTOR SUBSCRIPTION	1 - 6 months unless there are fixed allotment dates for each tax year	12 - 24 months

<sup>1</sup> Subject to conditions being met.

\* From 6 April 2018, maximum £2m where at least £1m is invested in knowledge-intensive companies.

\*\* VCT managers do often offer share buyback schemes to enable divestment, but these are usually at a discount to the underlying asset value and are not guaranteed. VCTs' shares are not widely traded

and they usually trade at a discount to their Net Asset Value (NAV).

\*\*\* EIS managers do not offer buy-backs. Investors should regard themselves as locked in to the shares until the underlying company lists on a recognised stock exchange, achieves a trade sale, or the company is wound up. AIM listed EIS-qualifying shares have the potential for faster disposal.

VCT fundraising is crucial to the UK's younger companies, as they will benefit from the VCT investment and expertise they need to grow. VCT-backed businesses deliver vital economic, social and environmental benefits, with jobs more than doubling after VCT investment.

IAN SAYERS, CHIEF EXECUTIVE,  
ASSOCIATION OF INVESTMENT COMPANIES





# Thought Leadership

## THE IMPORTANT ROLE OF VCTs

### RHODRI WHITLOCK

ASSURANCE & ADVISORY PARTNER  
HEAD OF FINANCIAL SERVICES AND ASSET MANAGEMENT, CROWE UK

Venture Capital Trusts (VCTs) have been with us since 1995 and provide ‘tax advantaged’ long-term finance (‘patient capital’) to small businesses, a key segment of the UK economy that often struggles to raise development, or scale-up capital from other sources.

While VCT investment cannot guarantee a business’ success, the funding they provide has contributed to the success of many household names as well as the innovation of less familiar names but nevertheless **key to maintaining UK Plc’s reputation** as a key innovation hub.

VCTs do not just invest then wait for returns. Through their investment managers, many VCTs **engage directly with the investee companies** acting as mentor and offering advice on a range of strategic and development issues. Research undertaken by the AIC identified that “66% of companies currently within the sector’s portfolio have benefited from a representative of the fund joining their board”.

The success of VCTs has attracted attention and 2018 saw significant changes to the VCT regulations which narrowed the range of investment types that could be made, revised certain investment qualifying criteria and amplified that, to be eligible for the attractive tax reliefs VCTs afford, the VCTs must be providing genuine risk capital. The tightening of the qualifying criteria can make it challenging when evaluating investment opportunities and requires focused due diligence on areas such as the date of first commercial sale.

So what is the appeal of VCTs? Typically, investing in early stage high growth businesses is a risky activity. A view reinforced by the recent rule revisions. Investing in a VCT **lowers the risk** by diversifying the risk across a portfolio of companies and the investor benefits from the expertise of an experienced professional investment manager. However, it does remain the case that the investments are in small, privately owned and young companies which may or may not succeed. They can be a much riskier investment than investing in larger, more established companies. Ultimately this is an equity investment and an investor’s money is at risk.

In recognition of this risk/reward dynamic the government offers tax incentives to retail investors to place funds with VCTs to compensate for the higher risks of investing in small companies.

### Non-compliance

If the VCT itself doesn’t comply with a range of conditions, both the VCT and the investors lose all the tax benefits.

There have been a small number of instances where VCT status has been withdrawn over the years. There can be some latitude where the breach was unintentional and outside of the control of the VCT but it is essential that VCTs and their managers remain diligent and vigilant.



# Rules for VCTs

## Structure of VCTs

VCTs are specialist investment companies that list their shares on an EU regulated market. An EU regulated market is one in which the relevant competent authority is recognised as meeting the commission’s definition of a regulated market. There are currently seven recognised regulated markets in the UK, including the London Stock Exchange, EDX, and ICE Futures Europe. All existing VCTs are currently listed on the LSE.

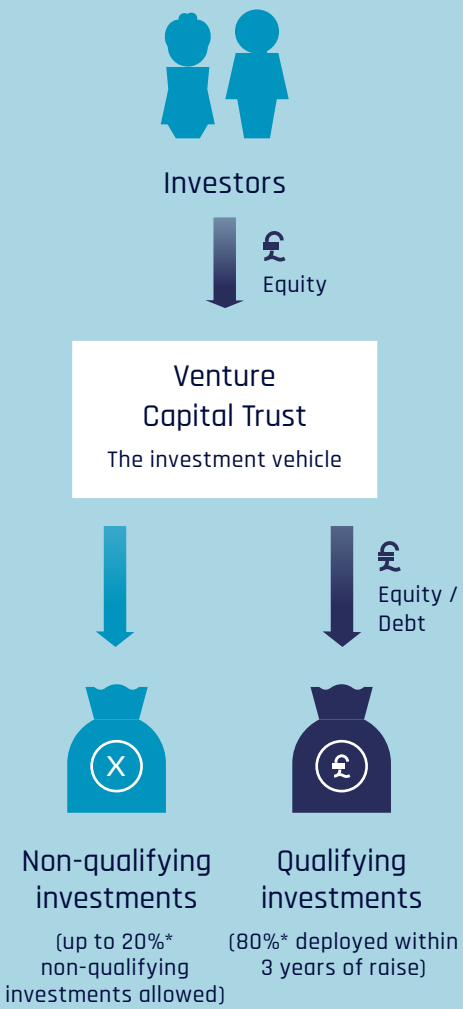
Because VCTs are investment companies, they have a closed-ended structure. This enables the VCT fund manager to take a long-term view and invest in less liquid assets than open-ended structures would normally do, as they do not have to worry about selling assets to meet redemptions.

The flip side to this is that if demand for their shares is low (because the upfront income tax relief is not available when buying VCT shares on the secondary market), then it is likely that they will trade at a discount to their Net Asset Value (NAV).

Many VCTs offer to buy back shares from the investors who originally subscribed for them, at a predetermined discount to the NAV (usually between 5% and 10%).

This helps address the issue of the lack of liquidity in VCT shares and gives investors a potential exit; however the VCT is not obliged to buy back shares and it is not guaranteed. VCTs will typically allocate a

## Simple VCT Structure



\*For accounting periods beginning before 6 April 2019 this was 30% and 70% respectively.

In addition, at least 30% of all new funds raised in accounting periods beginning after 5 April 2018 need to be invested in qualifying holdings within 12 months of the end of the accounting period in which the VCT issues its shares.

budget for buy backs, and may suspend the service if the budget is exceeded.



As investment companies, VCTs also have an independent board of directors who are responsible for looking after the VCT’s interests.

Investors are shareholders of the VCT itself (not customers of the fund management company as is the case with open-ended funds) and therefore, in theory, they have a say on how the company is run in accordance with their voting rights and company law.

Unlike open-ended funds, VCTs can use gearing (borrowing money to invest), which can magnify both gains and losses. However, the use of gearing is rare. VCTs can also retain some of their profits and pay them out later, which can allow VCTs to “smooth” dividend income.

Fundraising

Bearing in mind the closed-ended structure of VCTs, there are several different types of fundraising that VCTs might engage in.

- 1. **A brand new VCT** issuing shares for the very first time. There is no existing portfolio for investors to buy into.
- 2. **A new share class in an existing VCT** that will invest in a new portfolio of investments that will be kept separate from the existing portfolio. The investor will only enjoy returns from the assets allocated to that share class. The benefit

OPEN VCTS	AVERAGE	MODE	MIN	MEDIAN	MAX
TARGET DIVIDEND	4.00%	5.00%	3.00%	5.00%	5.00%
MINIMUM SUBSCRIPTION	£3,900	£5,000	£2,500	£4,000	£5,000
TARGET FUNDRAISE	£34,520,000	£40,000,000	£10,000,000	£25,000,000	£120,000,000
DIVERSIFICATION	43.1	43	5	43	90

over a new VCT is that the VCT’s performance thus far can be assessed (although the new share class investors won’t share in the performance of other VCT share classes, unless they already have an existing holding in the other class or classes) and the VCT’s costs can be spread across a larger asset base.

**3. Top-up to an existing share class** - Investors purchase shares that give them exposure to an existing pool of assets and can immediately start earning dividend income if income is available. The top-up will also spread the VCT’s costs across a larger asset base. VCTs do not necessarily raise new money every year, and some VCT fundraises can be relatively small and completed quickly.

OPEN VCTS INVESTMENT METRICS

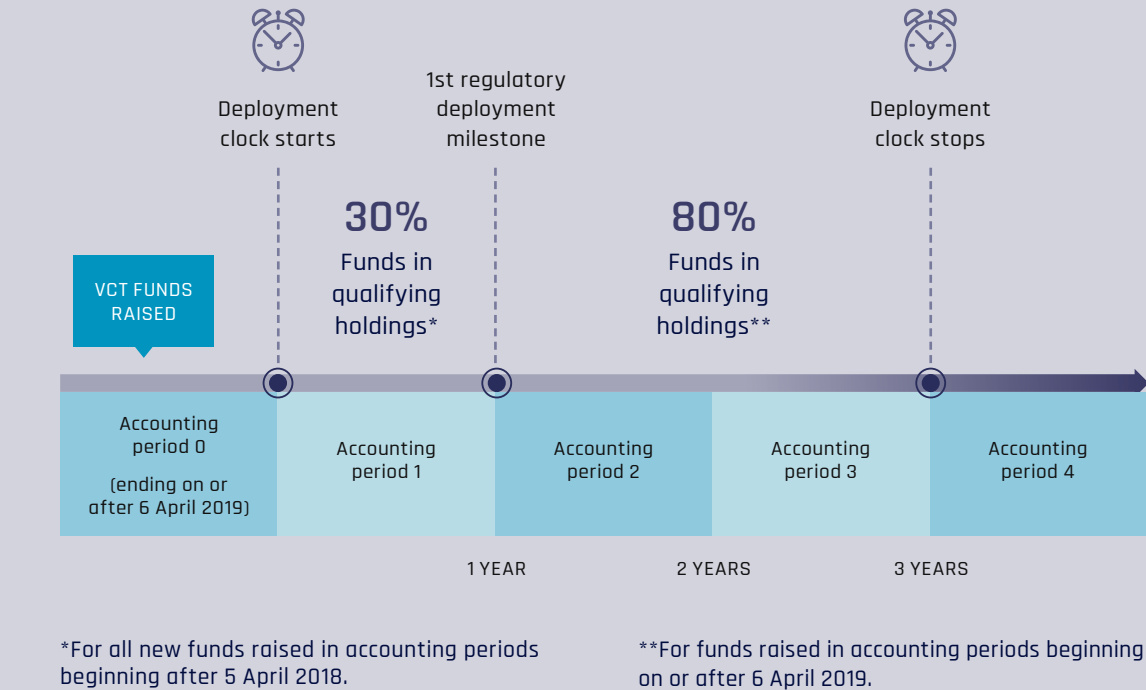
There is a diverse range of sizes among VCT investments, as shown by the following target fundraises taken from MICAP, in relation to the 2018/19 tax year fundraising period.

It is difficult to plot a correlation between a VCT’s target fundraise and other characteristics as, the varying fundraising capabilities of the managers must be taken into account.

Typically, the majority of open VCTs do not have a sector bias and invest in General Enterprise, although there are VCTs that focus on Industry & Infrastructure and Pharmaceuticals & Biotechnology.

SOURCE: MICAP (AT SEPTEMBER 2019)

Timing of deployment



Budget 2017

The following measures were announced in the 2017 Budget and published in the 2018 Finance Act, which was enacted on 15 March 2018:

- 30% of funds raised by VCTs now need to be invested in qualifying holdings within 12 months of the end of the accounting period in which the funds were raised, for accounting periods beginning after 5 April 2018.
- VCTs will need to increase the proportion of funds held in qualifying companies within three years of the end of the accounting period in which the funds were raised from 70% to 80%, for funds raised in accounting periods beginning on or after 6 April 2019.

- These measures will mean that more money is invested in qualifying companies and that VCTs will hold less cash and liquid resources.

During the period that the new money raised is not invested in qualifying holdings, it is usually invested in cash, certain short-term deposits, listed shares and securities (including investment trusts) until funds can be deployed in suitable qualifying companies.





## Rules governing portfolio construction

There are a number of rules governing portfolio construction for VCTs. VCTs must:

1. Derive their income wholly or mainly from shares and securities.
2. NOT retain more than 15% of the income from shares and securities.
3. NOT hold an investment in a company that exceeds 15% by value of the VCT's total investments.
4. Have at least 80% of their investments in qualifying trading companies (for VCT accounting periods ending before April 2019 this percentage was 70%).
5. NOT make an investment in a company that causes that company to receive:
  - more than £5m of State-aided investment (which includes EIS and VCT investment) in the 12 months ending on the date of the investment (this increases to £10m for qualifying knowledge-intensive

companies (more details are available on knowledge-intensive companies on page 25) from 6 April 2018); or

- more than a lifetime total of £12m (£20m for a knowledge-intensive company).
6. In general, NOT invest in a company whose trade is more than seven years old (ten years for a knowledge-intensive company).
  7. Only make minority investments (less than 50%) in investee companies.
  8. NOT invest in a company that goes on to use the VCT funds to acquire another company or business.
  9. VCTs must only invest in:
    - Qualifying holdings (i.e. unquoted where "unquoted" means not quoted on a recognised investment exchange, for example the Main Market of the LSE, meaning that companies quoted on AIM can be VCT qualifying investments) in or qualifying trading companies that meet certain conditions;
    - certain permitted non-qualifying holdings (cash and short-term deposits, allowed for liquidity management purposes, together with listed shares and securities).

At least 10% of a VCT's investment in a company must be in "eligible shares" (broadly, ordinary shares that don't carry any present or future preferential rights).

The remainder of a VCT's investment in a company can comprise any class of shares (even preference shares) or loans. However, loans must not be secured or guaranteed, be repayable within five years (other than in default situations) and must be at a commercial rate of interest.

The qualifying trading companies in which VCTs invest must also meet a number of detailed rules, as described on page 23.

A trade is NOT a qualifying trade if it consists of certain 'excluded activities'. Excluded activities are explained further on page 23.

## Returning capital to shareholders

A VCT must NOT return capital to shareholders within three years of the end of the accounting period during which the shares were issued. If it does, this is a prohibited payment and could result in the VCT losing its qualifying status.

In addition, certain arrangements that previously allowed investors to sell and then buy back shares in the same VCT, thus qualifying for another round of tax relief, are now excluded.

If an investor buys shares within six months of a disposal of shares in the same VCT, the shares will not qualify for a new round of tax relief. This applies whether the disposal takes place before or after the purchase of shares in the same VCT.

# Qualifying companies

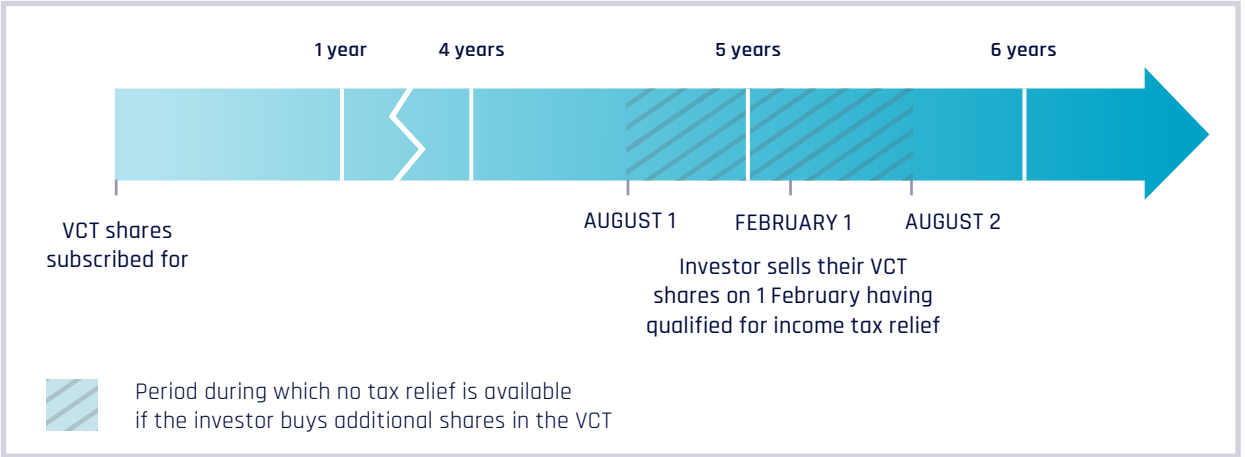
## Introducing the rules

In order to ensure that VCTs are meeting their objective of financing small to medium-sized businesses that might otherwise struggle to obtain investment from other sources, there are stringent criteria that govern whether a company and its proposed share issue is a qualifying investment for a VCT. These criteria change from time to time.

A VCT may well have a portfolio of existing investments that would not currently qualify if being made as new investments (such as renewable energy investments, hotels and care homes) and such investments are effectively 'grandfathered' from the current rules (although no new investments in such trades can be made by the VCT).

This section sets out the rules as they stand today and also details some of the most recent changes.

## Timeline of share acquisition and disposal in a single VCT by a single investor





# Risk-to-capital condition

Announced at the Autumn Budget 2017, the risk-to-capital condition applies to all investments made on or after Royal Assent of the Finance Act 2018 on 15 March 2018. However, HMRC has applied the test for all advance assurance applications submitted from December 2017.

From this point, HMRC has declined to provide advance assurances for investments that, taking into account all the facts available to them, appear likely to fail the risk-to-capital condition.

The government is keen to stress that the Venture Capital Schemes are intended to support early-stage, entrepreneurial companies that have the potential to grow in the long term. The company must be set up to carry out trade on an ongoing basis, not to carry out a single project before being wound up.

Following the government’s 2017 consultation, ‘Financing growth in innovative firms’, the enactment of the 2018 Finance Bill on 15 March 2018 saw the introduction of new conditions.

The conditions are intended to exclude tax-motivated investments, where the tax relief provides most of the return for an investor or with a limited risk to the original investment (that is, preserving an investor’s capital).

The condition depends on HMRC taking a ‘reasonable view’ as to whether an investment has been structured to provide a low risk return for investors.

## THE RISK-TO-CAPITAL CONDITION HAS TWO PARTS:

1. Whether the company has objectives to grow and develop over the long term (which broadly mirrors an existing test with the schemes); and

2. Whether there is a significant risk that there could be a loss of capital to the investor of an amount greater than the net return.

The condition requires all relevant factors about the investment to be considered in the round.

The legislation contains a non-exhaustive list of the factors that may be considered. Even if one or more indicators of potential capital preservation are present, this does not necessarily mean that the risk-to-capital condition will not be met in a particular case.

A judgement about whether capital preservation activity is taking place will depend on the overall context of the investment.

Likewise, even if none of the indicators listed in the legislation are present, the risk-to-capital condition may NOT be met if the wider circumstances of a case suggest that capital preservation is taking place.

Ultimately, a judgement will depend on the level of risk posed to investors’ capital and whether the company has genuine intent to grow and develop in the long term.

Following Royal Assent of the Finance Act 2018 on 15 March 2018, the new risk-to-capital condition will sit above the other existing eligibility requirements for the venture capital schemes. Even if the new condition is met, all other requirements must also be met for an investment to be eligible for tax relief under the schemes.



# Thought Leadership

A YEAR UNDER THE NEW RULES



DAVID BROOKES  
TAX PARTNER, BDO

If new VCT shares are subscribed for they attract initial income tax relief of up to 30% of £200,000 and qualify for tax free disposal after five years. In addition, VCT income and gains can be paid to investors by tax-free dividends (VCTs typically aim to pay a stream of tax-free dividends to investors).

A VCT can invest a mixture of equity and long-term debt into investee companies. The investors hold shares in a listed entity and therefore, unlike direct unquoted EIS investments, VCT shares do not qualify for inheritance tax business relief.

The most significant change for VCTs was the **introduction of an age limit for investee companies**. Generally, companies can only raise VCT funds in the period up to seven years after their trade started, or within 10 years for Knowledge Intensive Companies (KICs), with a few limited exceptions. Historically, VCTs have tended to invest in more mature companies which are at the point of paying dividends but now they have to focus on younger companies and can find follow-on investments problematic.

Historically, VCT investments have been used to fund management buy-outs or the acquisition of other businesses. This is no longer permitted; the VCT’s investment must now be used for the **‘growth and development’** of the investee company.

Finally, there were well publicised changes to prevent VCTs investing in low risk, so-called

‘capital preservation’ investments. In practice, most VCTs have always invested in genuine risk capital investments and so the **‘risk to capital’ rules have had less of an impact** than for some Enterprise Investment Scheme (EIS) funds.

The changes above apply to VCT and EIS investee companies but there have also been some changes specifically applying to VCTs.

VCTs have to deploy 30% of the funds they raise in qualifying investments within the first 12 months; 80% of the VCT’s funds must be invested in qualifying investments (previously 70%) **within three years**. This means VCTs have to deploy the funds they raise more quickly into qualifying investments.

**The VCT industry has adapted well to the changes.** The main challenge is finding suitable investee companies which are less than seven years old and then meeting investors’ expectations of receiving dividends. It is also difficult to launch new VCTs because they are competing with established VCTs with an existing portfolio of ‘older’ companies paying a reasonable level of dividends from day one.

Despite the tighter rules, with the restriction of pension tax relief and very few tax efficient investments available, the future still looks bright for VCTs.



## Examples of non-qualifying companies

With the rule changes , a VCT may well have a portfolio of existing investments that would not currently qualify if being made as new investments. Some examples are set out on the right hand side of this page.

Example 1

In 2013, VCT A plc invested in a company that was constructing and operating a solar-photovoltaic farm.

This would no longer be a qualifying investment for a VCT, as energy generation activities no longer qualify.

Example 2

In 2013, VCT B plc invested in a company which was undergoing a Management Buyout (MBO) and the VCT funds were being used to acquire the shares of exiting management.

This would no longer be a qualifying investment for a VCT as VCTs funds can no longer be used to acquire part of an existing business.

Example 3

In 2015, VCT C plc invested in a company which was established to operate, through subcontractors, a pub. Certain factors indicated a capital preservation strategy.

This would no longer be a qualifying investment for a VCT as it is unlikely to qualify under the ‘Risk-to-capital’ conditions introduced for all EIS and VCT investments made on or after 15 March 2018.

***“These changes are intended to provide significant additional support to knowledge-intensive companies, which evidence suggests face the greatest difficulties in accessing growth investment.”***

## Rules governing the size and type of company

There are rules which set out in detail the criteria for firms that wish to issue VCT-qualifying shares. In summary, a qualifying company must:

- 1
- NOT be in financial difficulty (as defined by EU guidelines).
- 2
- Be unquoted (however, the AIM market is not a recognised exchange for this purpose).
- 3
- NOT control another company which is not a subsidiary of the company; and it cannot itself be controlled by another company and there can be no plans in place at the time of the share issue that would jeopardise this independent status.
- 4
- Have a permanent establishment in the UK (the company does not need to be a UK company, however).
- 5
- Have fewer than 250 employees (or 500 for a knowledge-intensive company).
- 6
- Have gross assets under £15m immediately before shares are issued and under £16m immediately after shares are issued. However, the company can continue to grow afterwards.
- 7
- Not have been trading for more than seven years (ten years for a knowledge-intensive company) unless specific conditions are met.

- 8
- Be operating in a qualifying trade, preparing to trade and commence trade within two years, or conducting research and development. Most trades qualify, however, there are a number of exclusions:
- Dealing in land, commodities, futures, securities or financial instruments (including investment activities)
  - Dealing in goods other than normal retail or wholesale distribution
  - Banking, insurance, hire purchase, money lending, and other financial activities
  - Leasing
  - Receipt of royalties or licence fees
  - Legal and accounting services
  - Property development
  - Farming and market gardening
  - Forestry
  - Operating or managing hotels or residential care homes
  - Coal production, steel production and shipbuilding
  - All energy generation activities (from 6 April 2016)
- !
- Excluded activities must not be a ‘substantial’ part of the company’s trade. HMRC take ‘substantial’ to mean more than 20% of the company’s activities.



# Rules governing the raising and spending of funds

There are rules governing the amounts that qualifying companies can raise and how quickly that money must be deployed within the business.

The funds raised by the issuance of VCT-qualifying shares must be employed by the issuing company, or by a qualifying subsidiary which is at least 90% owned by the company, within two years of the share issue.

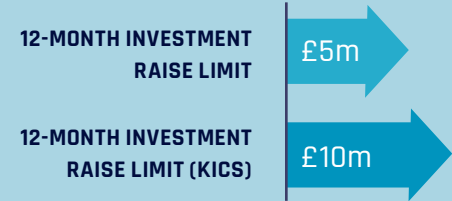
The funds must be used either for carrying on a qualifying trade, or for preparing to carry on a qualifying trade which is then begun within two years of the share issue. They cannot be used to acquire the shares, goodwill or intangible assets of another company, even if that company is carrying on a qualifying trade.



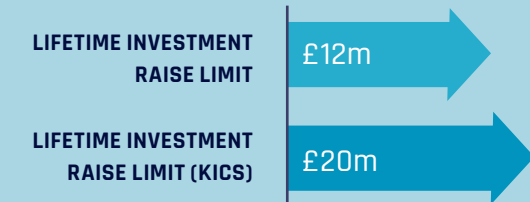
In calculating the maximum amounts that can be raised, funds raised from any of the UK's tax-advantaged venture capital schemes must be counted. The FOUR schemes are:

- The Enterprise Investment Scheme
- The Seed Enterprise Investment Scheme
- Social Investment Tax Relief
- Venture Capital Trusts

In addition, any other relevant approved risk finance State Aid must also be counted. This includes Enterprise Capital Funds and certain Regional Development funding.



The maximum amount that a firm can raise from tax-advantaged venture capital schemes and any other form of risk finance State Aid in any 12-month period is £5 million (although for investments made on or after 6 April 2018, the 12-month maximum amount of funding that knowledge-intensive companies can receive increased from £5 million to £10 million).



The maximum amount that a firm can raise from tax-advantaged venture capital schemes (and risk finance explained above) cumulatively over the firm's entire lifetime is £12 million (or £20 million for a KIC).

# Knowledge-intensive companies

Knowledge-intensive companies (KICs) are considered to be a special case and more generous rules apply. Broadly, these are:

- In at least one of three years prior to investment, the company or group has spent at least 15% of operating costs on research and development or innovation; or
- In each of those three years it has spent at least 10% of operating costs on research and development or innovation;
- either of the following conditions is also met:
  1. The **'innovation condition'** – When the relevant shares are issued, the company or group is engaged in the creation of intellectual property from which, within 10 years, it is expected, will derive the greater part of the company's or group's business, either from the exploitation of the intellectual property or by the creation of new products, processes or services which use the intellectual property.
  2. The **'skilled employee condition'** – At least 20% of the company's or group's

employees are 'skilled' and are engaged directly in research and development or innovation activities carried on by the issuing company or any qualifying subsidiary of that company. The definition of 'skilled' relies on higher educational attainments.

Since 6 April 2018, knowledge-intensive companies have been able to choose whether to use the current test of the date of first commercial sale or the point at which turnover reached £200,000 to determine when the 10-year period has begun.

## What is research and development?

R&D for tax purposes takes place when a project seeks to achieve an advance in science or technology.

The activities which directly contribute to achieving this advance in science or technology through the resolution of scientific or technological uncertainty are R&D.

Certain qualifying indirect activities related to the project are also R&D.

### More generous rules for knowledge-intensive companies

10YRS  
AGE LIMIT

£20m  
LIFETIME CAP ON  
TAX-ADVANTAGED VC

499  
EMPLOYEE  
LIMIT

£10m  
12-MONTH RISK CAPITAL  
FUNDING LIMIT



## The growth and development test

This was introduced in the 2015 Budget, based upon an examination of the business plan. Generic indicators of a focus on the growth and development of a business include proposals to:

- Increase revenues over time;
- Increase its customer base;
- Increase the number of employees.

In essence, the money must be employed to deliver something that enables the company to grow rather than preserve the status quo such as simply paying pre-existing day to day expenditure.

As part of the advance assurance process, companies need to state in their business plans how they meet the growth and development requirement.

## Advance assurance

Companies can apply to HMRC in advance of issuing shares to a VCT to check that the proposed share issue meets the qualifying criteria for VCT purposes and that, once issued, the investment will be regarded as a ‘qualifying holding’ for the VCT.

Requests for such assurances are made to the Venture Capital Reliefs Team (VCRT) of HMRC.

The advance assurance service is discretionary and non-statutory. There is no requirement for a company to obtain an advance assurance before receiving an investment or issuing shares to investors.

The advance assurance service allows the company to provide information about its intentions; about its structure and activities, about the proposed investment and about how the monies raised will be used.

As mentioned, there is no obligation upon firms to go through this advance assurance process, but it does provide an opportunity to spot any problems before the shares are issued and an assurance from the VCRT is useful for companies to show to potential investors.

Advance assurance is NOT a guarantee that a share issue qualifies or that the company will continue to qualify. If something important was not disclosed to the VCRT or, if between receiving advance assurance and the share issue something changes, it may be that the share issue or company is no longer qualifying.

However, if nothing has changed, advance assurance is normally considered binding on HMRC (although VCT tax reliefs are also subject to the circumstances of the individual investor, which HMRC will not opine on in advance).

From early 2018, HMRC has declined to consider speculative applications. Confirmation of who the likely investors are is required before HMRC will give an opinion. If details can’t be provided HMRC rejects the application.

HMRC has also confirmed that it does not intend to identify which companies qualify as knowledge-intensive companies at the time of advance assurance review unless this status is relevant to the proposed investment (for example if a prospective investor is interested in investing over £1 million into the company in a single tax year, or if the company is raising more than £5 million from VCT investors in a tax year).

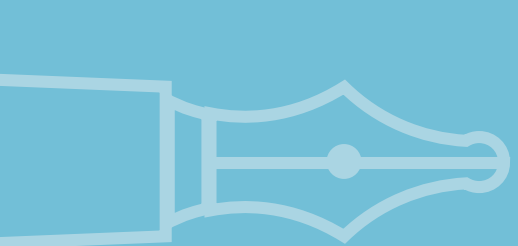
## Rules for VCT-qualifying companies

Pre-November 2015		Today
MAXIMUM AGE	No limit	7 years unless total investment represents more than 50% of the company's average turnover over the preceding 5 years and the company is using the funds to enter a new product or geographic market, or it received previous risk finance within its first 7 years
LIFETIME CAP FROM ANY COMBINATION OF VCT, EIS OR CERTAIN OTHER GOVERNMENT INCENTIVES	No limit	£12m
GROWTH AND DEVELOPMENT TEST	No requirement	Requirement that all investments are made with the intention to grow and develop business
12-MONTH INVESTMENT LIMIT (ALL TAX ADVANTAGED VC)	£5m	£5m
EMPLOYEE LIMIT (FTE)	Fewer than 250 FTE	Fewer than 250 FTE
THE USE OF VCT MONEY FOR ACQUISITIONS OF BUSINESS	Allowed	New rules to prevent VCT funds being used to acquire existing businesses or part of a business (including intangible assets that have already been used in a trade)
KNOWLEDGE-INTENSIVE	MAXIMUM NUMBER OF TRADING YEARS	10 years. From 6 April 2018, a knowledge-intensive company is able to use the date from which its annual turnover exceeded £200,000, instead of the date of its first commercial sale, when determining the date from which the end of the initial investing period is calculated
	12-MONTH INVESTMENT LIMIT (ALL TAX ADVANTAGED VC)	£10m
	LIFETIME CAP (ALL TAX ADVANTAGED VC)	£20m
	EMPLOYEE LIMIT	Fewer than 500 FTE

The Government wants to ensure that the venture capital schemes are focused towards its original objective of supporting investment

in companies with high growth potential – and not tax motivated investments structured to provide limited risk.





# Claiming the tax reliefs

## Process for claiming income tax relief

VCT income tax relief can be used to reduce or offset any income tax liability for the tax year in which the VCT shares are issued (unlike EIS income tax relief, VCT income tax relief cannot be carried back to a prior year).

In any single tax year investors cannot claim more income tax relief than the amount of income tax owed, and investors can only claim tax relief on the first £200,000 invested. Investors should therefore carefully consider the merits of investing more than they need to in order to cover their tax bill in the current year.

Once the shares are issued, the VCT’s Registrar will send tax and share certificates to investors.

Investors can then either claim the tax relief:

- by reducing their monthly tax bill through PAYE (if they are employed); or
- via the self-assessment tax return process.

Some VCTs enable regular direct debit subscriptions from investors, spreading the subscription over a period of time. While this reduces ‘lump-sum’ investments, it will result in multiple tax and share certificates, where shares are allotted on more than one date.

### To claim through PAYE

Investors can call HMRC but may also need to write a letter to them including their national insurance number, form P60 (if they have one), and a copy of their VCT tax certificate.

### To claim via the self-assessment process

Investors need to complete the additional information form SA101 and enter the total value of their VCT investments in the appropriate section of the form.

Investors in VCTs can claim income tax relief up to four years after the 31 January following the tax year in which they made the investment.

## Tax-free dividends

Investors who receive exempt dividends do not have to declare them on their tax returns.

Many VCTs have automatic reinvestment schemes, which allow investors to use the VCT dividend (which is ordinarily tax-free) to buy more shares in the VCT. With some exceptions, usually the shares are newly-issued rather than bought in the market, meaning that the amount reinvested qualifies for 30% income tax relief as a fresh VCT subscription.

## Tax-free growth

If disposal relief is due, an investor won’t have to pay CGT on any gain made on the disposal of VCT shares. For both tax-free dividends and tax-free growth there are a number of conditions that have to be met, including:

- Relief is limited to acquisitions not exceeding £200,000 worth of VCT shares in any one tax year;

- The investor is an individual (not a trustee);
- The investor is aged 18 or over at the date of disposal.

To claim tax-free growth, the company must be an approved VCT both when the shares are acquired and when the investor disposed of them. Any loss made on the disposal of VCT shares isn’t allowable for capital gains purposes.

## HMRC Venture Capital Schemes Manual: VCTs

Where individuals to whom new ordinary VCT shares have been issued so request, VCTs must, within 30 days of the request, issue income tax relief certificates. In practice VCTs may issue certificates as a matter of routine along with share certificates.

The certificate should show the name of the investor, the investor’s permanent address, including postcode, the date on which the shares were issued, the amount paid and the date it was paid, and in the case of partly paid shares, the amounts and due dates for future payments.

The certificate should certify that eligible shares have been issued to the investor, to the best of the VCT’s knowledge and belief the shares were subscribed for and issued in accordance with ITA07/S261(3) (shares subscribed for and issued for genuine commercial purposes and not as part of a tax avoidance scheme).

## Self Assessment Form SA101 for claiming VCT tax relief

Share schemes and employment lump sums, compensation and deductions, certain post-employment income and patent royalty payments

1 Share schemes - the taxable amount - excluding amounts included on your P60 or P45 £ 0 0 0 0 0 0 0 0 0 0 Box 2 is not in use	8 Exemptions for amounts entered in box 4 £ 0 0 0 0 0 0 0 0 0 0
3 Taxable lump sums and certain income after the end of your job - excluding redundancy and compensation for loss of your job £ 0 0 0 0 0 0 0 0 0 0	9 Compensation and lump sums up to £30,000 exemption £ 0 0 0 0 0 0 0 0 0 0
4 Lump sums or benefits received from an Employer Financed Retirement Benefits Scheme excluding pensions £ 0 0 0 0 0 0 0 0 0 0	10 Disability and foreign service deduction £ 0 0 0 0 0 0 0 0 0 0
5 Redundancy, other lump sums and compensation payments - the amount above the £30,000 exemption £ 0 0 0 0 0 0 0 0 0 0	11 Seafarers' Earnings Deduction - give the names of the ships in the 'Additional information' box on page A1 4 and enter pay on your 'Employment' page £ 0 0 0 0 0 0 0 0 0 0
6 Tax taken off boxes 3 to 5 £ 0 0 0 0 0 0 0 0 0 0	12 Foreign earnings not taxable in the UK £ 0 0 0 0 0 0 0 0 0 0
7 If you have left box 6 blank because the tax is included in box 2 on the 'Employment' page, put 'X' in the box <input type="checkbox"/>	13 Foreign tax for which tax credit relief not claimed £ 0 0 0 0 0 0 0 0 0 0
	14 Exempt employers' contributions to an overseas pension scheme - read the notes £ 0 0 0 0 0 0 0 0 0 0
	15 UK patent royalty payments made £ 0 0 0 0 0 0 0 0 0 0

Other tax reliefs - read the notes

1 Subscriptions for Venture Capital Trust shares - the amount on which relief is claimed £ 0 0 0 0 0 0 0 0 0 0	7 Maintenance payments (maximum £3,260) - only if you or your former spouse or civil partner were born before 6 April 1935 £ 0 0 0 0 0 0 0 0 0 0
2 Subscriptions for shares under the Enterprise Investment Scheme - the amount on which relief is claimed (and provide more information on page A1 4) £ 0 0 0 0 0 0 0 0 0 0	8 Payments to a trade union etc. for death benefits - half the amount paid (maximum £100) £ 0 0 0 0 0 0 0 0 0 0
3 Community Investment Tax Relief - the amount on which relief is claimed £ 0 0 0 0 0 0 0 0 0 0	9 Relief claimed on a qualifying distribution on the redemption of bonus shares or securities £ 0 0 0 0 0 0 0 0 0 0
4 Annual payments made £ 0 0 0 0 0 0 0 0 0 0	10 Subscriptions for shares under the Seed Enterprise Investment Scheme £ 0 0 0 0 0 0 0 0 0 0
5 Qualifying loan interest payable in the year £ 0 0 0 0 0 0 0 0 0 0	11 Social Investment Tax Relief - the amount on which relief is claimed £ 0 0 0 0 0 0 0 0 0 0
6 Post-cessation trade relief and certain other losses £ 0 0 0 0 0 0 0 0 0 0	

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## Sample VCT income tax relief certificate

Please 'fold' attached your Income Tax Relief Certificate.  
This document is valuable and should be kept in a safe place.  
You may be required to submit this certificate to HM Revenue & Customs.

Shareholder Reference Number  
C000000000

Please be aware that, once you have registered, you can also download your Income Tax Relief Certificate from [Investorcentre.co.uk](#)

Income Tax Relief Certificate				
CERTIFICATE No. AB123456	DATE OF ISSUE OF SHARES 01 November 2017	AMOUNT PAID £200.00	DATE AMOUNT PAID 01 November 2017	NUMBER OF SHARES "4,000"

INCOME TAX RELIEF CERTIFICATE  
(Incorporated and registered in England and Wales under the Companies Act 1985 with registered number 0307796)

MR AB SAMPLE

THIS IS TO CERTIFY that four thousand, one hundred and twenty eight eligible shares (as defined in paragraph 273, Income Tax Act 2007 ("ITA")), being fully paid Ordinary Shares of 10p each in Octopus Train VCT plc, have been issued to the above named holder.

To the best of the Company's knowledge and belief the shares were both subscribed for and issued for genuine commercial reasons and not as part of a scheme or arrangement the main purpose of which, or one of the main purposes of which, is the avoidance of tax (in accordance with paragraph 8(1)(3) of ITA).

To the best of the Company's knowledge and belief the shares were not issued in a case where the above named holder was not entitled to relief under paragraph 262, ITA, because the case is one to which paragraph 264, ITA (relating to loans made which would not have been made had the investor not subscribed for the shares) applies.

Company Secretary

If you don't receive the relief you think you're entitled to, please write to HM Revenue & Customs within 30 days of the expiry date of the relief to see if it is still able to be withdrawn or retained.  
THIS DOCUMENT IS VALUABLE AND SHOULD BE KEPT IN A SAFE PLACE.  
You may be required to submit this certificate to HM Revenue & Customs.





# Interaction with pensions and other wrappers

## VCT income tax relief interaction with other investments

VCT income tax relief is limited to an amount that reduces an investor’s income tax liability to NIL.

Advisers and clients should be aware that the amount of VCT income tax relief that the investor can claim could be reduced by any other transaction that effectively benefits from income tax relief, such as a Gift Aid payment.

This is because, certain transactions, including Gift Aid payments to charities, for example, are treated as having been made after deduction of income tax. As a result, HMRC requires the donor to have paid enough income tax or CGT in that year to cover the tax the charity can claim from HMRC.

In this scenario, if VCT income tax relief is used to reduce a client’s income tax bill to NIL for a year in which that investor has no CGT liability but has made Gift Aid donations, the client may

have to pay an additional amount of income tax to cover the amount of tax reclaimed for the year by all the charities to which the client has made Gift Aid donations.

Generally speaking, VCT income tax relief is given before EIS income tax relief and tax advice should be taken as to optimising any claims made (for example, EIS relief could potentially be carried back to a prior year, leaving just VCT income tax relief in consideration for a particular year).

### VCTs and ISAs

Some VCT providers offer VCT investment via an ISA, whereby an investor could choose to transfer their existing ISA to a VCT ISA (so no new cash investment is needed to fund the investment and the investor can still benefit from 30% VCT income tax relief on the investment, subject to the permitted maximum).

While there would be no change to the tax position on dividends for those who subscribe to the VCT within the annual permitted maximum (currently £200,000), it would theoretically enable an investor to subscribe more than the VCT annual maximum and receive tax-free dividends on the additional level of the investment held within the ISA.

However, as mentioned, an investor is only able to claim tax relief on up to £200,000 invested in a VCT in any single tax year.

### VCTs and pensions

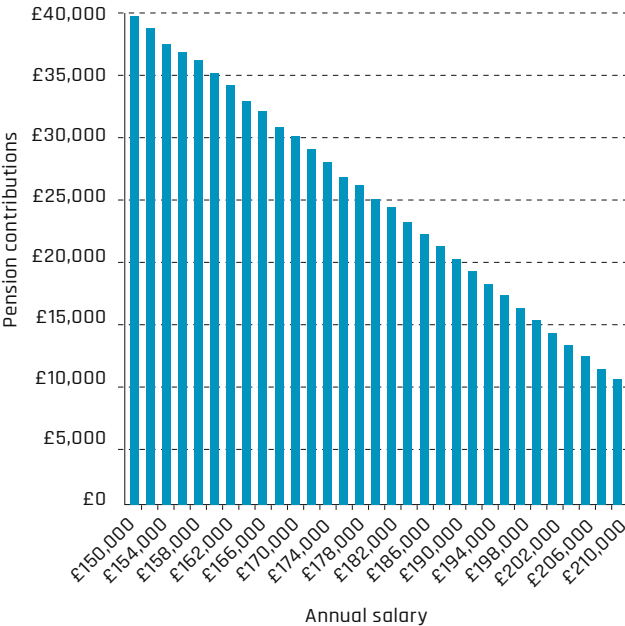
An investor may wish to use a VCT to complement existing pension and retirement planning strategies. However, it should be remembered that a VCT (which invests in what most would classify as high-risk companies) should NOT be considered as a replacement for pension investments, which will typically be lower risk.

Additional rate tax-payers (those who earn more than £150,000 per year) have their annual pension allowances reduced by £1 for every £2 extra income earned. For those earning over £210,000, their annual pension allowance is capped at £10,000.

If an investor exceeds the annual allowance in a year, they won’t receive tax relief on any contributions that exceed the limit and will be faced with an annual allowance charge. High earners may be concerned that they can’t get enough money into their pension as a result of this restriction.

In this situation, an investment into a VCT alongside the pension could provide an appropriate longer-term and tax-efficient investment.

ANNUAL PENSION CONTRIBUTIONS ALLOWANCE



TAX WRAPPER OPTIONS SUMMARY	ISA	Pension	VCT	EIS	SEIS
ANNUAL MAX	£20,000	£40,000	£200,000	£1m (£2m for KICs)	£100,000
LIFETIME MAX	X	£1.055m	X	X	X
INCOME TAX RELIEF	X	✓	30%	30%	50%
POTENTIAL FOR LOSS RELIEF	X	X	X	✓	✓
POTENTIAL FOR IHT RELIEF	X only available for AIM	it depends	X	✓	✓
CGT FREE GROWTH	✓	✓	✓	✓	✓
CGT DEFERRAL	X	X	X	✓	X*
TAX TREATMENT OF INCOME	No further tax to pay for higher rate taxpayers; Interest: tax-free.	No further tax to pay for higher rate taxpayers; Interest: tax-free – but only in roll-up phase; Payouts from annuity or drawdown will be taxable.	Dividends within £200k annual maximum subscription: tax-free.	Dividends: taxable.	Dividends: taxable.
TAX-FREE LUMP SUM	✓	25%	✓	✓	✓

\* However, where an investor disposes of an asset that would give rise to a capital gain, and reinvests all or part of the gain in shares which qualify for SEIS income tax relief, 50% of the gain reinvested will be exempt from CGT.





# VCT charges and practicalities

## Typical fees and charges

One of the challenges with making a meaningful comparison between different VCTs is the range of different fees and charging structures.

Typically a VCT will have:

**INITIAL FEES** – Initial fees to cover the marketing and promotion of a particular offer for investment – these are taken from an investor’s cash subscription so as not to penalise existing investors in the VCT. As a result, the amount of a client’s subscription available for tax relief will vary;

Most commonly applied fees		%
INITIAL FEE	2.5% - 5%	
AMC	1.75% - 4.5% of the investment amount	
ANNUAL RUNNING COSTS	3% - 3.6% of a VCT's net asset value (including AMC)	
ANNUAL PERFORMANCE FEE	20% of profits above a certain hurdle	

SOURCE: MICAP (AT SEPTEMBER 2019)

**AMC** – An annual management charge (AMC) which is paid by the VCT to the VCT Manager for managing the investment strategy of the VCT;

**PERFORMANCE FEE** – A performance fee paid to the VCT manager to reward performance in excess of a certain hurdle, which will be set out in advance;

**RUNNING COSTS** – A VCT will also have its own running costs (including its operating costs, directors’ fees, and administration fees). These will include the annual management charges explained above, but the overall quantum of running costs is often capped by a VCT.

Low fees in one area may be offset by higher fees in another area, so, when comparing charges, it is important to look at them in total. Many VCTs offer discounts to the initial fees via ‘early bird offers’ when the offer first opens or loyalty discounts to existing investors, in order to incentivise investment.

## Minimum subscription

Minimum subscription levels typically range from £3,000 to £5,000.

## Typical target returns

Some VCTs quote specific target dividends. These typically range from 3% to 5% per year, net of fees. Sometimes this is quoted as a fixed amount per share (e.g. 5p per share).

While the overall risk profile of VCT investments has gone up as a result of the changes announced in the 2017 Autumn Budget, the risk profiles of the offerings still vary. Returns must be placed in the context of the risk, liquidity and level of charges when choosing the most suitable VCT for a client.

## Target Fundraises

The amounts raised by VCTs in new rounds varies considerably but the average is around £15 million. This is based on the availability of new investment opportunities that satisfy the defined selection criteria of the particular VCT. On top of the stated target, VCTs can also specify an over-allotment amount which can be triggered if the VCT’s board notes strong demand that is likely to exceed the original target, where suitable investment opportunities can be identified.

## Performance information

VCTs must produce full audited accounts and interim reports at a minimum, which offers a good amount of transparency. Some VCTs may issue quarterly reports as well, although this is not a requirement. However, VCTs often invest in small, unquoted companies which are illiquid and hard to value. The VCTs will generally value their assets in line with international private equity guidelines or similar, which can involve estimating a fair value for these illiquid investments, based on what someone might be prepared to pay for the business in an arm’s length transaction. However, VCTs may only value their portfolio every three or six months, and the valuation is an estimate of unrealised value. The purchase prices of similar businesses sold recently are sometimes used as a guide. This is less of an issue for AIM VCTs, because the underlying investments are publicly traded.

## Legal and regulatory status

All existing VCTs are listed on the LSE, which means they must comply with UK company law (including the VCT directors’ compliance with their fiduciary duties) and the LSE’s Listing Rules (including the disclosure and transparency requirements and the Prospectus Rules). VCTs are also funds, which means that they will have certain regulatory requirements:

- Under the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation, VCTs are classified as PRIIPs. This means that the VCT must issue a Key Information Document (KID), designed to help investors to better understand and compare the key features, risk, rewards and costs of different PRIIPs.
- VCTs are also alternative investment funds which gives them certain obligations under EU law, such as the requirement to provide investors and regulators with complete transparency over the risk profile of the fund.
- For the purposes of the Retail Distribution Review (RDR), all VCTs are considered to be retail investment products and, therefore, advisers cannot receive adviser commissions. However, VCTs may facilitate adviser charging, as agreed between the investor and their adviser.
- As VCTs are not FCA regulated funds, an investment into a VCT is not covered by the FSCS. The underlying investments are not covered by the FSCS. However, the VCT itself will be covered by both the FSCS and FOS in the event of it not being able to meet liabilities of investors and a claim is upheld.

VCTs can be marketed and sold to ordinary retail investors.

### Key Information Documents

There are concerns that the PRIIPs regulation on KIDs is not drafted in a way that creates consistent results that do not mislead the consumer. In an effort to deal with this issue, in 2019 the Joint Committee of European Supervisory Authorities (ESAs) issued the following new wording to be included with KIDs: “Market developments in the future cannot be accurately predicted. The scenarios shown are only an indication of some of the possible outcomes based on recent returns. Actual returns could be lower.” In its 2019 Annual Report, the FCA said it would work with ESAs on a full review of the Regulatory Technical Standards under the Regulation, primarily focusing on KIDs.



# Thought Leadership

## Understanding the KID

**SARAH MCGUFFICK**

LEAD REGULATORY POLICY ADVISER, PIMFA

Concerns about the clarity and reliability of the information provided have led to questions about whether Key Information Documents (KIDs) are doing consumers more harm than good.

Even so, provision of the KID is mandatory whenever a client is advised to buy a PRIIP. So, how do advisers take account of the KID when advising their clients and what areas should they be cautious about?

### Performance

KID performance scenarios (derived from past performance data reflecting strong market growth over recent years) are overly-optimistic for many products, even in supposedly “unfavourable” and “moderate” conditions. Consequently, advisers should:

- look for additional KID wording (stressing the indicative nature of the performance scenarios) that the ESAs have recently mandated for products “where adjustments...are necessary to reflect specific features of the PRIIP”;
- ascertain whether a PRIIP’s issuer has provided further information outside the KID that seeks to put the KID performance scenarios into context; and
- explain to clients that KID performance information may be over-optimistic and should be seen as an estimate rather than a reliable indicator of future results.

### Risk

The KID’s Summary Risk Indicator is not a “summary” – rather than quantifying all risks relevant to a product, it focuses on historic



volatility, relegating other risks to the small print. Consequently, advisers should:

- look beyond the headline SRI number – research by the Association of Investment Companies shows that 70% of all VCT KIDs carry a summary risk indicator (SRI) of 3 (i.e. medium-low risk) even though the Money Advice Service describes them as “high risk”; and
- pay close attention to the SRI narrative, especially those elements dealing with additional risks, capital guarantees and payment obligations or where the PRIIP issuer has a free-hand to explain the product’s risk classification.

### Costs

Advisers will be aware of the discrepancies between PRIIP and MiFID II requirements regarding costs and charges and how they are disclosed to consumers. Particularly problematic – in terms of ensuring client understanding – is the disclosure of the “implicit transaction costs” incurred when the assets underlying a product are traded. If these costs are negative (as is frequently the case), advisers need to explain to clients why something that looks like a deduction has no impact on the overall amount they pay.

The performance, risk and cost elements of the KID will be addressed in a consultation from the ESAs in late 2019. In the meantime, the only safe conclusion to draw about the KID is that advisers need to draw on wider sources of information (e.g. product prospectuses and third party commentary, research and ratings) in formulating their advice.



# Suitability

Suitability is a large and important topic, and what follows are guidelines to bear in mind when considering whether a VCT investment is a suitable investment for a client.

Investments into smaller, unquoted companies are high risk and advisers need to spend time thinking about suitability and documenting the thought process in suitability reports when recommending a VCT.



### The FCA rules on suitability reports require that advisers:

- ✓ Specify the client’s demands and needs.
- ✓ Explain why the firm has concluded that the recommended transaction is suitable for the client, having regard to the information provided by the client.
- ✓ Explain any possible disadvantages of the transaction for the client.

## FCA classification

VCTs are classified as alternative investment funds and retail investment products. An adviser who wants to advise their client to invest into a VCT requires retail permissions to advise on securities. They will have to determine whether an investment into listed securities is suitable for their client.

Further information on legal and regulatory status is also set out on page 33.

## Tax capacity

Although tax benefits alone should not be the primary driver for the investment, a prospective investor is likely to be an individual who is in a position to take advantage of the tax reliefs available from investing in VCTs.

Therefore, if they are planning to purchase newly-issued shares in a VCT, the client should have an income tax liability that could be offset by the upfront income tax relief available for VCT investors.

The client should also be aware that the tax reliefs can be withdrawn and that the shares might, at some point in the future, be worth less than they initially cost, although, where the reliefs are retained, income tax relief can limit losses.

## Attitude to risk

In general, a VCT investment is likely to be suitable for clients with a high tolerance for risk. Where succession planning is relevant, you should also make the client’s intended heirs aware of the risks involved.

While some VCTs may be riskier than others, all VCT investments should be considered as carrying the potential of a capital loss for investors. While this will never be a 100% capital loss when the income tax relief is taken



into account (if it isn't withdrawn for some reason), and while it may be that, given time, the VCT will recoup any losses, clients should be comfortable taking on this level of risk with the funds they have allocated to VCT investing.

## Capacity for loss

If a loss of the capital they have earmarked for VCT investment would have a materially detrimental effect on the client's standard of living, then they should be advised against investing in VCT shares.

Attitude to risk and capacity for loss should be assessed independently of each other. They measure the risk an individual is willing to take (attitude to risk) and the risk an individual can afford to take (capacity for loss). Attitude to risk is subjective and based on a client's personal opinions. This differs to capacity for loss, which is objective in nature and based on fact.

It is also worth remembering that CGT loss relief is not available should the shares be sold at a loss.

Suitability Client Considerations

OBJECTIVES

Reduce or eliminate income tax liability up to £60,000

They have a requirement for tax-efficient investment for capital growth

They have a requirement for tax-efficient investment with tax-free dividends

CLIENT PROFILE

They have surplus capital

They are aware of the potential to lose all of the investment

They are aware the reliefs could be withdrawn or clawed back

WARNINGS

No market for the shares

Likely to trade at a discount to the NAV (true value)

Five-year holding period to retain income tax relief although a five to ten-year holding period is more realistic

Tax relief isn't an excuse for high risk nature

## Liquidity and investment horizon

Although VCTs are listed, their shares can suffer from low levels of liquidity. In addition, the minimum holding period to qualify for the upfront income tax relief is five years. Therefore VCT investments should be viewed on a five to ten year investment horizon. If clients anticipate an urgent need for their investment capital at any point sooner than this, they should be advised against investing in VCT shares.

## Knowledge and experience

Investors (or their representatives) must have the capacity to understand the nature of VCTs and the associated risks.

In general VCT investors will have experience of investing in a portfolio of more conventional retail investment products, and/or experience in business or a profession and, therefore, be in a position to make informed decisions about investing in VCTs.

## Portfolio balance and diversification

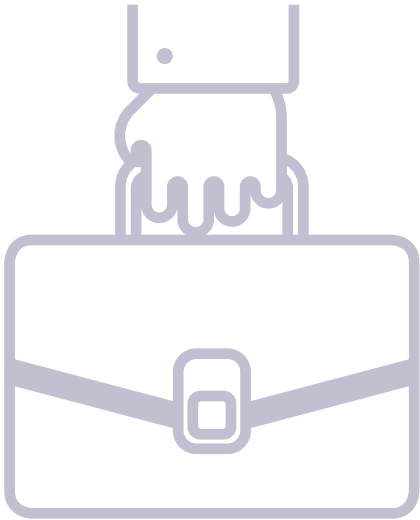
It is highly unlikely that it would be appropriate for a client to concentrate their wealth in VCTs and, in the majority of cases, VCT investors will already have a substantial portfolio of conventional investments that meets the majority of their investment objectives.

Investors should not be over-exposed to high risk investments, illiquid assets or unquoted securities.

The risks and disadvantages of VCT shares should be more than offset by the rest of the portfolio.

Typically, VCT managers will deploy an investor's subscription across multiple companies. The target number varies by manager, but typically is between 30 and 60.

It is also important to diversify a client's VCT investments across different VCT fund managers and VCT offerings. There are varying methodologies for selecting potentially successful investments across managers and the objectives and strategies of investment offerings also vary.

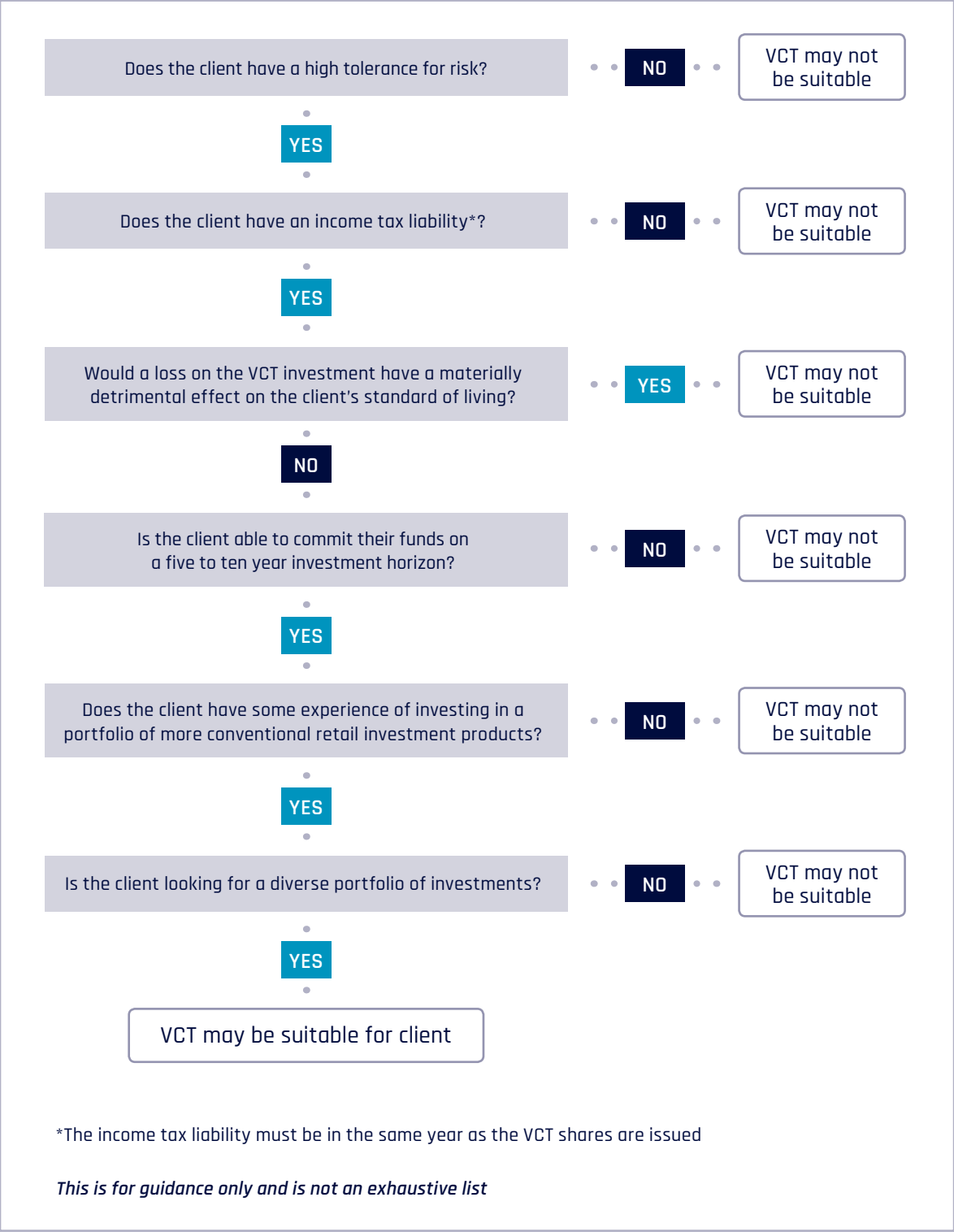


***"The main challenge is finding suitable investee companies which are less than seven years old and then meeting investors' expectations of receiving dividends."***

DAVID BROOKES, TAX PARTNER, BDO



Indicators of when a VCT recommendation may be right



# Research and due diligence



## Types of VCT

Although all VCTs have the same structure and their investments are governed by the same rules, there are THREE common types of VCT.

**Generalist** - which covers private equity, including development capital;

**Specialist sectors** - for example, technology or healthcare;

**AIM** - predominantly investing in companies issuing shares listed on AIM.

Some VCTs previously operated as limited life VCTs. These aimed to invest capital and then

wind up within 5-10 years. Given the new 'risk-to-capital' condition most VCTs now operate one of the above three strategies.

However, within these categories, managers employ a wide range of investment strategies, with different levels of diversification, targeting different levels of growth and income, with different risk profiles and investing in companies at different stages of development.

The most common type of VCT is Generalist, investing in unquoted businesses with no sector preference.

	PROS	CONS
<b>GENERALIST VCTs</b> Predominantly investing in unquoted companies (excluding companies on AIM) across a broad range of sectors	<ul style="list-style-type: none"><li>• More influence on investee companies</li><li>• Not generally correlated to public markets</li></ul>	<ul style="list-style-type: none"><li>• Lower liquidity</li></ul>
<b>AIM VCTs</b> Predominantly investing in companies issuing shares on AIM	<ul style="list-style-type: none"><li>• Greater liquidity</li><li>• High diversification</li><li>• Publicly available information on investee companies</li></ul>	<ul style="list-style-type: none"><li>• Managers are not the dominant shareholder</li></ul>
<b>SPECIALIST VCTs</b> Predominantly investing in a specialist sector, for example technology or healthcare	<ul style="list-style-type: none"><li>• Specialist skills and technical knowledge</li><li>• Not generally correlated to public markets</li></ul>	<ul style="list-style-type: none"><li>• Can be less diversified</li></ul>



# Assessing VCTs

As well as assessing clients’ suitability for a VCT investment or investments, advisers must also assess the range of offers available in the market, carry out due diligence and select the most appropriate investments for their clients.

In assessing VCT offers, there are a number of areas advisers need to cover and advisers should document their assessment of each of them to create a thorough research and due diligence process on record.

Step 1

The first step is to assess the VCT managers operating in the marketplace and the VCT offers that are open to investment.

A lot of VCT managers are likely to offer EIS and perhaps Business Relief (BR) investments as well (and their assets under management may reflect this), so their boards and investment committees will be looking at this wider horizon of investments, tax wrappers and investment sectors.

The following aspects are specific to the VCT Manager:

**Financial stability** – as VCTs are designed to be held for a minimum of five years, the financial stability and trading history of a VCT’s investment manager can be a consideration. However, as VCT investment managers must be authorised and regulated by the FCA, they will have minimum capital adequacy requirements.

Their **deal flow access** and **investment selection process** – do they see enough of the market to get the best deals and how much consideration is given to the merits and potential of the companies? If there is not sufficient deal flow, there is a temptation for the manager to invest in opportunities that do not fit their stated investment mandate, that are more risky than deals they would normally invest in or at higher valuations (making it harder to earn returns).



**Experience** – the investment manager’s experience in this field, along with that of their investment committee, is critical. The changes in VCT rules announced in the Autumn 2017 Budget have also introduced the possibility of some managers that previously focused on VCT investments targeting low risk, capital preservation strategies, having to pivot their activities. This means it is important to review the relevance of their track record to their current investments.

Their **track record** of investment performance, exits and ensuring their investments retain VCT-qualifying status.

Relevant sector expertise and **ability to adapt to changes** in rules and regulations.

# Performance metrics

Two main metrics are used to measure and compare the performance of VCTs:

- **The share price total return** – the value of any dividends paid plus the difference between the current share price and the price at which the shares were issued, expressed as a percentage of the original investment amount;
- **The Net Asset Value (NAV) total return** – the value of any dividends paid plus the difference between the current NAV per share and the NAV per share when the shares were issued, expressed as a percentage of the original investment amount.

Where a share price total return or NAV total return is calculated, it typically assumes that dividends are reinvested. However, some VCT managers may publish their NAV returns as a cumulative return, i.e. with dividends added but not reinvested. Whatever method is used, it is important that comparisons are made on a like-for-like basis.

The traded share price can fluctuate with market sentiment, whereas the NAV per share is based on the value of the VCT’s net assets. For this reason the NAV total return is generally considered to be a more reliable indicator for assessing the performance of a VCT’s investment strategy.

Step 2

The next step is to assess the performance history of the VCT (if it has one). However, past performance is not a guide to the future and while many VCTs have a ‘target dividend’, dividends are variable and are not guaranteed.

A VCT offer comprises new shares in:

- A new VCT;
- An existing share class in an existing VCT; or
- A new share class in an existing VCT.

The performance of a VCT can be assessed by considering the dividends previously paid by the VCT. However, dividends paid should not be considered in isolation – if the VCT’s Net Asset Value (NAV) per share or traded share price has fallen more than the amount paid in dividends, then the investor may have made an unrealised loss over that period.

*“Advisers can rely on factual information provided by other EEA-regulated firms as part of their research and due diligence. However, they should not rely on the provider’s opinion, for example, on the investment’s risk level.”*

THE FCA’S THEMATIC REVIEW ASSESSING SUITABILITY: ‘RESEARCH AND DUE DILIGENCE OF PRODUCTS AND SERVICES’ FEBRUARY 2016



Other areas of research and due diligence on VCT investments could include:

**VCT PROSPECTUS, FACTSHEETS AND ANNUAL REPORTS** - These documents contain key information about the offer as well as the VCT as a whole, the parties involved, investments held and past performance.

**KEY INFORMATION DOCUMENT (KID)** - A three-page overview of a fund's main features including its objectives, summary risk indicators, charges and performance scenarios. However, some commentators, trade bodies and VCT managers have expressed concerns over the methodology behind the risk ratings in KIDs, as they generally (and controversially) give VCTs very low risk ratings (see page 33).

**PORTFOLIO STRATEGY** - The investment strategy of a VCT defines what it will invest in, such as what sector investee companies are involved in, how established they are and whether they are quoted on AIM. It will also discuss the sector and subsector (there is a range of general and specific VCTs). These factors will determine the potential risks and rewards that the VCT is exposed to.

**PORTFOLIO COMPOSITION** - Is the portfolio of investments concentrated or diversified? The level of diversification across underlying investments varies, but advisers should assure themselves that it is in line with the investment objective and is commensurate with the nature of the underlying investments.

**LIQUIDITY** - Liquidity at an investor level is concerned with how readily and at what discount an investor can liquidate their investment outside of any pre-determined realisation strategy. VCTs' shares are not widely traded and they often trade at a discount to their Net Asset Value (NAV). VCT managers do often offer share buyback schemes to enable divestment, but these are usually at a discount to the underlying asset value and are not guaranteed.

**ANTICIPATED DIVIDENDS/RETURNS (WHERE STATED)** - Advisers should assess how returns (without tax reliefs) are generated and take a view on the likelihood of those returns being achieved in different economic conditions.

**HMRC COMPLIANCE AND MONITORING** - Failure to adhere to the rules could result in the VCT losing its approved status, which would result in a clawback of tax relief for any investors who have held their shares for less than five years. Most VCTs have appointed professional advisers to monitor the VCT and the investments it makes.



# Discounts and premiums

When investment company shares are traded on a stock market, the share price may be higher or lower than the NAV. The difference is known as a discount or premium.

- Buying shares at a discount means you pay less than the NAV.
- Buying at a premium means you pay more than the NAV.

## UNDERLYING INVESTMENTS

It is important to understand:

- The nature of proposed underlying trades
- The investment stage
- The industry sectors they are in
- The risks they are exposed to
- The level of returns they can generate and how they are generated
- How quickly they return to cash or how liquid they are
- The manager's experience investing in the proposed trades.

Advisers should also evaluate the anticipated deal flow and deal pipeline for the VCT and assure themselves that the manager is able to deploy the VCTs they raise in line with the proposed investment strategy.

The VCT rules generally restrict companies that can receive VCT funding to smaller companies that have been trading for seven years or less (ten years or less for KICs, although a KIC also has more flexibility regarding when this ten-year point starts – see page 25 for more information on KICs). In commercial terms, this means that the companies in a VCT portfolio are all 'early stage'. But, within

this classification, there are various stages of fundraising depending on the development stage of the investee.

The funding stage definitions are not fixed, but are typically:

**Seed:** Seed rounds are among the first rounds of funding a company will receive, generally while the company is young and working to gain traction and build a product from an idea. It is likely to be pre-revenue.

**Series A:** The company may have some established revenues and is typically pre-profit. At this stage, it is seeking to identify the commercial viability of its product or service (product-market fit).

**Series B:** The company may be making small profits but is looking to scale and has growth aspirations outside current revenue streams.

Therefore, the funding round is an indicator of risk, with earlier stage funding likely to be higher risk, but lower cost. This brings the opportunity for higher returns, but also greater potential for losses.

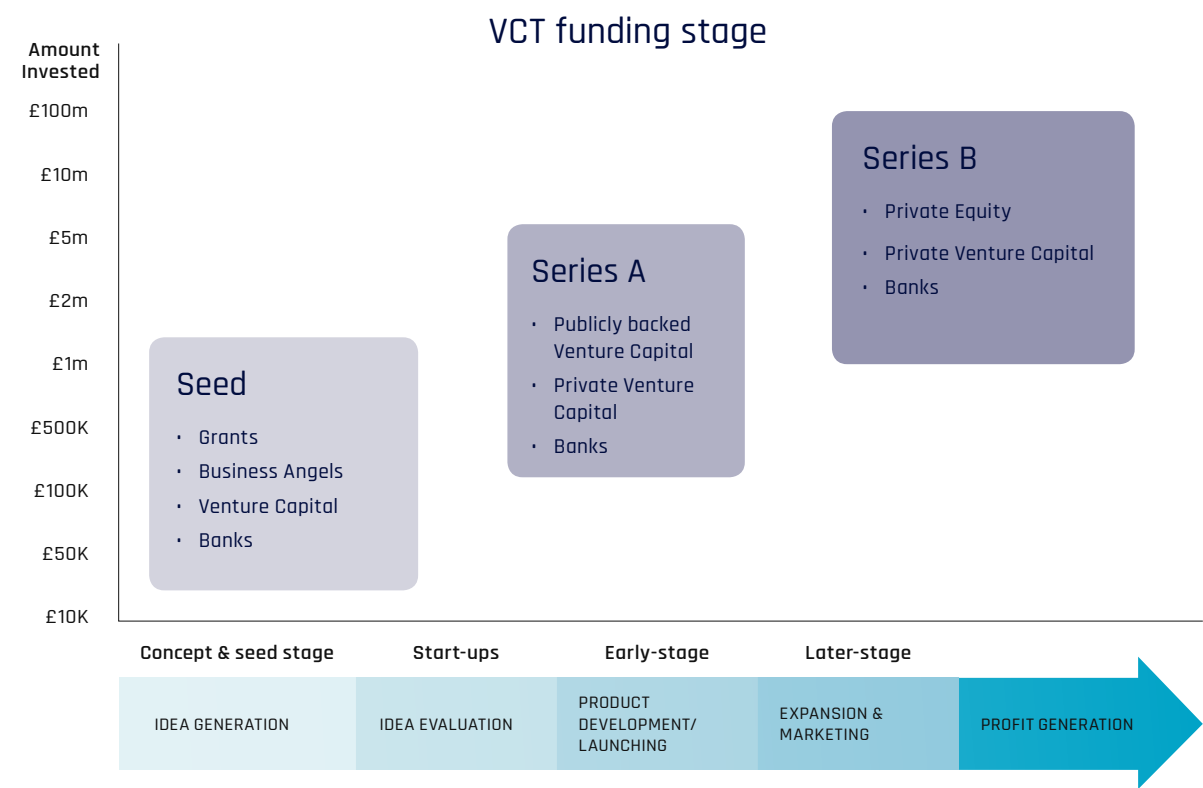
It is not unusual for VCT managers to diversify across funding stages. Some also reinvest in the same company at a later stage as it develops and proves its value.

It is also worth noting that follow on investment, by any party, can dilute the shareholding of earlier stage investors if they are not prepared to invest in the new round of funding. Shares issued to a VCT can't have anti-dilution rights. Consequently, each time equity investment is taken by the company, new shares are issued. As a result the total number of shares in issue increases, meaning that an existing shareholder who does not invest in the new round (which would increase the number of shares they hold) will hold a smaller percentage of the new total number of shares.

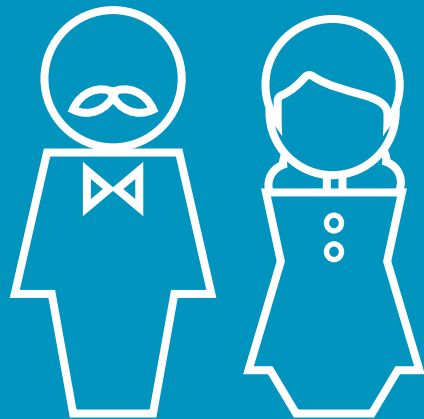


Nevertheless, if the company is doing well, even without participation in follow on rounds, the smaller percentage of the company held by the shareholder should have a larger value than before the investment round. This is because the price of shares in new funding rounds is likely to rise as the company becomes more successful and this valuation is applied to the business as a whole.

In terms of investees, as a general rule, the riskier the underlying investments are, the greater the level of diversification should be. However, some research suggests that beyond a certain point diversification can go too far and that the additional costs incurred do not bring any additional diversification benefits. Advisers need to be confident that the VCT is not overly-diversified.



# Case studies



**Disclaimer**

The following case studies are designed to demonstrate a number of different scenarios that might apply to certain prospective investors. Nothing here should be viewed as advice. Advisers should consider, among other things the impact of charges (including any initial fees as well as annual charges) and the quantum of tax relief that might be available to a particular prospective investor. Any suitability decisions should be based on a comprehensive review of a client’s objectives, needs, capacity for loss, investment experience and attitude towards risk.



# Tax efficient extraction from pension

David has been retired for three years and is financially comfortable in retirement.

Following the birth of his second grandchild and, with the new pension freedoms, David would like to use some of his pension to assist with the future education of his grandchildren. David is keen to plan well ahead and is investigating options to take money out of his pension in a tax-efficient manner.



David would like to use his pension to assist with the education of his grandchildren



Following a discussion with his IFA and a suitable recommendation, David invests in a VCT.



VCT investment benefits:

up to 30%

+

TAX-FREE

**Income tax relief**  
on up to £200k p.a

**Dividend Gains**

\*Note, in the lower rate taxpayer example, the £5,100 income tax relief only applies if David has at least £5,100 of income tax to offset in total in the tax year. If not, based upon the tax due on the pension withdrawal, only £3,000 of it can be offset against income tax due. The remaining £2,100 will be lost.



## HIGHER RATE TAXPAYER (40%)

This illustration assumes that David has other income which means he pays the higher rate of tax



**£20,000**

withdrawn from pension



**£6,000**

tax due on pension:  
25% tax-free, 75% at higher rate



save remaning cash in savings account



**£14,000**

remaining after tax



**£14,000**  
invested into a VCT



**£4,200**  
30% tax relief



**£18,200**

remaining after tax  
(70% of initial tax has been offset)



## LOWER RATE TAXPAYER (20%)

This illustration assumes that David is basic rate tax payer



**£20,000**

withdrawn from pension



**£3,000**

tax due on pension:  
25% tax-free, 75% at basic rate



save remaning cash in savings account



**£17,000**

remaining after tax



**£17,000**  
invested into a VCT



**£5,100**  
30% tax relief



**£22,100**

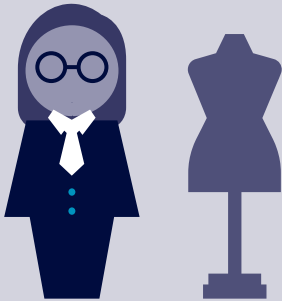
remaining after tax



2

Client looking to extract money from a business tax-efficiently

Tanya is looking to be more tax-efficient with the funds she withdraws from her company. She is a sophisticated investor with both a high capacity for loss and high attitude to risk. She has experience of investing in small start-up companies.



Tanya runs her own clothing company and draws a salary of £12,500 per year tax-free\*

\*within the personal allowance



£80,000

Dividend, of which:



£2,000

Dividend allowance



Next

£35,500

(Basic rate of 7.5% = £2,662.50)



Remaining

£42,500

(Higher rate of 32.5% = £13,812.50)

£16,475 TOTAL TAX BILL



Adviser recommends VCT investments to get the benefits of investing money withdrawn from a small business into a VCT

The diagram below illustrates how Tanya could use the money withdrawn from her company to invest in a VCT during the 2019/20 tax year. There are two versions depending on whether Tanya invests her net dividend into a savings account or whether she uses some of the dividend to invest into a VCT



The tax benefits of investing money withdrawn from a small business into a VCT

£80,000

dividend paid out with part used as income and part placed into savings account

£80,000

dividend paid out with part used as income and part placed into VCT investment

£16,475

Dividend tax due on the initial £80,000 extracted

£16,475

Dividend tax due on the initial £80,000 extracted



£54,917

Invested in a VCT



£8,608

Remaining in cash after payment of dividend tax and VCT investment to generate tax relief equal to the dividend tax

£16,475

30% tax relief on VCT used to reclaim dividend tax

£63,525

Remaining after tax in addition to Tanya's £12,500 tax-free salary

£80,000

(£80,000 withdrawn - £16,475 dividend tax + £54,917 net VCT investment + £8,608 remaining cash + £16,475 tax reclaim) Remaining after tax can be used to provide immediate income in addition to Tanya's £12,500 tax-free salary



### 3

## A married couple with regular income and assets

Peter and Valerie have been married for 25 years and they plan on retiring in 10 years’ time. Peter is a higher rate taxpayer and has a good level of pension provision.

Valerie, on the other hand, doesn’t have a significant pension pot but does have a residential property which she lets out. She has always seen this as being ‘her pension’ and she doesn’t wish to sell the property and be left with a large CGT bill. Valerie earns £30,000 of net rental income and has other income up to her personal allowance. She expects to pay £6,000 income tax this year (20% x £30,000).

The initial income tax relief Valerie receives on her VCT investment (£6,000) would eliminate the £6,000 annual income tax she’s required to pay on her rental income. VCT shares must be held for at least five years in order to continue to qualify for the initial income tax relief (should Valerie sell the shares before the end of five years, she’d have to repay the income tax relief to HMRC).



The following diagram illustrates how Valerie could claim income tax relief on a series of VCT investments over several consecutive tax years. The illustration shows a period of eight years as an example, but Valerie could use this method to keep investing and claiming income tax relief indefinitely, subject to the rules remaining the same and certain conditions.

Tax benefits of investing annually into a VCT

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8
VCT Investment	£20K	£20K	£20K	£20K	£20K	£20K	£20K	£20K
Cumulative investment	£20K	£40K	£60K	£80K	£100K			
30% income tax relief	£6K	£6K	£6K	£6K	£6K	£6K	£6K	£6K
Cumulative income tax relief	£6K	£12K	£18K	£24K	£30K	£36K	£42K	£48K



After six years, Valerie has claimed £36,000 income tax relief from a total £120,000 investment. It is worth noting however that, under current rules, after selling shares in a VCT it is not possible to claim tax relief on new shares bought in the same VCT within six months of the initial sale.



# 4

## VCT dividend reinvestment

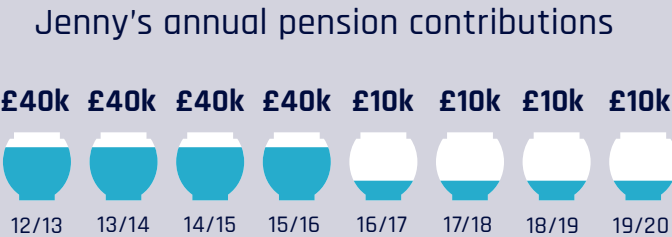
Jenny earns £210,000 per year and therefore, with her savings income, pays tax at the 45% additional rate.



**£210K**  
Payslip  
p.a.

She has fully funded her pension setting aside at least £40,000 a year. However, due to the tapered annual allowance Jenny is now restricted to just £10,000 annual pension contributions

⋮



↓

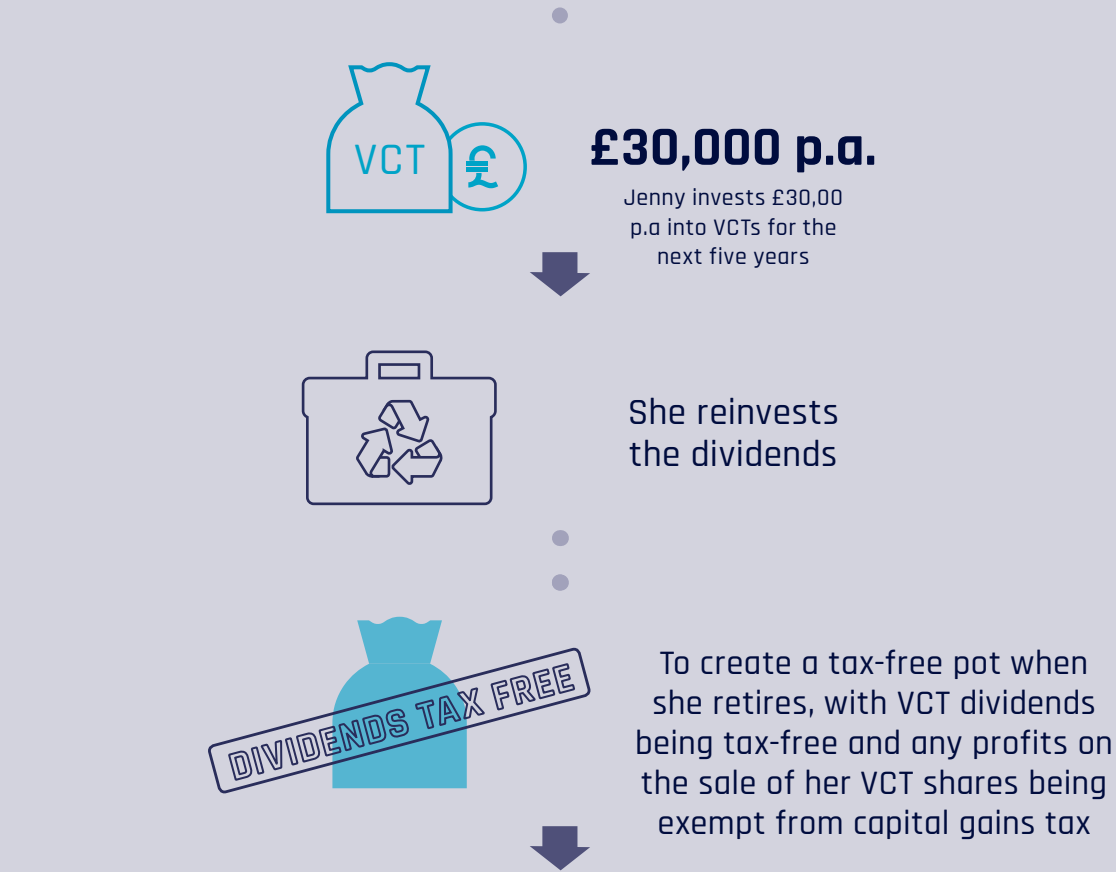
**£30,000 p.a.**  
Looking for a tax-efficient home for Jenny's future

⋮



Adviser recommends VCT investment

⋮



The diagram below illustrates how Jenny invests £30,000 into a VCT over five years, and reinvests dividends (at a rate of 4% per annum paid from the fourth year onwards). It assumes no gains or losses on the VCT or any adviser charges and that Jenny chooses not to reinvest her tax relief.

	Year 1	Year 2	Year 3	Year 4	Year 5	TOTAL
Investment	£30,000	£30,000	£30,000	£30,000	£30,000	£150,000
Tax relief (30%)	£9,000	£9,000	£9,000	£9,000	£9,000	£45,000
Dividends	-	-	-	£1,200	£2,448	£3,648
Tax relief on reinvested dividends	-	-	-	£360	£734	£1,094
Value carried forward	£30,000	£60,000	£90,000	£121,200	£153,648	
Total return (including tax relief)						£199,742

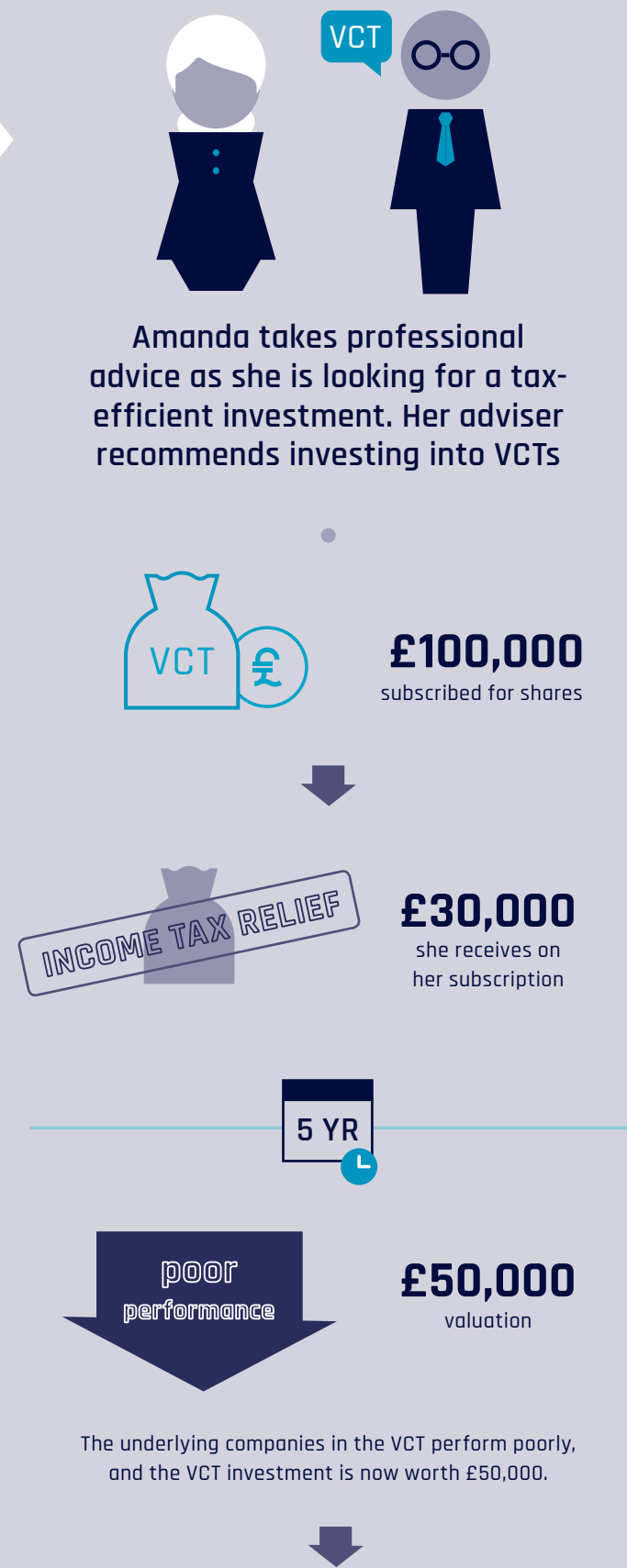


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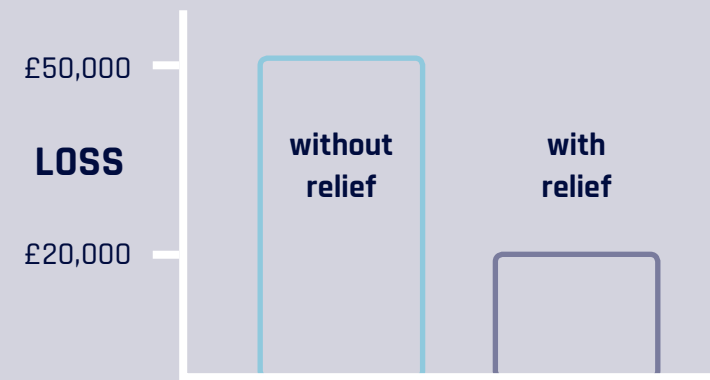
VCT income tax relief cushioning the blow of any losses

Amanda has maximised her pension contributions and has income tax liabilities she wishes to mitigate.

She subscribes for shares in a VCT at a cost of £100,000.



She retains her shares for five years to ensure she retains her tax relief and then sells them for £50,000. But her total proceeds, including her £30,000 tax relief, are £80,000.



The tax relief limits the loss

The tax relief has meant that her losses are much less severe (without the tax relief she would have lost £50,000, however, in this situation she has lost £20,000).

It should be remembered that any loss made on the disposal of VCT shares where the conditions for VCT Disposal Relief were met are not allowable for capital gains purposes.

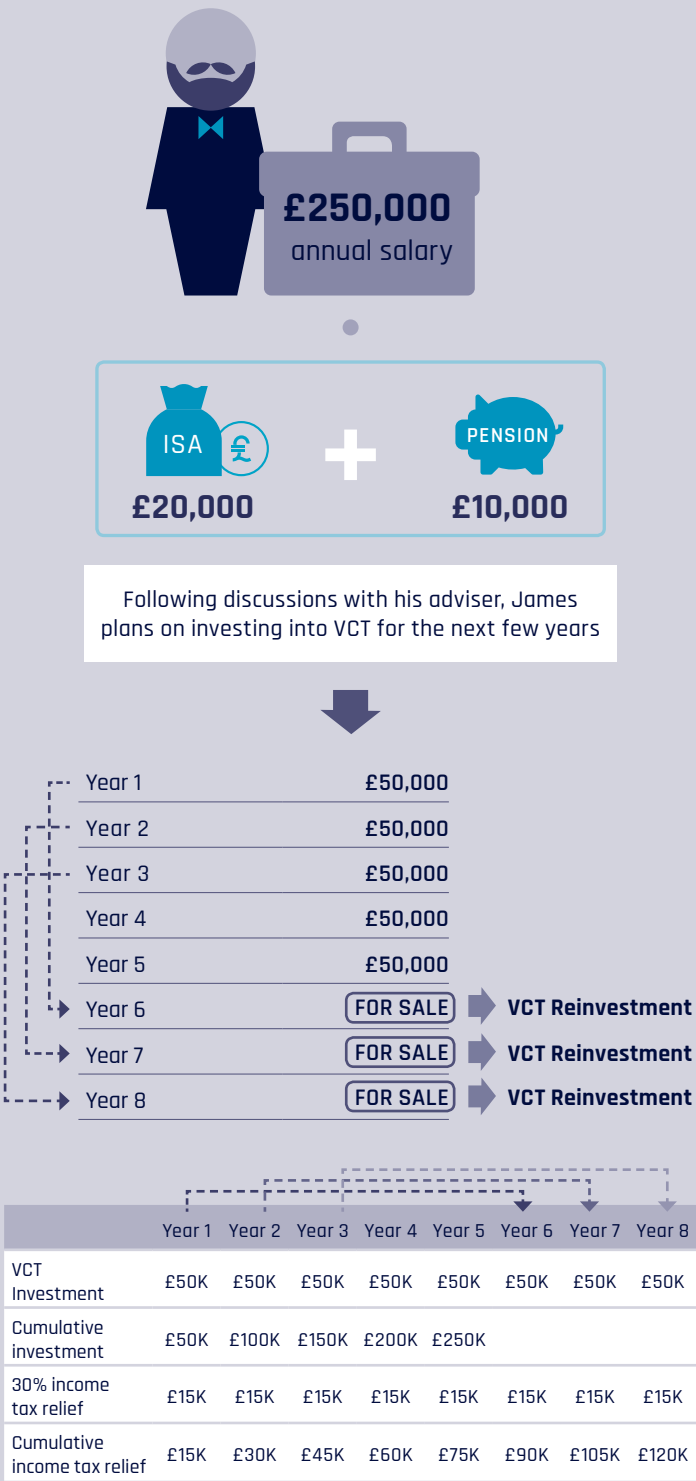


6

Tax benefits of annually investing into a VCT

James has an annual salary of £250,000 and maximises his ISA savings and pension contributions each year. He is interested in tax-efficient investments and using any annual allowances available to him. He is comfortable with the associated risks of investing in a VCT.

VCT shares must be held for at least five years in order to continue to qualify for the initial income tax relief. James could sell his first VCT investment after the first five years, then reinvest the proceeds in another VCT. He could then use the further amount of income tax relief on his second VCT investment to reduce his year six income tax bill. Similarly, James’ year two VCT investment could be sold and reinvested in another VCT in year seven, giving him additional income tax relief, and so on. The illustration assumes no gain or loss on the investment (although it is common for VCT shares to be sold at a discount to NAV), and doesn’t take into account any initial or ongoing fees or costs associated with selling the VCT shares. It is worth noting however that, after selling shares in a VCT it is not possible to claim tax relief on new shares bought in the same VCT within six months of the initial sale.



James could use this method to keep investing and claiming income tax relief indefinitely, subject to the rules remaining the same and certain conditions. But remember that VCT income tax relief can only be claimed for the same year as the year of investment and against tax actually paid.

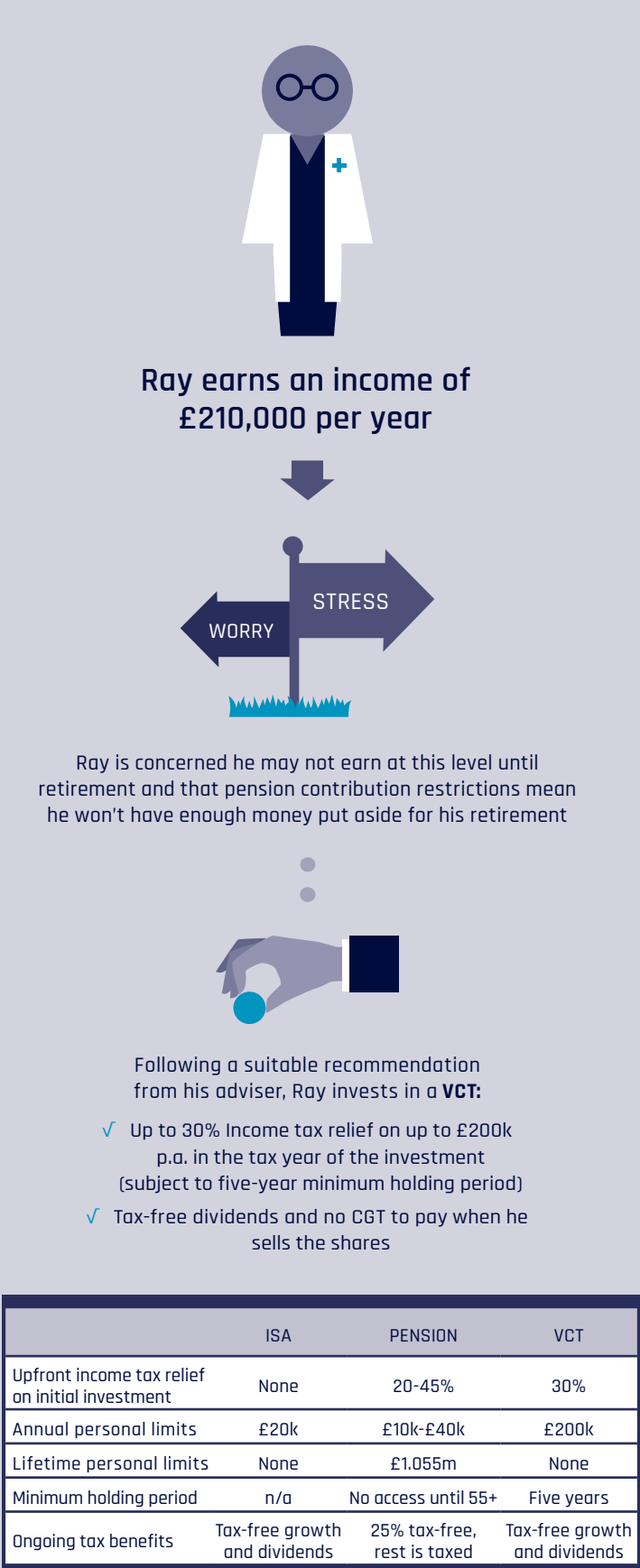
7

Clients who are additional rate taxpayers

Ray is a doctor who earns an income of £210,000 per year.

With his other savings income this means £60,000 of his income is taxed at the additional rate of 45%. His annual pension contributions are now restricted to £10,000 per year, as he has reached the upper limit of the tapered annual allowance.

It’s worth pointing out that VCTs are high-risk and inherently different to pensions and ISAs and shouldn’t be compared on tax benefits alone. One investor’s circumstances will be different to another and a VCT investment won’t be suitable for all, but the attractive tax benefits mean that VCTs could be considered as part of a portfolio for some people, alongside pensions and ISAs.





# Providers in Focus

## About the provider

Amati Global Investors is an award-winning specialist fund management business based in Edinburgh. It focuses on UK small and mid-sized companies, with a universe ranging from fully listed constituents of the FTSE Mid 250 and FTSE Small Cap indices, to stocks quoted on the Alternative Investment Market (AIM). The fund management team is made up of Dr Paul Jourdan, David Stevenson and Anna Macdonald (supported by analyst Dr Gareth Blades) and collectively they manage all Amati funds with a combined experience of over 65 years in smaller company investments.

## Our VCT Offer

Amati AIM VCT Prospectus Offer 2019/20 & 2020/21 is seeking to raise up to £25 million with an over-allotment facility of £20 million.

Key Elements/Benefits:

- Investing into an established portfolio dominated by profitable growth companies
- The weighted average market capitalisation of the qualifying portfolio is £360m and two holdings are in excess of £1 billion
- Eight out of the top 10 holdings are dividend paying
- No performance fees

## CUMULATIVE PERFORMANCE TABLE

	1 year Total Return	3 years Total Return	5 years Total Return
Amati AIM VCT	-7.8%	56.5%	70.3%
Benchmark*	-12.6%	28.9%	29.6%

\*Benchmark: Numis Alternative Markets Total Return Index

SOURCE: AMATI GLOBAL INVESTORS AS AT 31 JULY 2019

## Case Study

AB Dynamics was founded by Tony Best in 1982 and floated on AIM in 2013, supplying engineering and testing services to the automotive industry. The founder maintains a near 28% stake in the business.

The shares have performed strongly and AB Dynamics is our largest single stock holding in the VCT. Our strong faith in the strategy and management of AB Dynamics is demonstrated by our purchase of further shares for our smaller companies fund and IHT portfolios.

Automotive manufacturers have faced serious challenges over the last few years, such as the diesel emissions scandal, tighter regulations, autonomous driving development and the rise of electric vehicles. AB Dynamics' success has come through its ability to help carmakers transition to the new demands of consumers and governments by allowing manufacturers to test technologies ever more accurately and efficiently.

The stock continues to attract new investors owing to its:

- good organic revenue growth and robust margin delivery;
- excellent market positioning across broad client base (top25 global vehicle manufacturers, all seven Euro NCAP laboratories and numerous government test authorities);
- strong balance sheet (net cash);
- and potential to build through further acquisitions.

**AB**  
Dynamics



## About the provider

Blackfinch Group is an award-winning investment specialist with over £300 million in assets under management and administration. Founded on evolutionary principles, Blackfinch continuously adapts to market change, to offer strong solutions. It works in partnership with advisers, delivering value through expertise and high-quality service with a transparent approach.

Blackfinch has specialisms in early stage and tax-efficient investing, covering EIS and VCT vehicles. The expert Blackfinch Ventures team enables investment in fast-growing UK companies, supporting start-ups and early stage businesses. Blackfinch co-invests alongside clients, ensuring alignment of interests.

## Our previous VCT Offers

The Blackfinch Spring VCT will be open from October 2019 to 30 October 2020 for investment with a share offer of up to £20 million Ordinary shares and over-allotment facility for a further £10 million.

The VCT plans to invest in a diversified range of early stage technology firms operating across sectors. These will be firms that are poised for growth and success and by 2024 we plan to return the profits to investors as tax-free dividends of 5% per annum.

***“Blackfinch Ventures brings access to fresh opportunities, supports companies to develop, and seeks to deliver highly successful outcomes for businesses and investors.”***

— RICHARD COOK, CEO AND FOUNDER BLACKFINCH GROUP

## Case Study

Tended is a technology start-up that designs intelligent personal safety wearables and monitoring systems. Its patent-pending technology uses machine learning to automatically monitor a user's safety and alert key contacts in the event of an accident or emergency. Now focusing on its commercial offering, Tended has created an enterprise solution which is being used by large organisations to monitor and improve the safety of their workforce.

The passion and drive of the Tended team was evident when they pitched for the first time to Blackfinch Ventures in April 2019. The team had achieved an incredible amount in a very short period, developing a comprehensive platform from hardware to software and landing early commercial trials. Blackfinch Ventures EIS Portfolios made an investment of £810k at the time to help the company through its next stage of growth.

This investment has allowed Tended to grow the technology team and hire sales staff. Their supply chain is now well developed, production units are shipping, and revenue is starting to flow from large multinationals. When it launches, Blackfinch Spring VCT will invest in high growth innovative technology companies like Tended.



## About the platform

GrowthInvest is an adviser-focused platform designed to simplify research, investment and reporting on tax-efficient and alternative investments. We provide you with digital solutions that give you choice, control and oversight.

We are on a mission to make tax-efficient and private investments more widely accessible to wealth managers, financial advisers, and their clients, through the provision of digital solutions and education in a fast-growing but currently inefficient market.

The GrowthInvest platform gives portfolio-level and individual investment analytics across SEIS, EIS, VCT and IHT products.

## Our VCT service

Investing into a diversified portfolio of VCT products has historically been difficult to achieve, which is why we have digitalised the application and administration process to make it as simple as possible.

The GrowthInvest VCT service allows you to access a diversified portfolio of high-quality VCT providers, with minimal administrative burden.

Using the GrowthInvest platform allows you to access granular online reporting, incorporating tax reliefs and real-time performance analysis across your underlying VCT investments and consolidated portfolio.

## Case Study

One GrowthInvest client, a Surrey-based financial adviser, has been advising a group of high-earning clients on VCTs for over 20 years. Their VCT portfolios range from £150,000 to over £1.5 million, with clients typically investing £50,000 per annum across multiple VCTs.

Previously, the management of these portfolios had been paper-driven and inefficient, relying on multiple spreadsheets. Investments were made via multiple paper applications with wet signatures and cheques, and dividends paid directly to the client outside the control of the adviser.

Once the adviser started using GrowthInvest, all client portfolios were loaded onto our platform, with VCT holdings transferred into a custody CREST account – removing the need for paper share certificates.

Now, the adviser benefits from robust and transparent management of their portfolio. Daily valuations including NAV and Total Return (including dividends and any corporate actions) are just some examples of metrics available online or through downloadable reports.

Going forward, all future investments will be made via the GrowthInvest VCT Service using online applications: enabling a single cash transfer for all VCT investments, digital shareholding and dividends flowing back onto the central client account.



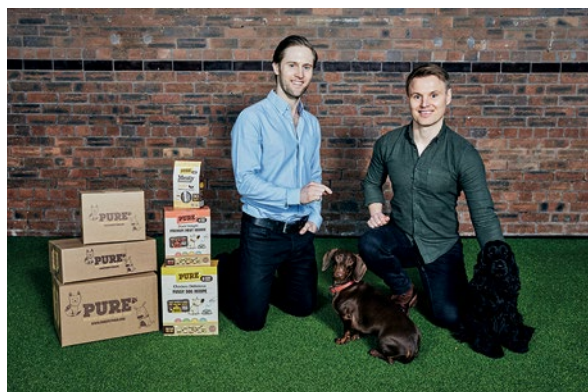


## About the provider

Founded in 1988, NVM is one of the longest-established venture capital trust managers focused on investing in SMEs. Since 1995, the three Northern VCTs have invested over £440 million in 246 companies, ranging from start-ups and growth capital deals to management buy-outs. NVM is committed to building a portfolio of investments in innovative UK smaller companies with significant growth potential across a diverse range of sectors. The NVM team has a track record of identifying opportunities to support the growth of young companies, providing professional guidance and achieving profitable realisations.

## Our previous VCT Offers

The investment objective for the Northern VCTs is to provide high long-term tax-free returns to investors through a combination of dividend yield and capital growth, by investing primarily in unquoted UK manufacturing, service and technology businesses which meet NVM's key criteria of good value, growth potential, strong management and ability to generate cash in the medium to long term. Previous offers from NVM have been very popular with VCT investors and target yields are currently between 4% and 5% per annum of Net Asset Value. NVM is planning to launch a new offer in 2020.



## Case Study

NVM invested £2 million development capital in Pure Pet Food (Pure), Halifax, in March 2019.

Founded in September 2012, Pure manufactures and sells specialist dehydrated and freeze-dried pet food including snacks and treats/toppings for dogs and cats. The business uses human-grade ingredients which are dehydrated or freeze-dried and convenient, to produce natural pet food mixes to meet the nutritional needs of dogs and cats using its own recipes and manufacturing/mixing process. The food appears to be particularly suited to animals with digestive issues/sensitivities and other allergies or associated ailments.

The £2 million funding from NVM will be used to build out and scale a direct-to-consumer and subscription service for the speciality pet food management via online marketing channels. NVM introduced a specialist digital marketing consultancy to assist management with this task. Additionally, NVM's investment would provide the team with funding to invest in the wider business, such as larger premises and increased staffing to facilitate growth in the customer base.

Since investment we are already seeing some good growth in customer acquisition and Pure is successfully converting initial orders into recurring purchases or formal subscriptions.



## About the provider

Since 2000, Octopus Investments has been providing advisers and investors with fresh ideas that help them do more. As well as being the market leader in venture capital trusts and inheritance tax investments, Octopus also provides a cash savings service, a property-backed peer-to-peer investment, and investment funds that draw on deep experience in smaller company and multi manager investing. As at 30 June 2019, Octopus manages £8.5 billion on behalf of its customers.

## Our VCT Offer

Octopus Titan VCT is the UK's largest Venture Capital Trust, giving investors the opportunity to participate in the growth of some of the UK's most exciting entrepreneurial businesses. Managed by one of Europe's most experienced investment teams, it currently has a portfolio of over 75 early stage companies operating in a diverse range of sectors. Titan has backed some of the UK's most successful entrepreneurs, including the founders of Zoopla Property Group, Secret Escapes and graze.com.



## Case Study

Elvie is looking to develop a range of products to improve women's lives and provide support through different life stages such as pregnancy, motherhood and menopause. In so doing, the company aims to build a strong brand that consumers associate with well-designed, beautiful devices that improve women's health.

Elvie launched its second product, the world's first silent, wearable, fit-in-your-bra breast pump, in late 2018. The first batch sold out within minutes, a phenomenon that has repeated itself several times on both sides of the Atlantic. The success of Elvie Pump has boosted interest in the company's first product, Elvie Trainer, a device which helps with pelvic floor exercises.

Elvie made history in 2019 when the company successfully completed the largest ever femtech fundraising. Femtech is the umbrella-term for apps, services, and devices that use technology to improve women's health and wellbeing. For decades, healthcare products were designed with little attention paid to the physiological needs of women. Femtech has emerged to change that, and Elvie's co-founder, Tania Boler, is at the forefront of the trend.





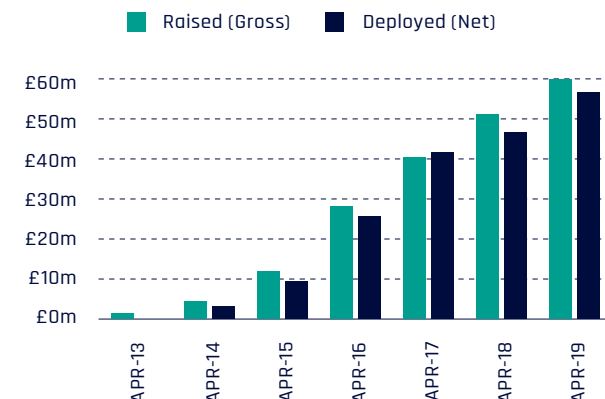
## About the provider

Seneca Partners is a specialist investment and corporate advisory business based in the North of the UK. Seneca provides equity and debt funding to UK SMEs, helping business owners to both finance their growth and realise value on exit either via trade sale, flotation or restructuring. With over £750 million of AUM across the various Seneca businesses, Seneca is a long standing EIS and private equity investor with a strong track record of value realisation for investors. Seneca's strong regional presence provides access to high quality and unique investment opportunities.

## Our VCT Offer

As investment manager, Seneca Partners is seeking to raise up to £10 million under the current open offer with an over-allotment facility of up to a further £10 million. Seneca intends to distribute a large proportion of the net profits it receives from realisations of investments made by way of regular and special tax-free dividends. Therefore, the offer is intended for those investors who are primarily seeking tax-free income from a diverse portfolio of investments in established SMEs across the UK, whilst also seeking to maintain the value of the capital invested.

GROWTH CAPITAL FUNDS RAISED AND DEPLOYED



## Case Study

In December 2018, the VCT invested in a fast growing ecommerce business, SilkFred Limited, which specialises in independent ladies' fashion brands, as part of a £4 million funding round.

The business works with approximately 600 independent brands, selling to over 500,000 customers. It acts as a central marketing and sales platform, charging commission for these services. As a result, the business takes minimal inventory and working capital risk on new brands, lines or products. Seneca's funds and board level guidance have enabled the company to continue to invest in core infrastructure and to innovate its methods to enhance the customer experience.

Seneca's first investment in Silkfred was in March 2018 (via its EIS Portfolio Service). Those funds and the VCT's later investment have enabled the company to grow Gross Marketplace Sales from approximately £11 million in the 12 months ended December 2016 to a current annual run-rate of approximately £50 million, and forecast sales of £60 million in the 12 months ending December 2019.

SilkFred®

## Comparison table

	Amati AIM VCT Prospectus Offer 2019/20 & 2020/21	Blackfinch Spring VCT Plc
MANAGER NAME	Amati Global Investors Ltd	Blackfinch Investments Limited
YEAR FOUNDED	2010	1992
AUM (IN TOTAL) / AUM (VCT)	£438m / £134m	£330m / £0
DESCRIPTION OF OFFER	Amati AIM VCT aims to make long-term investments in innovative businesses which have the potential to become successful AIM-quoted growth companies. As this is a long established VCT, the portfolio is dominated by companies that have achieved this transition	Blackfinch Spring VCT plans to invest in a diversified range of early stage innovative technology firms operating across sectors. These companies are poised for growth and success and by 2024 we plan to return the profits to investors as tax-free dividends of 5% per annum
LAUNCH DATE	Q4 2019	October 2019
UNDERLYING ASSETS	AIM quoted securities	Shares in high-growth technology companies
TARGET NO. OF HOLDINGS	Currently portfolio of 66 companies	10 - 15
TARGET ANNUAL RETURN	N/A	5%
TARGET FUNDRAISE	£25m with an over-allotment facility of £20m	£20m with an over allotment facility of £10m
INVESTMENT OBJECTIVE	The objective of the company is to provide a tax-free dividend return to shareholders primarily through the realisation of capital gains while maintaining the capital value of the shares. The company is managed as a VCT in order that shareholders may benefit from the tax reliefs available	Growth & Income
INVESTMENT HORIZON	5 years	4-7 years (minimum 5 years to retain income tax relief)
MINIMUM INVESTMENT	£4,000	£3,000
INITIAL FEE	3% for new investors, 1% for existing shareholders and applications via an authorised financial intermediary	2.5% advised, up to 5.5% execution only
AMC	1.75% (Ongoing charges figure 1.96% inc. AMC)	2.5% with up to 0.5% used to facilitate ongoing adviser charges, difference rebated as extra shares
OTHER FEES	No performance fees	Performance fee - 20% with 130% hurdle. Annual costs cap of 3.5% of net assets. Refer to prospectus for full details



	Octopus Titan VCT	Seneca Growth Capital VCT Plc
MANAGER NAME	Octopus Investments	Seneca Partners Ltd
YEAR FOUNDED	2000	2010
AUM (IN TOTAL) / AUM (VCT)	£8.6bn / £825m	£151.2m / £8.1m
DESCRIPTION OF OFFER	The UK's largest VCT*, giving investors the opportunity to participate in the growth of some of the UK's most exciting entrepreneurial businesses. Managed by one of Europe's most experienced investment teams, Titan has backed some of the UK's most successful entrepreneurs, including the founders of Zoopla Property Group, Secret Escapes and graze.com	£10m open offer with an over-allotment facility of up to a further £10m. Therefore, the offer is intended for those investors who are primarily seeking tax-free income from a diverse portfolio of investments in established SMEs across the UK, whilst also seeking to maintain the value of the capital invested
LAUNCH DATE	16 September 2019	10 July 2019
UNDERLYING ASSETS	75** early stage companies in a diverse range of sectors	Unquoted and AIM quoted shares
TARGET NO. OF HOLDINGS	No specific target	7 to 10 per £10m
TARGET ANNUAL RETURN	No target return, 5% dividend target. We expect to maintain the NAV/grow it as well as pay out the 5%	N/A
TARGET FUNDRAISE	£120m	£25m with £20m over-allotment facility
INVESTMENT OBJECTIVE	Invest in UK tech-enabled businesses that have the potential for a 10x return	To generate tax free income and capital growth over the longer term
INVESTMENT HORIZON	5 year minimum holding period, although no recommended investment horizon (usually 5-10 years for a VCT makes sense but depends on client and advice etc)	5 years +
MINIMUM INVESTMENT	£3,000	£5,000
INITAL FEE	Please refer to the brochure for fees and charges	3% (advised), 5.5% (non advised) - Early Bird and Loyalty Discounts may be available
AMC	Please refer to the brochure for fees and charges	2% + VAT
OTHER FEES	Please refer to the brochure for fees and charges	Performance Fee 20% + VAT*

\*AIC, 29 August 2019

\*\*As at 31 April 2019

\* Charged each year on distributions made where the total return for that year is 5% or higher

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# Final summary

## 1. High growth potential



- Over £8bn invested into VCTs since 1995
- 'Risk-to-capital' requirement means focus in on investments with higher growth and risk potential

## 2. Potential tax benefits



- Up to 30% income tax relief
- 100% income tax relief on dividends
- Tax-free capital growth
- All subject to permitted maximum investment amount of £200,000 per annum

## 3. Potential risks



- Investment risk of smaller companies
- Liquidity
- Tax risks
- Regulatory risk

## 4. Rules for VCTs



- 80% of investments deployed in qualifying assets within 3 years of raise
- Up to 20% non-qualifying investments allowed
- At least 30% of all new funds must be invested in qualifying holdings within 12 months of the end of the accounting period in which the VCT issues its shares
- Do not retain more than 15% of income from shares and securities
- Do not hold an investment in a company that exceeds 15% by value of the VCT's total investments
- Only invest in qualifying holdings (with certain permitted non-qualifying exceptions)
- Only make minority investments (less than 50%) in investee companies

## 5. Rules for qualifying investee companies



- £12m lifetime investment raise limit
- £5m per company per year investment limit
- 249 employee limit
- 7 year age limit
- Unquoted (other than AIM)
- Qualifying trade

## 6. Knowledge-intensive companies



- Benefit from more generous rules
- £20m lifetime investment raise limit
- £10m per company per year investment limit
- 499 employee limit
- 10 year age limit



### GUY TOLHURST

MANAGING DIRECTOR, INTELLIGENT PARTNERSHIP

*Since their launch in 1995, Venture Capital Trusts (VCTs) have raised over £8 billion in just under a quarter of a century, making them an important source of investment for small businesses and a vital contributor to the UK economy.*

*However, the changes announced in the Autumn Budget 2017 have refocused the market and raise important questions over when and where it is right for financial advisers to recommend a client invests in VCTs. In particular, the 'risk-to-capital' condition that now applies means that potential investors will need to be fully aware of the risks to their investments and understand what the pitfalls might be.*

*The new legislation is designed to ensure the focus of tax efficient investments remains trained on helping those small businesses that really need it, rather than providing a safe haven for money in companies that are able to stand on their own feet. And it appears that the move has not been interpreted as a regressive step: the latest figures from the Association of*

## Closing Statement

*Investment Companies show VCTs raised £731 million in 2018/19 - the second highest amount since their inception - despite the changes.*

*I hope this guide has provided a useful reference to not only the most recent changes to the world of VCTs, but a thorough overview of the rules and framework in which VCTs operate. It is intended to provide the information you need to advise clients interested in VCTs and we will regularly update it so you can be confident of being fully up-to-date.*

*We at Intelligent Partnership passionately believe that equipping advisers with the tools to support their clients is a vital cog in helping investors find appropriate homes for their money, in a way that can help small businesses across the country to grow and prosper. To that end, we provide a variety of guides and reports covering not only VCTs but also markets such as Business Relief and the Enterprise Investment Scheme, which together can broaden the basis on which advisers support their clients.*



4  
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# VCT Accreditation

Intelligent Partnership provides an accessible, CPD accredited e-learning resource on VCTs for regulated advisers, paraplanners, accountants, solicitors and investment professionals.

The VCT accreditation works for a wide range of market stakeholders, from beginners to those who already have knowledge of VCTs, who will gain CPD accreditation and a certificate evidencing successful completion of the course.



*The AIC supports Intelligent Partnership's initiative to improve levels of understanding and knowledge of venture capital trusts (VCTs), and welcomes the launch of this online course."*

NICK BRITTON, HEAD OF TRAINING, ASSOCIATION OF INVESTMENT COMPANIES

## Why online learning?

- Gain a recognised individual Accreditation in VCT
- Receive a 'Certificate of Knowledge & Understanding in VCT'
- Engage in a mix of written, video and interactive original content including case studies, calculators, template documents, process flowcharts and decision-making trees
- Receive hard copies of the regular VCT Industry Report and Adviser's Guide to VCT
- Claim up to four hours of CPD from the PFS, CII and CISI

## What's included in the VCT accreditation:

- 12 interactive modules with charts, images and infographics to aid learning
- Knowledge checks after every module to evidence understanding
- Reflection slides to check against real-world scenarios
- Final assessment to test knowledge and understanding
- Access a suite of learner resources: case studies, guides, reports, videos etc

The Certificate is valid for 12 months.

Find more info and try a free sample at:

[intelligent-partnership.com/e-learning/eis-course](https://intelligent-partnership.com/e-learning/eis-course)





# Helpful resources

[www.theaic.co.uk](http://www.theaic.co.uk)



The UK's trade association for the closed-ended investment company industry, providing investor data on funds including investment trusts & venture capital trusts

[www.micap.com](http://www.micap.com)



MICAP is a provider of quality independent due diligence and research on tax-advantaged investments



## Steps after reading

### Claim your CPD

This guide is accredited for structured CPD by the CISI, PFS and CII and readers of the guide can claim one hour of CPD for each hour spent reading the guide, up to a total of four hours. In order to claim CPD, readers will need to complete a short online test.

For more details on claiming CPD go to:

- [intelligent-partnership.com/cpd](http://intelligent-partnership.com/cpd)

Educational content is also available from Intelligent Partnership, which produces regular CPD accredited VCT reports.

The reports are available at:

- [intelligent-partnership.com/research-format/publications](http://intelligent-partnership.com/research-format/publications)

### Provide Feedback

Intelligent Partnership actively welcomes feedback, thoughts and comments to help shape the development of this guide. This guide is produced on a regular basis.

Feedback can be given on the website or via email:

- [Intelligent-partnership.com/feedback](http://Intelligent-partnership.com/feedback)
- [Guides@intelligent-partnership.com](mailto:Guides@intelligent-partnership.com)

**Participation and feedback  
are gratefully received**

# About Intelligent Partnership



Intelligent Partnership is the UK's leading provider of insights and education in the tax advantaged and alternative investments space.

We provide a suite of materials to keep advisers and industry professionals up to date with the latest developments and on course to meet their training and CPD targets.

Our range of engaging, accessible and CPD accredited resources includes:



### INDUSTRY REPORTS

Free, award winning series including EIS, VCT, BR and AIM Reports offering ongoing observations and intelligence, the latest thoughts and opinions of managers and providers and a comparison of open investment opportunities. Visit: [www.intelligent-partnership.com/research-format/publications](http://www.intelligent-partnership.com/research-format/publications)



### E-LEARNING

A series of e-learning courses for regulated advisers, paraplanners, accountants and solicitors that require a recognised level of knowledge and understanding in all areas of Tax and Estate Planning. Visit: [www.intelligent-partnership.com/e-learning](http://www.intelligent-partnership.com/e-learning)



### SHOWCASES

Free events across the country, giving advisers the opportunity to build their knowledge of tax wrappers and less mainstream asset classes and ask questions. Providers present their investment opportunities on a like for like basis. For information about an event near you, go to: [www.intelligent-partnership.com](http://www.intelligent-partnership.com)



### WEEKLY INVESTMENT BRIEFINGS

A weekly snapshot of the latest articles, commentary and market data for financial services professionals, in two easy-to-read briefings on Tax-Efficient Investments and Alternative Finance. Visit: <https://intelligent-partnership.com/investment-briefing-sign-up/>



### PROVIDER SPOTLIGHTS

A deeper dive into individual providers giving their input on particular market issues and more detail on the strategies and offerings they have developed to address them.





*The rules around VCTs have changed considerably in recent years, but they remain a vital contributor to the UK's small business economy. Advisers need the tools and expertise to make sure they can make best use of VCTs when managing clients' finances tax-efficiently.*

GUY TOLHURST, INTELLIGENT PARTNERSHIP