



## Venture Capital Trusts

Venture Capital Trusts (VCTs) are investment companies which typically invest in unquoted shares including new shares of privately owned companies, and new shares of companies that are traded on the Alternative Investment Market (AIM) and PLUS Market.

VCTs were launched in 1995 as vehicles to encourage UK resident private investors, aged 18 and over, to invest in small higher-risk UK unlisted companies which need start-up, early stage or expansion capital. VCTs pool investors' money and employ a professional fund manager to make the day-to-day investment decisions.

VCTs make an important contribution to the economy by investing in smaller, potentially high growth businesses that promote innovation, industrial change and modernisation of working practices. These young companies are often not generating sufficient cashflow to service traditional forms of debt and so need other sources of finance. The amounts of capital these companies require often varies between £100,000 and £2million and so are beyond the means of most individual investors.

Investing in a VCT enables you to gain exposure, at a relatively low cost, to a professionally run portfolio of privately owned, AIM and PLUS traded shares. With any equity investment your money is at risk, however you should remember that VCTs are buying shares in small, often privately owned and young companies and, due to their nature, should be viewed as higher risk than investing in larger, more established companies.

VCTs themselves are listed on the London Stock Exchange and subject to regulation by tax law, company law and the UK Listing Rules.

### How do they work?

#### Invest in a range of companies

The fund manager invests in companies to maximise the return to shareholders, subject to the stated objective of the trust. VCT fund managers tend to work with/provide advice to their privately owned companies over the long-term and aim to help increase their value.

#### Closed-ended

VCTs raise money for investing by issuing shares. Generally, this happens once – when the trust is created. This makes VCTs closed-ended i.e. the number of shares the trust issues is fixed at the outset.

#### Specialised objectives

All VCTs are specialist investment vehicles which aim to buy into companies that have the potential for good growth. VCTs commonly fall into three broad sectors: generalist (which covers private equity including development capital), AIM, and specialist sectors e.g. technology.

#### A board of directors

Each VCT has a board of directors which meets at least four times a year and monitors the trust's performance. The board of a VCT has a legal duty to uphold the interests of its shareholders.

#### Fund management and fund management groups

The board normally appoints a fund (investment) manager who manages the fund on a day-to-day basis. A small number of VCTs are 'self-managed' by their directors.

#### Charges

Due to the way in which VCTs are managed (i.e. the specialist expertise involved in managing this type of investment) the costs involved in running the company are generally higher than those of other investment companies. As with many other collective investments, performance fees may also be charged. The majority of VCTs have performance fee arrangements in place. These costs, commonly shown as a Total Expense Ratio (TER), affect the returns available to shareholders. If you want to know more about TERs please see the AIC website and individual trusts for more specific information.

#### Tax

VCTs offer investors certain income and capital gains tax reliefs. These include:

- income tax relief on the initial investment when subscribing to new VCT share issues (providing the shares are held for a minimum period of time)
- tax-free dividends
- tax-free capital gains

The tax reliefs available and the rules governing VCTs have changed over the years. For more information on these rules, past and present, please see the table in the following section.

## What are the benefits?

### **Allows you to pool your money**

When you purchase shares in a VCT you pool your money with other investors, providing potential economies of scale, in terms of dealing costs and administration.

### **Allows you to spread your risk**

Each VCT owns shares in a range of companies. So buying shares in a VCT effectively gives you a diversified portfolio in this specialist sector.

### **Specialist professional management**

Each VCT uses professional fund management expertise.

### **Tax-free income and capital gains**

There are two tax reliefs available to all VCT shareholders. These are tax-free income by way of dividend payments and tax-free capital gains on any disposal of your shares. VCTs can also distribute capital profits from the trust as a dividend.

You should remember that the value of the dividend stream can fall and rise. You should check how the individual VCT aims to provide your returns as these methods will differ from trust to trust. As with any equity investment, capital returns are not guaranteed and you may get back less than you invested or nothing at all in extreme cases.

Due to the types of investments VCTs hold they should be considered long-term investments. You should ensure that the investment risks and potential rewards are considered before making any decision on the suitability of a VCT and ensure that the tax advantages are not the main driver for the investment decision.

## Tax benefits when VCT shares are bought at launch

VCTs are listed on the London Stock Exchange. Income tax relief is available to investors subscribing to new VCT shares i.e. on launch of the VCT or when a VCT raises new money. This enables you to potentially reduce your tax bill by taking advantage of the relief. You should be aware that the income tax relief cannot exceed your income tax liability.

VCT tax benefits have changed over time. Below is a table showing these changes.

Date shares were issued	6 April 1995 to 5 April 2000	6 April 2000 to 5 April 2004	6 April 2004 to 5 April 2006	6 April 2006 to date
Tax-free capital gains	Yes	Yes	Yes	Yes
Capital gains tax deferral if bought at launch	Yes	Yes	No	No
Amount of income tax relief on subscription	20%	20%	40%	30%
Maximum investment for income tax relief on subscription	£100,000	£100,000	£200,000	£200,000
Minimum time investor must hold VCT to qualify for income tax relief on subscription	5 years	3 years	3 years	5 years
Tax free dividends	Yes	Yes	Yes	Yes

Tax reliefs are only available to individuals aged 18 years or over who are UK income tax payers and are subject to the trust maintaining VCT approval.

**You should not invest in a VCT simply for the tax benefits. VCTs can be high risk investments and you should take professional advice if you are not certain whether a VCT is suitable for you.**

## Secondary market

If shares are bought on the secondary market, the price will be determined by supply and demand in the marketplace. If there is little demand, the difference between the buying and selling price, called the spread, may widen. You should be aware that it can be difficult to sell VCT shares on the secondary market, although some VCTs offer a 'buy-back' facility. VCTs often trade at a discount to their Net Asset Value.

If shares are bought on the secondary market, you cannot obtain tax relief on your initial investment, however you are still able to obtain tax-free income and capital gains (see tax section above).

## How do VCTs differ from other investment companies?

As with other investment companies, VCTs must adhere to a number of rules set out in legislation. However, in order for investors to receive the tax reliefs, VCTs must also comply with additional rules, the main ones being:

- At least 70% of their investments must be in 'qualifying investments' e.g. shares in private UK companies which carry on certain qualifying trades.
- The 70% must be invested within three years of the VCT's launch. There may be additional investment risk incurred depending on how much of the VCT's money is invested up to that three-year point and where it is invested.
- The maximum size of company that a VCT can invest new money in has been reduced from £15million to £7million (for investments of VCTs that raise new funds after 5 April 2006). This means that the investment risk may increase due to the relative size of these companies. This has the potential to increase the risk profile of new issues of VCT shares.
- There is a maximum of £1million that any VCT can invest in a single company in any tax year.

Failure to meet these rules may mean that a VCT could lose its approved tax status. If this happened, you would also lose your income and capital gains tax benefits.

The remaining 30% can be invested in 'non-qualifying investments' which are essentially any other investment e.g. cash, listed equities, large company debt instruments, but may also include higher risk debt and equity investments. This should be clearly explained in the VCT's prospectus and literature. All this may have the effect of increasing the overall risk of the underlying portfolio. Some forms of debt may reduce the risk in the underlying portfolio. You should aim to establish the facts in order to compare different VCTs.

Date shares were issued	6 April 1995 to 5 April 2000	6 April 2000 to 5 April 2004	6 April 2004 to 5 April 2006	6 April 2006 to date
Maximum size of company VCTs can invest in	£10M	£15M	£15M	£7M

---

## Valuing the underlying portfolio

Because the shares of unquoted companies are not freely traded on any recognised stock exchange, it is more complex to establish their current market value. The board of directors will use valuation methods, based on established principles (e.g. the British Venture Capital Association's Valuation Guidelines or the International Private Equity & Venture Capital Valuation Guidelines), to estimate the value of each private company shareholding. It should be remembered that they can only be estimates and may not actually reflect the value realisable on any subsequent sale, which is dependent on there being a willing buyer in the market and the price they are prepared to pay at that time.

For VCTs which hold AIM, PLUS or other traded investments, this part of the portfolio may be easier to value due to there being a quoted market price, though there may still be liquidity issues for these types of shares.

## Net Asset Value and share price

Due to the nature of their portfolios, VCTs often only produce Net Asset Value (NAV) figures on a quarterly or half-yearly basis. This means that the NAV will move infrequently each year. You should therefore bear in mind that, in addition to the difficulty in valuing unquoted investments, the published NAV may have been calculated some weeks, or even months, earlier.

When assessing investment returns on VCTs it is important that the returns data should include all the dividends. You should remember that the NAV and share price value of the VCT will depend on the performance of the underlying assets and demand for the shares.

## How to invest

### Investing with advice

You can go to a professional adviser, who will give you advice on what to invest in. Together you can work through all the different factors that may affect your decision. Your adviser can then advise you on whether VCTs are a suitable investment for you.

The AIC website [www.theaic.co.uk](http://www.theaic.co.uk) has further information about seeking a specialist financial adviser or you can find a Certified Financial Planner by calling the Institute of Financial Planning on 0117 945 2470 or going to [www.financialplanning.org.uk](http://www.financialplanning.org.uk).

### Investing without advice

If you are prepared to select your own VCT you can choose whether to go direct to a stockbroker or an execution-only dealing service to buy the shares for you. However, if you are in any doubt you should seek specialist advice.

## Key things to remember

- VCTs invest in unquoted shares including new shares of privately owned companies, and new shares of companies that are traded on the Alternative Investment Market (AIM) and PLUS Market.
- VCTs are complex and may be higher risk than conventional investment companies. They should be viewed as long-term investments.
- Though VCTs offer generous tax benefits, you should not invest in a VCT simply for the tax benefits.
- It can be difficult to sell VCT shares on the secondary market, although some VCTs offer a 'buy-back' facility.
- As with any equity investment, returns are not guaranteed and you may get back less than you invest or nothing at all in extreme cases.
- If you are unsure whether VCTs are suitable for you, you should take professional advice.

## For further information

### Visit our website

Our website is a good place to start if you want to learn more about investment companies and find detailed information on all our member companies. You can find it at [www.theaic.co.uk](http://www.theaic.co.uk).

### Information factsheets

The AIC publishes a range of factsheets which are available free of charge by calling 0800 085 8520 or can be downloaded from our website.



### AIC Information Services Limited

24 Chiswell Street  
London EC1Y 4YY

Telephone 020 7282 5555

Fax 020 7282 5556

[enquiries@theaic.co.uk](mailto:enquiries@theaic.co.uk)

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

### September 2010

#### Disclaimer

*This document is for information only and does not constitute investment advice or a personal recommendation and it is not an invitation or inducement to engage in investment activity. You should seek independent financial and, if appropriate, legal advice as to the suitability of any investment mentioned here. AIC Information Services Limited, a wholly owned subsidiary of the Association of Investment Companies, has taken all reasonable steps to verify the information contained in this document, but does not accept responsibility for any errors or omissions or for losses of any nature incurred by any person acting in reliance on such information. This document may not be printed, reproduced or further distributed to any other person or published, in whole or in part, for any purpose.*

*The AIC is a company registered in England and Wales, registered number 4818187.*

*AIC Information Services Limited is a company registered in England and Wales, registered number 01910539.*