



Dragon's den – adventure capital

Venture Capital Trusts (VCTs) have steadily grown in popularity with over £2 billion invested since their introduction in 1995. VCTs are collective investment schemes quoted on the London Stock Exchange that provide individuals with the opportunity to invest in small companies with exciting growth prospects.

A number of tax advantages have been available to encourage VCT investors which have been revised and amended at various times. For an investment of up to 200,000 in any tax-year, investors receive:

- ✓ **Income tax relief of 30%, provided that the investment is held for five years**
- ✓ **Gains on realisation free from Capital Gains Tax**
- ✓ **Tax free dividends which will include distributions of capital realised within the trust**

The VCT investment manager will take a great deal of care in selecting appropriate opportunities and undertake a thorough due diligence process on the underlying investments. This should include a complete analysis of the fiscal position, business model and route to market including competition, principals, key employees and customers.

Broadly speaking VCTs can be categorised in three types; Generalist, AIM and Specialist:

Generalist VCTs are more akin to traditional venture capital investments and tend to invest in unquoted private companies in the hope of making money in a future trade sale or when a company is floated on an investment market. Typical investments may include companies who require development capital for the next stage of development or management buy-outs.

An AIM VCT will invest predominantly in the shares of companies which are traded on the Alternative Investment Market (AIM) of the London Stock Exchange or unquoted companies approaching an initial public offering (IPO) on AIM. The AIM market offers greater liquidity than unquoted private company shares and some investors are further reassured by the increased transparency associated with public companies. Shares in some well known brands are traded on the AIM market including Domino's Pizza, Majestic Wine and Mulberry Group.

Other VCTs tend to concentrate investments solely in specific market sectors such as technology media or healthcare, reflecting the expertise of the management team.

VCTs are usually between £10m and £50m in size and invest within predetermined criteria on the size of the business and the nature of the trade. These are broadly similar to the criteria for Enterprise Investment Schemes. A typical VCT will invest in somewhere between 30 and 50 different companies across a variety of sectors.

There are strict limits and criteria that VCT managers must follow which cap the amount that can be invested in each company and dictate a timetable for investing the VCT funds. Up to 30% of funds raised may be invested in any asset and tend to be allocated into collective funds either in interest bearing securities such as cash and gilts or riskier, smaller company equities, depending on the risk profile of the trust.



A recent development is the emergence of VCTs which are designed to provide investors with the benefits of the tax relief whilst taking the minimum possible risk. Investments are not targeted for growth potential but based upon the smallest prospect of capital loss and investments are held for the minimum period. Trusts of this nature are sometimes criticised as not being “in the spirit of the legislation” and have led to an extension to the qualifying period which investments must be held. To an investor however, these “protected” VCTs can offer an attractive investment proposition.

Although there are tax concessions, investors should not lose sight of the fact that VCTs invest in comparatively small businesses. Whilst every investor dreams of getting in “on the ground floor” to a Microsoft or Google, we must be mindful of the fact that small businesses are more prone to failure. VCT investments are therefore not suitable for all. Only those investors that are willing to accept a relatively high level of risk should consider VCTs and then only for a relatively small part of their overall investment portfolio.

Venture capital is a dynamic and exciting sector which can offer attractive returns and excellent tax planning opportunities but impartial expert advice is vital in selecting the most appropriate vehicle from a market which encompasses such a broad spectrum of risk.

At PFP we are at the forefront of tax efficient capital planning, working in conjunction with individuals and their professional advisers. For further information please contact your usual PFP consultant on 01423 523311, or email mail@pfpq.co.uk

Investment in film schemes should generally only be considered by sophisticated investors as they are long term illiquid investments which often have a high degree of risk and complexity.

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