

Briefing document

Venture Capital Trusts

Introduction

A Venture Capital Trust (VCT) is a company which is approved by HMRC and subscribes for shares in, and in some cases lends money to, small unquoted trading companies. The VCT scheme is intended to encourage investment in small unquoted trading companies while spreading the risk for investors. It does so by providing a range of tax reliefs for individuals who subscribe for qualifying shares in VCTs. Both UK and non-UK resident individuals may be eligible for relief.

There are a number of detailed conditions which must be met by both the investor and the VCT over a prescribed period in order for tax relief to be available. Tax advice should always be taken, both on investment and in respect of any changes during the prescribed holding period.

This briefing note contains an outline of the VCT tax reliefs. Similar schemes, the Enterprise Investment Scheme (EIS) and the Seed EIS, provide tax reliefs for investments directly into small unquoted trading companies. EIS and SEIS are not covered in this briefing note, though we have compared some aspects of VCTs with EIS and SEIS for information. Separate briefing notes on EIS and SEIS are available on request.

Outline of the reliefs available

Provided all of the conditions are met throughout the relevant period, the following tax reliefs may be available:

- Income tax relief of up to 30% of the amount subscribed for new ordinary shares in the VCT, up to a maximum investment of £200,000 per annum. This can result in an income tax reduction of up to £60,000 per annum. Unlike with EIS and Seed EIS income tax relief, it is not possible to make a claim such that VCT relief is available against income in the previous tax year.
- Dividends received by the investor from qualifying ordinary VCT shares are exempt from income tax.
- Qualifying ordinary VCT shares are exempt from capital gains tax (CGT), which means that gains are not chargeable, but losses are not allowable. This applies both to newly issued and 'second-hand' shares (e.g. shares acquired through a stock exchange).

It is not possible to defer capital gains arising on disposal of other assets by subscribing for VCT shares. CGT deferral is available on qualifying EIS investments and 50% re-investment relief is available on subscriptions for SEIS shares (which effectively exempts half the gains arising on disposal of other assets).

Note also that, while shares which qualify for EIS or SEIS may be eligible for 100% business property relief after two years, which can reduce the value of the shares held to nil for inheritance tax purposes, this relief is, in practice, not available to investors in VCTs.

VCT investments

A number of conditions must be met by both the investor and the VCT in order for VCT reliefs to be available. The investor's shares and the underlying investments of the VCT itself must also meet specific criteria. Notably:

- The VCT's own share capital must be listed on registered stock exchange, such as the London Stock Exchange or another EU regulated market. AIM is not a recognised stock exchange for the VCT's shares.
- At least 80% of the VCT's underlying investments must be in unquoted trading companies carrying on a qualifying trade. Listing on AIM and PLUS markets is acceptable for this purpose.
- Broadly, the companies in which the VCT invests must have objectives to grow and develop their trade in the long-term, and there must be a significant risk that the investment could result in the VCT losing more capital than it receives as its net investment return.

- No more than 15% of the total value of the investments made by the VCT can be in a single company.
- Income in the VCT must be wholly or mainly derived from shares or securities. HMRC regard this condition as met where at least 70% of the VCT's income is derived from shares and securities.
- At least 85% of the VCT's gross income from shares and securities must be distributed by the VCT, unless the VCT is required to retain more than 15% of income by law, or if the amount the VCT is required to distribute is less than £10,000 per annum. The £10,000 is proportionately reduced where the accounting period is less than 12 months.
- For income tax relief to be available the VCT shares must be new ordinary shares, which are fully paid up and which do not have any terms which protect the investor from the risk of investing in a qualifying VCT. For the CGT and dividend exemption the shares can be 'second-hand' shares (i.e. the shares can be acquired from third parties, for example, through the London Stock Exchange), though the other of the aforementioned conditions must be met.
- Income tax relief may be unavailable if shares are acquired in a VCT where the acquisition is 'linked' to a sale of shares in the same VCT, or if the acquisition and disposal occur within six months of one another. Relief is also unavailable on investments into 'predecessor' and 'successor' VCTs of VCTs into which investments eligible for VCT relief have already been made.

For income tax relief to remain available, the conditions must be met both at the date of the investment and for the five years following the issue of the VCT shares. If the above conditions are not met throughout the five year period, any income tax relief claimed may be clawed back.

Furthermore if at any time the shares no longer qualify as VCT shares, whether this is within the five year time period or after, any dividends received from the disqualification date will be subject to income tax and the CGT exemption on disposal of the VCT shares will be unavailable for growth in value from the disqualification date (investors will be treated as having disposed of and reacquired shares on the disqualification date).

There is no minimum holding period for the purposes of the CGT exemption.

As mentioned above, it is currently not possible to defer capital gains realised on disposal of other assets when qualifying investments into VCTs are made. However, gains could be deferred when qualifying investments into VCTs were made before 6 April 2004. If gains were so deferred, those gains will come back into charge if the VCT shares are now disposed of, or if the other conditions for deferral relief to be available cease to be met.

Commercial issues

VCTs can be attractive to investors both because of their tax benefits and because, unlike EIS investments, the risk is spread over a number of companies instead of having a direct investment in one company. That said, the investment is still higher risk and this is just one of the aspects of which a potential investor should be aware. It is essential that appropriate investment advice is taken.

Investors also need to be aware that there may be some difficulty in selling the shares. Income tax relief is only available on subscription for new shares, and so there may not be many potential purchasers of second-hand VCT shares. As such, VCT investments should only be considered as part of your overall investment strategy and, as noted above, advice should be taken from a qualified investment advisor before proceeding with an investment.

Find out more...

This note reflects the law in force as at 5 August 2019. Please be aware that this note does not cover all aspects of this subject.

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