

**A Guide to Venture Capital Trusts
2010 - 2011**

DOWNING

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PURPOSE

This Guide has been prepared to provide an introduction to VCTs and, in particular, the related tax reliefs and how to claim them. The risks of investing in VCTs, their performance, the different types of VCTs and how they operate are also explored. Finally, the key pointers on how to select a VCT and detailed questions and answers are set out at the end of the Guide. Investors should note that the Guide is in respect of VCT tax reliefs available in the 2010/11 tax year only. The Guide is not meant to be comprehensive and Investors should seek independent advice before investing in a VCT. **In particular, Investor’s attention is drawn to the Important Notice at the end of the Guide.**

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1. EXECUTIVE SUMMARY

Overview

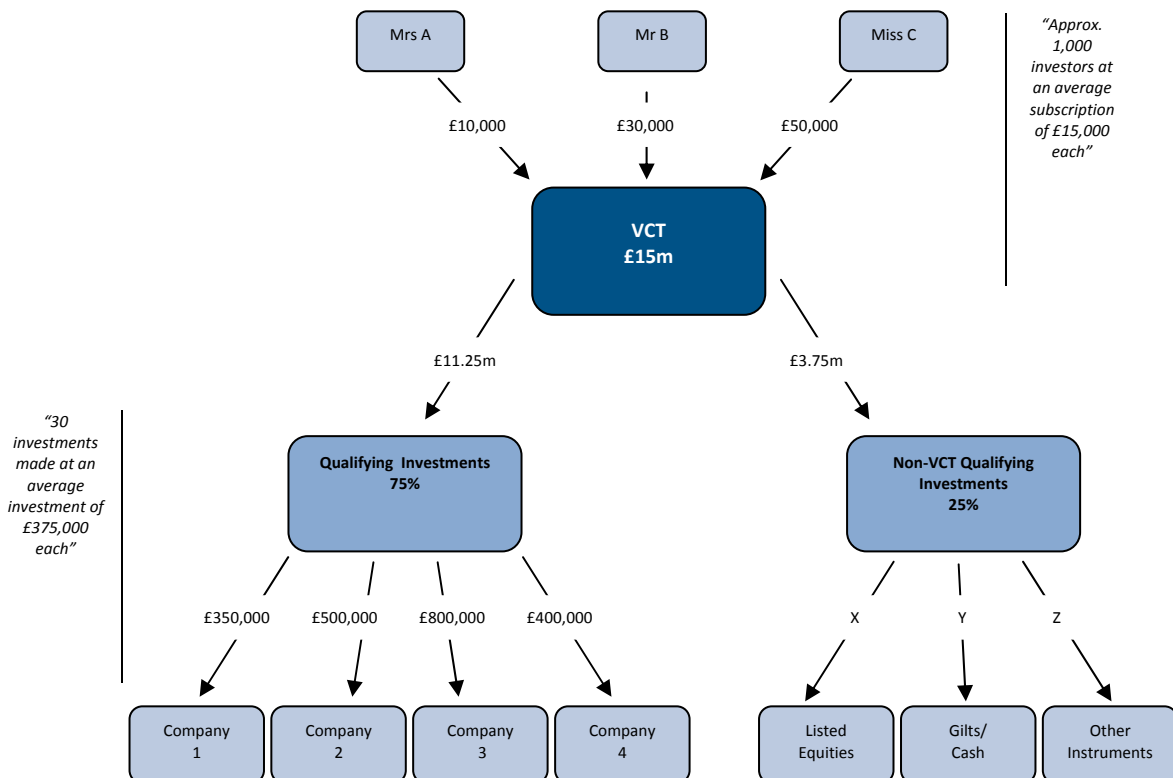
- VCTs can provide access to portfolios of potentially high growth companies with the benefit of very generous tax reliefs
- 30% income tax relief on VCT subscription up to £200,000 per tax year was introduced from the 2006/07 tax year
- Under certain circumstances, subscriptions to VCTs may be considered as part of retirement planning, particularly in the light of current and forthcoming pension funding restrictions
- Planned exit VCTs may address the issue of exiting a VCT investment at fair value
- Evergreen VCTs can provide a highly tax efficient income stream
- VCT tax relief may be claimed against all forms of taxable income (but not capital gains)

Introduction

VCTs were introduced by the Government in 1995 to encourage individuals, by way of substantial tax benefits, to invest in small UK trading companies. VCTs are investment companies, whose shares are traded on the London Stock Exchange. Approximately £4 billion has been raised by over 100 VCTs to date.

An Illustrative Example

Set out below is an example of a typical VCT structure:



The above diagram illustrates one type of VCT. VCT sizes and strategies differ and Investors should not assume all VCTs will mirror the above. Costs have been ignored.

How do Investors make a return on their VCT investment?

- **Dividends – Income:** The VCT receives income from its investments in companies in the form of interest and dividends. If the VCT receives more income than its running costs it will generally pay a dividend to its shareholders, which is tax-free in their hands.
- **Dividends – Capital Distributions:** This is usually a VCT's main focus. Although some investments made by a VCT may fail, VCT Managers aim for the "winners" to be substantial enough to cover the "losers". If, in the above example, Company 1 was sold for £2.5 million then, even if Companies 2-4 all failed, this sum would be sufficient to cover those losses. The gain on the investment in Company 1 of £2.15 could potentially be distributed to shareholders tax-free. Some VCTs take a more conservative approach to investments than others, seeking lower returns and hence have lower risk.
- **Capital Growth:** Investors may sell their VCT Shares at any time and benefit from capital gains tax free growth (although Investors must hold their shares for at least five years to retain the initial income tax relief). Capital losses are not tax allowable.

Some VCTs take a more conservative approach to investments than others, and will accept lower returns in exchange for lower risk. This may be by seeking to invest in asset backed businesses. or electricity generation through solar and wind installations. The generation of electricity through solar and wind installations may benefit from the generous Feed-In Tariffs (FITs) introduced in April 2010, which could reduce risk and enhance returns.

Why are VCTs attractive to Investors?

VCTs primarily invest in new shares issued by "unquoted" companies, i.e. companies not listed on a stock exchange, but which may be quoted on AIM or on PLUS markets. Most private Investors do not have access to these types of investments, or the expertise to assess opportunities and hence they are often the preserve of institutional investors. VCT investors can benefit from the opportunity to "get in on the ground floor" and reap the rewards if the VCT's investments increase in value.

Therefore, a VCT provides access to a portfolio of potentially high growth companies, in addition to the very generous tax reliefs summarised in Section 2 of this document.

Why are Governments encouraging investment in VCTs?

Governments have identified that small and medium sized enterprises (SMEs), which employ over 50% of the private sector workforce, face a shortage of venture capital funding to support their growth. This "equity gap" is at its most severe for businesses seeking investments of between £250,000 and £2 million and is a barrier to productivity growth. Lack of finance can stifle the development of innovative early-stage businesses and can constrain the supply of capital to established businesses that are seeking to modernise, diversify or expand their activities. The current situation where banks are loath to lend to small business has exacerbated the situation but leads to excellent conditions for VCTs making investments.

VCTs were set up to invest in SMEs and thereby help to fill the equity gap.

"...and we hear that some [British businesses] are still unable to access finance they need to innovate, invest and grow. These lost opportunities represent both an economic cost – through reduced job creation and lower productivity growth – and a social cost to the communities in which they trade."

Rt Hon Gordon Brown MP, December 2003

This rings very true in the current economic climate.

2. TAX RELIEFS

The principal tax reliefs, which are available on a maximum investment of £200,000 per individual in the 2010/11 tax year, are set out below:

- **Income tax relief at 30%** of the amount subscribed, provided that the VCT shares are held for at least five years. It is not necessary for an Investor's marginal tax rate to be 30% for the Investor to obtain 30% income tax relief, however, relief will be limited to the amount which reduces the Investor's income tax liability to nil.
- **Tax-free dividends and capital distributions** from a VCT.
- **Capital gains tax exempt** on the disposal of ordinary shares in a VCT.

The table below shows the effect of the initial tax relief:

Effect of initial income tax relief		
Cost of Investment	per Share pence	Subscription £
Gross Investment	100.0p	10,000
30% income tax relief	(30.0p)	(3,000)
Net of tax cost of investment	<u>70.0p</u>	<u>7,000</u>
Initial Value of Investment		
Gross subscription by Investor	100.0p	10,000
Issue costs (say 5.5%)	(5.5p)	(550)
Initial Net Asset Value	<u>94.5p</u>	<u>9,450</u>
Initial "Uplift" (pence/£)	+24.5p	+2,450
Initial "Uplift" (%)	+35%	+35%
Notes		
The table above shows that, assuming income tax relief is received at 30%, the Investor's net of tax cost of investment is 70p per Share and the initial NAV is 94.5p per Share, an "uplift" of 24.5p per Share or 35%. Investors should note that they are required to hold the VCT Shares for at least five years in order to retain the income tax relief and, as such, the initial uplift cannot be immediately realised.		

VCT Investment Calculator for 2010/11 Tax Year

Set out below is a table which calculates the maximum VCT investment (to claim 30% income tax relief) at various levels of income. The maximum VCT investment is 3.33 multiplied by the investor's tax liability (with a maximum investment of £200,000 per tax year).

	Mrs A	Mr B	Miss C	Mr D	Mrs E	Mr F
	£	£	£	£	£	£
Income	25,000	50,000	75,000	100,000	200,000	300,000
Less: personal allowance	(6,475)	(6,475)	(6,475)	(6,475)	(0)	(0)
Taxable income	18,525	43,525	68,525	93,525	200,000	200,000
Tax liability before VCT investment	3,705	9,930	19,930	30,730	77,520	127,520
Multiplier	3.33	3.33	3.33	3.33	3.33	3.33
Maximum VCT investment	12,348	33,067	66,367	102,423	200,000	200,000

1. VCT income tax relief may be claimed against all forms of taxable income (but not against capital gains), including income from employment, self-employment, interest income, dividend income and rental income. Please note that tax credits on dividends are notional and cannot be repaid.

2. Mrs A can claim VCT income tax relief at 30% even though she is a basic rate taxpayer.

3. The maximum VCT investment, to claim 30% income tax relief in tax year 2010/11, is equivalent to the tax liability divided by 30% and would reduce each of A-E's tax liability to nil.

4. The maximum investment in VCTs in the 2010/11 tax year is £200,000. Therefore Mr F will receive income tax relief of £60,000 (£200,000 at 30%) and will be left with a tax bill of £67,520.

Investors are strongly urged to take professional advice when calculating the level of subscriptions to VCTs and the corresponding value of the tax reliefs.

(Source: Downing)

How Investors claim VCT tax reliefs

Upfront Income Tax Relief

- Investors should receive a certificate of entitlement to income tax relief for each VCT subscription. These certificates, which are usually sent out by the VCT's registrar at the same time as the share certificate, should be kept in a safe place.
- After the tax year end, Investors should enter the gross subscriptions (across all VCTs in each tax year) on their tax return. If an Investor does not receive a tax return, then they should write to their tax office in the same way as set out under "Tax Code Adjustment" below.
- Alternatively Investors may apply to HM Revenue & Customs (HMRC) for income tax relief during the tax year as follows:

OR

Tax Code Adjustment

- A copy of the tax certificate should be sent to the Investor's tax office together with a letter requesting a change to their tax code to reflect the VCT subscription.

OR

Reduction in Payments on Account

- Investors may apply for a reduction to their payments on account (payable on 31 January and 31 July each year) by completing form [SA303], which can be downloaded from HMRC's website (www.hmrc.gov.uk) and type ["SA303"] in the "search" box.

Capital gains tax ("CGT") disposal relief

Investors who make gains from the disposal of VCT shares, do not have to pay CGT, but may be required to enter details of the disposal on pages CG2 and CG3 of the Capital Gains Tax pages of their tax return. If either the total value of the VCT shares and any other assets disposed of, or the total chargeable gains, were more than the figures shown on page CGN2 of the Notes on Capital Gains, then entries should be made on CG2 and CG3. The VCT shares should be listed in column A on page CG2, the disposal proceeds entered in column F, nil in column H, and 'VCT disposal relief' written in column G, stating the amount of relief claimed.]

Dividend Relief

Dividends from VCTs are tax-free and should not be entered on an Investor's tax return. Although VCT dividend vouchers itemise out a tax credit, it should be ignored. This tax credit is only relevant if the VCT dividend is taxable, for example, where an Investor subscribes more than £200,000 to VCTs in a tax year.

Note

The above information is in respect of investors who are entitled to claim full VCT reliefs e.g. individuals, aged 18 or over, subscribing or acquiring VCT shares worth £200,000 or less in the 2010/11 tax year.

3. RISKS

Risks

VCTs are deemed to be high risk investments and the primary risks fall into two categories: Investment Risk and Liquidity Risk. Investor's capital is at risk.

Investment Risk

VCTs primarily invest in small unquoted companies which, by their nature, are higher risk than their 'blue-chip' counterparts.

Liquidity Risk

VCT shares must be held for a minimum of five years in order for investors to retain the 30% income tax relief. Even after the five year holding period, VCT shares may not be easy to sell at full value (most VCT shares trade at a discount to net asset value and can have wide "bid-offer" spreads). Purchasers of "second-hand" VCT shares will not benefit from 30% income tax relief and, therefore, sellers of VCT shares tend to outnumber purchasers.

How VCTs Reduce Risk – Investment Risk

- **Portfolio Approach** – It is acknowledged that each Qualifying Investment that a VCT makes may be risky. However, risk is spread by the VCT investing in a portfolio of stocks (usually at least 20 Qualifying Investments in each VCT). For example, an individual who invests £5,000 in each of four different VCTs may have his funds spread across 100 different Qualifying Companies, i.e. effectively £200 in each. Is this approach more or less risky than an individual with £5,000 invested in each of four different FTSE 100 companies?
- **Lower Risk Strategy** – Some VCTs focus on investing in mature, profitable companies or asset-backed businesses. These types of strategy should reduce risk compared to VCTs that invest in technology companies or 'start-ups'.
- **Professional Managers** – VCTs are managed by experienced fund managers who carry out substantial due diligence prior to making investments.
- **Not all VCT Investments are Higher Risk** – In practice, most VCTs will ultimately invest 15%-30% of their funds in lower risk investments such as bank deposits, gilts, bonds, quoted equities or other instruments.
- **Non-Equity Instruments** – At least 30% of a VCT's Qualifying Investments must be held in ordinary shares, but the balance can be held in less risky preference shares or loans (some of which may be secured).
- **Tax Relief Buffer** – For every £1 subscribed, Investors qualify for an income tax rebate of up to 30p, making the effective cost of the investment as low as 70p. Therefore, even if the value of the VCT shares fall by 30%, the Investor has not lost any of his net capital.

How VCTs Reduce Risk – Liquidity Risk

Generally, VCTs buy-back their own shares where there are no "external" purchasers in the market. A VCT's share buy-back policy will be determined by its Board of Directors. The buy-back policy will determine the amount of the VCT's funds that are set aside for buy-backs and the buy-back price (typically a 10%-20% discount to the VCT's NAV). Under Stock Exchange rules, the maximum number of shares a VCT can buy-back per year, without making a general offer, is approximately 15% of its

issued shares. VCT regulations also restrict the amount of VCT funds which can be used for share buy-backs.

Planned exit or limited life VCTs look to address this issue by targeting a full exit over a pre-determined timeframe and at full Net Asset Value.

Comparison of Tax Efficient Products

	VCTs	EISs	ISAs	Pensions
Income tax relief	30%	20%	Nil	20% TO 50% ¹
Capital gains deferral	N	Up to 28%	N	N
Tax free dividends	Y	N	Y	N/A
Tax free exit	Y	Y	Y	Y on 25%
CGT on gains	N	N	N	N
IHT free	N	Y (after 2 years)	N	Depends
Limits 2010/11	£200,000	£500,000 (CGT deferral & IHT relief unlimited)	£10,200	£245,000 p.a. (cum £1.8m) ²
Minimum Holding Period	5 years	3 years	none	To age 55
Note				
The above table is a comparison of the tax reliefs available across the different products, with different risk profiles, presented in a very simplified format. Therefore, no reliance should be placed on the above table in making any investment decisions. Any Investor in doubt as to the tax consequences of investing in the above products should contact their financial adviser.				
¹ contributions restricted to £50,000 p.a. for 2011/12 with anti-forestalling rules restricting higher earners in 2009/10 & 2010/11				
² lifetime allowance reduces to £1.5m for 2012/13				
<i>(Source: Downing)</i>				

VCTs Compared to Pensions

Pensions are considered to be less risky than VCTs because they generally invest in large 'blue-chip' companies and their portfolios are more diversified. In addition, the charges on pensions are generally lower than VCTs. If Investors are comfortable with the additional risks and the higher charges, then VCTs may be considered in addition to pension contributions in the following circumstances (assuming the Investor is a higher rate taxpayer):

- **Reclaim income tax at 30%** – for an individual paying 40% or 50% income tax and not restricted by being a high earner, sufficient pension contributions are made to reduce taxable income to basic rate level and the balance of the tax paid may be reclaimed at the rate of 30% by making VCT subscriptions.
- **Obtain up to 80% tax relief** – by initially investing in a VCT (to obtain 30% tax relief) and using the proceeds from the VCT's initial income tax relief, VCT dividends and ultimately the sale of VCT shares to contribute to fund a pension and to obtain up to a further 50% tax relief.
- **Beat the pension cap** – contributions to pension schemes have an annual cap and total lifetime allowance. VCTs could, therefore, represent an alternative investment where an Investor's pension fund is, or could be, capped.
- **For high earners** – where tax relief from pensions is restricted VCTs may be a preferred alternative.
- **Access** – VCTs may allow a greater level of access to funds than pensions for those below the minimum retirement age of 55.
- **Generational Planning** – VCTs unlike annuities can be passed on to the next generation.

Investors are strongly urged to take professional advice when calculating the levels of contributions to VCTs and pensions (and the associated levels of tax reliefs).

4. DIFFERENT TYPES OF VCTs

VCTs tend to fall into one of three broad categories:

Generalist VCTs

Generalist VCTs mainly concentrate on investment in unquoted companies and are usually managed by traditional venture capital companies, most of which are members of the British Venture Capital Association (BVCA). Once a suitable investment opportunity has been identified the investment process is lengthy and a deal can often take over three months to complete. The 'due diligence' process involves reviews by lawyers, accountants and references are taken on the management team and the investee company. A typical VCT will end up investing in less than five out of every 100 opportunities it receives.

A theoretical example of the type of investment a Generalist VCT might make is set out below:

Example

Mama, a chain of five profitable top of the market maternity wear retailers, wish to expand to 20 shops and require funding of £2 million. *Mama* has been trading for four years and the management team, who have already invested £300,000 to fund the five existing shops, have previously worked in senior positions at leading department stores over the past 10 years.

Set out below is an example of how the £2 million investment requirement might be funded.

	£
VCT subscribes for Ordinary Shares (25% of <i>Mama</i>)	300,000
VCT subscribes for Loanstock (interest rate 8%)	700,000
	<hr/>
	1,000,000
Bank Loan (interest rate 6.5%)	700,000
Additional Investment by Management Team	250,000
	<hr/>
	<u>2,000,000</u>

AIM VCTs

AIM VCTs primarily focus on investing in companies whose shares are listed, or about to be listed, on AIM, which is the London Stock Exchange's junior market. AIM was launched in June 1995 with the objective of providing young and growing companies with means of accessing equity capital to facilitate their expansion. Private investors would not usually have access to these fund raisings as they are normally institutional placings.

AIM VCTs are now less widely available as restrictions to VCT investments made in 2006/07 had more impact on AIM VCTs than Generalist.

Sector Specific VCTs

Sector Specific VCTs specialise in investing in one sector or a limited number of related sectors. Examples include:

- Technology VCTs – Technology VCTs (including biotechnology) are generally perceived as the most risky type of VCT. However, on the other hand, technology VCTs have the potential for very high returns.
- Media/Leisure/Healthcare – In a similar way to technology VCTs, these are examples of sectors that VCTs specialise in.
- Low Carbon VCTs – VCTs focused on investing in solar, wind and other renewable energy businesses.

Asset Backed VCTs

These are VCTs that focus on investing in businesses that own capital assets, which comprise a substantial proportion of their value. Examples of such assets could include:

- Freehold Pubs
- Freehold Health Clubs
- Freehold Children's Nurseries
- Freehold Shops

The assets should provide some downside protection to the VCT, although this could be eroded by trading losses and a lack of alternative use for the asset. Investments in businesses that focus on care homes, hotels and property development do not qualify for VCT purposes.

Sub-divisions

"Planned Exit" VCTs

Planned Exit VCTs look to return Investor's funds within a pre-determined period of time, at Net Asset Value. This helps to tackle the issue of exiting at fair value that can sometimes be associated with VCT investments. These VCTs maximise the benefit of the initial 30% income tax relief.

"Evergreen" VCTs

These are VCTs that look to provide a dividend stream to Investors over a long period of time. The tax-free value of VCT dividends can make this very attractive – particularly in retirement.

5. OPERATION OF VCTs

Fund Raisings

VCTs will initially raise funds from investors by issuing a prospectus. The prospectus, whose issue is approved by the UK Listing Authority, describes the VCT's offer for subscription. The prospectus will include the VCT's investment strategy, details on the Board and the VCT Manager's track record, charges and an application form. .

After the initial fund raising, it is quite common for VCTs to seek further funds at a later date from Investors (to which full tax reliefs are available), primarily to diversify the portfolio further and to spread costs over a wider shareholder base. These fund raisings are usually either:

- Top-up issues – Investors subscribe for the same class of shares as existing shareholders. The price of the shares will depend on the value of the VCT's assets; or
- 'C' share issues – Investors will typically subscribe for a different class of ordinary share, at £1 per share and new shareholders' funds will be segregated from existing shareholders' funds. At some point in the future, the two pots may be merged.

Structure

General

VCTs are investment companies, whose shares are traded on the London Stock Exchange.

Board of Directors

VCTs are run by their non-executive board of directors. The majority of the Board members are required to be independent of the VCT Manager.

VCT Manager

The VCT Manager reports to the Board and is responsible for sourcing and negotiating investments, carrying-out due diligence and making investment recommendations/decisions. Thereafter, the VCT Manager monitors the VCT's investments and may be required to take a 'hands-on' role to protect, or to maximise, the value of the VCT's investments. Finally, the VCT Manager is responsible for advising on the sale of the VCT's investments. The VCT Manager's performance is, therefore, critical in determining the success of a VCT.

Other Advisers

Each VCT has a number of advisers including an administrator (responsible for accounting and reporting to shareholders), a tax status adviser (advises on compliance with VCT rules), registrars, auditors, solicitors etc.

Charges

VCT charges fall into three broad categories:

Upfront Charges

The costs of the fundraising are typically 5%-6% of funds raised, out of which all the launch costs are paid, including commission to financial advisers, legal fees, sponsor's fees, printing and marketing costs.

Annual Fees

The annual running costs are typically capped at around 3.5% of the VCT's net assets. Some VCTs exclude trail commission from the cap, which may increase the total annual expenses to around 4%. The largest component of the annual costs is the VCT Manager's fee, which is typically in the range of 1.5% to 2.5% plus VAT of net assets. Other costs include the administrator's fee, directors' fees, listing fees, audit fees and registrar's fees.

Performance Fees

The VCT Manager will usually receive a performance related reward if a target minimum return is achieved (known as a "hurdle"). The hurdle varies widely between VCTs, but is sometimes linked to a minimum level of dividends paid or total return (i.e. dividends paid plus NAV).

Why are VCT Charges High?

Charges on VCTs are generally higher than some other investment products, such as OEICs and pension funds, because:

- (i) **Economies of Scale** – VCTs are small, generally ranging in size from £2 million to £50 million. Therefore, a VCT's fixed costs are spread over a smaller base compared to large pension schemes and unit trusts.
- (ii) **Level of Work** – The Qualifying Investments made by VCTs are in small higher risk companies and the level of information available is often quite limited. If a poor investment is made, it may be very difficult, or indeed impossible, for the VCT to sell its investment. All these factors mean that the VCT Manager has to devote a significant amount of senior management time to due diligence, negotiating and structuring investments and subsequent monitoring. Where investments do not perform to plan, the VCT Manager may have to replace the investee company's management, in order to protect its investment.

Tax Rules Governing VCTs

To qualify as a VCT, a company must meet a number of conditions, including:

- At least 70% of its investments must be in held Qualifying Investments within three years and thereafter;
- At least 30% of the value of its Qualifying Investments must be in ordinary shares within three years and at least 10% of its holding in each company must be in such shares;
- Its income must be derived wholly or mainly from shares or securities;
- No holding in any one company may represent more than 15% of its total investments;
- Its ordinary share capital must be traded on the London Stock Exchange; and
- It must not retain more than 15% of the income that it derives from shares or securities.

The following are some of the rules specific to investee companies:

- Qualifying investments are newly issued qualifying shares or securities in an unquoted (including AIM and PLUS) UK trading company or group. Excluded trades include property investment, property development, financial services and commodities.

- The gross assets of the investee company must not exceed £7 million immediately prior to the VCT's investment nor exceed £8 million immediately after.
- The maximum a VCT can invest in any one company in any tax year is limited to £1 million.
- No more than £2m can be invested into a company from VCT/EIS/CVS schemes.
- No more than 50 employees at time of investment.
- Older VCTs set up prior to 07/08 are not subject to the same rules.

6. SELECTING A VCT

Investors should take into account the following factors when selecting a VCT:

Investment Strategy

Not all VCTs have the same risk profile. Investors should consider the strategy for both parts of the VCT's portfolio:

- VCT Qualifying Portfolio – Generalist, AIM or Sector Specific VCT? Does the VCT invest in technology start-ups or focus on profitable established companies? Does it invest in asset backed businesses?
- Non-VCT Qualifying Portfolio – does the VCT invest in unquoted companies, quoted equities or 'A' rated bonds, or use other structures? It is important that non qualifying money is made to work!

Manager's Track Record

The key pointers to look for are relevant track record and deal flow:

- Track Record – past performance of the VCT Manager's existing VCTs and its other smaller company investments.
- Deal flow – a good indication of the strength of the deal flow will be the investment rate of the VCT Manager's existing VCTs.

Charges

- Charges comprise an upfront charge, annual fees and a performance related fees. These costs should be compared across all VCTs.

VCT Share Buy-Back Policy

- As there is a very illiquid market in most VCT shares, it is important that VCTs have a strong buy-back policy in place, in order to provide an exit for Investors. Particular attention should be paid as to how the VCT intends to deal with Investors looking to sell shares after five years. The VCT's buy-back policy will be subject to the rules of the London Stock Exchange and VCT regulations.

Independent Reviews

- Third party 'expert' reviews such as Tax Shelter Report and Tax Efficient Review are available to help compare VCTs.

As with all investments, potential Investors should consider spreading their subscription across more than one VCT and taking advice from a suitably qualified financial adviser.

7. DETAILED TAX QUESTIONS

OVERVIEW

- 7.1 **What are the main personal tax incentives to invest in a VCT?**
- Income tax relief of 30% of the amount subscribed;
 - Exemption from income tax on dividends from the VCT; and
 - Exemption from capital gains tax on disposal of VCT shares.
- 7.2 **Can companies or trusts obtain these reliefs?**
- No. Companies or trusts can become investors in VCTs but only qualifying individuals can obtain these tax benefits.
- 7.3 **Is there a maximum investment?**
- No, but the tax reliefs only apply to the first £200,000 in each tax year.
- 7.4 **Can I claim VCT and EIS reliefs in the same tax year?**
- You can invest up to £200,000 in VCTs AND a further £500,000 in EIS issues each tax year and receive income tax relief. The EIS income tax relief may be carried back to the previous tax year (there is no carry back on VCTs). Capital gains tax deferral on subscription is available only on EIS shares and is unlimited.
- 7.5 **Are non-residents allowed to invest?**
- Yes, other than US persons or residents of Canada. All tax reliefs are available to both residents and non-residents, so long as they are paying tax in the UK. You can go abroad at any time and continue to enjoy the above tax reliefs. However taxation advice should be taken on the impact of any proceeds from the VCT in the country of residence.
- 7.6 **Can I make a joint subscription with my partner?**
- No. Joint subscriptions are not permitted. However, where spouses wish to invest individually, each is eligible to invest up to £200,000 each tax year.

INCOME TAX RELIEF

- 7.7 **How much income tax relief can I obtain?**
- Relief at 30% on investments of up to £200,000 in a VCT, provided the VCT shares are held for five years. This gives a maximum income tax saving of £60,000 per tax year.
- 7.8 **If I invest £100,000 and my income tax liability for the year is £15,000, is my income tax relief restricted?**
- Yes. You will only obtain income tax relief of £15,000, which will reduce your tax liability to nil. The excess of £15,000 cannot be used in other tax years and is lost.
- 7.9 **Must I subscribe for new VCT shares to obtain income tax relief?**
- Yes. Investors who buy “second-hand” shares in the market will not receive the initial income tax relief.
- 7.10 **I am a basic rate taxpayer and my only source of income is dividend income. Will I be entitled to income tax relief?**
- No, in these circumstances you will not be able to claim income tax relief, as tax credits on dividends are now notional and cannot be repaid.
- 7.11 **What tax documentation will the VCT provide as evidence of my investment?**
- If you subscribe for shares, you will receive a certificate of entitlement to income tax relief.

- 7.12 **How and when can I obtain the income tax relief?**
You need the formal certificate of entitlement to claim the relief. Each VCT will issue you with this certificate along with the actual share certificate. How you claim the relief depends on your circumstances. If you are employed or receiving a pension, you can submit your certificate to your tax office in order to amend your tax code. If you are, for instance, self-employed you will claim the relief through your tax return. In some circumstances, you may be eligible to reduce your tax payments on account and thus obtain the tax saving earlier.
- 7.13 **Can I borrow to invest in a VCT?**
Yes. However, the tax relief will not be available if the loan is “linked” with the VCT shares, for example if it is secured on the shares. A bank loan secured on other assets would normally qualify but you should check this with your financial adviser first.
- 7.14 **Do a husband and wife each get the income tax relief?**
Yes. Each is entitled to the upper limit of £200,000 on his or her own subscription. Income tax relief cannot however be transferred between spouses.
- 7.15 **Can my children qualify?**
Yes, but only if they are aged 18 or over when the VCT shares are issued to them.
- 7.16 **What about a family trust?**
No. The relief is available to qualifying individuals only.
- 7.17 **Can I apply in a nominee name?**
No. Individuals must subscribe in their own name and using their own address. A subsequent transfer to the Investor’s nominee is permitted, without loss of tax relief.

TAX-FREE DIVIDENDS

- 7.18 **Do I have any tax to pay on dividends received on my VCT shares?**
No. There is no income tax on VCT dividends even if you are liable to higher rate tax. This exemption is limited to acquisitions of shares within the annual £200,000 limit.
- 7.19 **Do I also receive the tax credit on dividends from my VCT shares?**
No. Tax credits on all dividends, not just those from VCTs, are now no longer repayable.
- 7.20 **Can capital gains made by the VCT be included in the dividends paid to investors?**
Yes. VCTs do not pay tax on capital gains they realise from selling shares. They can then pass on these gains tax free to investors. This gives VCTs a considerable advantage over conventional investment trusts, which are unable to distribute their capital gains.
- 7.21 **Is the dividend tax exemption preserved on VCT shares after death?**
Yes, beneficiaries of the deceased will continue to benefit from the relief, providing they are over the age of 18.
- 7.22 **Must I subscribe for new VCT shares to obtain the income tax exemption on dividends?**
No, VCT shares purchased in the market will also be eligible.

CGT FREE GROWTH

- 7.23 **How are gains on VCT shares taxed?**
The gains are exempt. This is available to subscribers and investors purchasing in the market. The exemption is limited to acquisitions of up to £200,000 each year.

- 7.24 **Do I need to hold on to the shares for any minimum period to get the CGT exemption?**
No. However, investors must hold their shares for at least five years in order to retain the income tax relief.
- 7.25 **Can I get relief for a loss on disposal of VCT shares?**
No. This is the price you pay for tax-exempt gains.
- 7.26 **Is CGT payable on VCT shares sold at a gain after death?**
No. Providing the beneficiaries are aged 18 or over, they can sell the shares free of CGT. The exemption does not, however, include sales made by executors.

MORE COMPLEX QUESTIONS

- 7.27 **I am an investor in a number of VCTs. Can I now spread the shareholdings by transferring my original VCT shares to my spouse and adult children?**
The transfer to your spouse is fine but the initial tax reliefs on subscription would be lost on shares transferred to your children within five years of subscription.
- 7.28 **What happens if I transfer my VCT shares to my spouse?**
There is no withdrawal of relief, providing you are married and living together. It does not matter if your spouse has already used the annual VCT investment limit of £200,000.
- 7.29 **If my spouse subsequently sells shares I gifted, what happens?**
If they are sold within the five year period, measured from your subscription date, there is a withdrawal of relief. Your spouse is liable to pay any income tax due. If they are sold after the five year period, there is no withdrawal.
- 7.30 **How is the withdrawal of relief monitored?**
It is your responsibility to inform HMRC within 60 days if you have disposed of VCT shares such that relief must be withdrawn.
- 7.31 **Are there any circumstances outside my control, which could give rise to withdrawal of income tax relief?**
Yes, if the VCT itself loses its approved VCT status within your five year holding period.
- 7.32 **Is the withdrawal of relief backdated?**
Yes, HMRC will make an assessment for the year for which the relief was originally given.
- 7.33 **What happens if I die?**
The death of an Investor (at any time) does not give rise to any withdrawal of tax relief. However, the VCT shares will form part of an Investor's estate for inheritance tax purposes and are not eligible for business property relief because they are listed on the London Stock Exchange.
- 7.34 **Is my income tax relief affected if I become involved as a director of, or shareholder in, a company in which the VCT invests?**
No.
- 7.35 **Tax-free income and growth are limited to £200,000 of VCT shares acquired per tax year. How is this defined?**
VCT shares acquired include new VCT subscriptions, VCT shares purchased in the market, VCT shares inherited, or received by gift (excluding gifts from one's spouse) and VCT dividends reinvested into VCT shares. The value of the VCT shares so acquired is the amount paid for them, or the market value if received by gift or inheritance. Any commission waived by an IFA to provide additional shares on subscription does not count towards the upfront 30% income tax relief or towards the £200,000 limit.

7.36 **What is Investment Company Status?**

VCTs generally begin life with investment status, which permits them to offset certain expenses against their capital account, thus making more funds available to pay income dividends. VCTs are required to revoke investment status in order to pay a capital dividend.

8. DEFINITIONS

“AIM”	The London Stock Exchange’s junior market
“CGT”	Capital Gains Tax
“EIS”	Enterprise Investment Scheme
“IHT”	Inheritance Tax
“Investee Company”	Company in which a VCT invests
“Investor”	Individual investor, aged 18 or over, investing no more than £200,000 in VCTs in any one tax year
“IRR”	Internal rate of return or compound annual return
“NAV”	Net Asset Value
“PLUS markets”	Trading facility for securities not listed on the London Stock Exchange
“Qualifying Company”	An unquoted company (including AIM quoted and PLUS traded companies) carrying on a qualifying trade wholly or mainly in the UK
“Qualifying Investment”	An investment in an unquoted trading company which comprises a qualifying holding for a VCT
“Share”	Ordinary share in a VCT
“VCT Manager”	Investment manager appointed by a VCT to manage its investments

9. USEFUL CONTACTS

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E: vct@downing.co.uk

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Useful Websites

BVCA	www.bvca.co.uk
Trustnet	www.trustnet.com/vct
HMRC	www.hmrc.gov.uk
Tax Efficient Review	www.taxefficientreview.com
Tax Shelter Report	www.taxshelterreport.co.uk

IMPORTANT NOTICE

Taxation

Independent tax advice should be sought. Tax reliefs referred to are those currently in force. The levels and bases of taxation and of reliefs from taxation may change and the value of reliefs depends upon personal circumstances. If the conditions required for any relief to be given and maintained are not satisfied the relief in question will not be given or may be subsequently withdrawn. Legislation, London Stock Exchange rules and Inland Revenue working practices are subject to amendment and change.

General

This guide is a short summary, which is not intended to be comprehensive and it contains opinions, which may be subjective. This guide is not an invitation, or a solicitation of such an invitation, to subscribe for shares in any VCT. The price of VCT shares may fluctuate and income generated may fall or rise and investors may not get back the full amount invested. The market for VCT shares may be limited and it may be difficult for investors to realise their value. VCT shares may not be a suitable investment for all recipients of this guide and advice should be bought from an independent financial adviser authorised under the Financial Services and Markets Act 2000. Information contained in this guide is not intended to be, and should not be construed as, investment advice on the merits of investing in any particular VCT. In relation to transactions, investments and arrangements referred to in this guide, Downing acts for certain VCTs and no-one else and will not be responsible to anyone other than those VCTs for providing the protections afforded to customers of Downing nor for providing advice. This guide has been issued by Downing, which is authorised and regulated by the Financial Services Authority.

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