CHAPTER 32

VENTURE CAPITAL TRUSTS

32.1 Introduction

If an investor subscribes for shares in a qualifying Venture Capital Trust (VCT), he will receive income tax relief. The income tax relief will be the lower of the amount subscribed for the shares and £200,000 and as with EIS subscriptions, income tax relief is given by way of a tax reducer. **For investments in 2010/11 the tax reducer is 30%.** ITA 2007, s. 261 ITA 2007, s.262(3) ITA 2007, s.263(2)

Maximum tax reducer = £200,000 x 30% = £60,000

VCT relief is always given in the tax year in which the subscription is made – there is **no carry back as with EIS relief**.

As with EIS relief, the tax reducer can bring an individual's tax liability for the year down to nil, but it cannot be used to generate a tax repayment. Note that there is nothing to prevent an investor subscribing for more than £200,000 worth of VCT shares in a tax year. However, income tax relief is given on the first £200,000 only.

32.2 Dividends

There is an exemption given for dividends received by an investor on shares in a VCT. **Dividends on VCT shares are exempt from tax, but this exemption only extends to the first £200,000** invested in a VCT in a tax year. It does not matter whether the shares were subscribed for (and therefore eligible for some tax relief) or acquired from another investor. This relief is not available for EIS shares – all dividends on EIS shares are fully taxable. ITTOIA 2005, s.709 & s.260

Illustration 1

An individual invests in two Venture Capital Trusts in the same tax year. The investor subscribes for £180,000 of shares in VCT No. 1 in May 2010 and £60,000 of shares in VCT No. 2 in July 2010.

He receives a dividend of £9,000 on his VCT No. 1 shares. As dividends on the first £200,000 invested in the tax year are exempt, this £9,000 dividend is tax free. It does not therefore enter his income tax computation.

A dividend of £3,000 is paid on the VCT No. 2 shares. Only dividends on the first £200,000 invested in the tax year are exempt from tax. This means that dividends on the first £20,000 of the VCT No. 2 shares will be exempt whilst dividends on the remaining £40,000 will be taxable. Therefore, of the dividend of £3,000, the first £1,000 – i.e. one-third of the dividend received – is tax free. The remaining £2,000 of the dividend is taxable in 2010/11.

32.3 Qualifying VCTs

ITA 2007, s. 274

As income tax relief is only available for subscriptions of eligible shares in a **qualifying Venture Capital Trust**, it is important that we are clear as to what a VCT actually is. A VCT is actually a **company whose shares are quoted on the Stock Exchange.** Contrast this with the Enterprise Investment Scheme where the investor subscribes for shares in an unquoted trading company.

The **VCT company must ensure** that **at least 70% of its investments are in shares in qualifying companies.** This means that it must primarily invest its funds in acquiring shares in unquoted trading companies which carry on a qualifying trade. A qualifying trade specifically excludes financial and legal trades as well as farming, marketing gardening, hotels, etc. You will note here that the **list of excluded trades for VCT** purposes is **exactly the same as** the list of prohibited trades under the **Enterprise Investment Scheme**.

ITA 2007, s.303

ITA 2007, s.274 & 277

In addition, at least 30% of the qualifying holdings must be in the form of eligible shares, i.e. ordinary shares with no preferential rights to assets or dividends and no right to be redeemed.

ITA 2007, s. 285(3)

A VCT cannot invest more than **15%** of its funds in any one company.

The company is not permitted to retain more than 15% of the income which it derives from its underlying investments. This essentially means that at least 85% of its profits must be distributed by way of dividends to its shareholders.

ITA 2007, s. 276(5)(b)

As with EIS companies, the money raised from a share issue must be used within two years for the purpose of a qualifying business activity and there are also restrictions on the value of the company assets and number of employees. The value of the company's assets cannot exceed £7 million before the share issue, and cannot exceed £8 million immediately afterwards. The company must have less than 50 full-time equivalent employees.

ITA 2007, s.293

ITA 2007, s.297

No company will be able to raise funds through the issue of shares qualifying for VCT relief if it has already raised more than £2 million under VCT and EIS schemes in the last 12 months.

ITA 2007, s.292A

From a purely commercial point of view, an investment in a Venture Capital Trust is generally less risky than an investment into an Enterprise Investment Scheme company. This is because the VCT invests its funds in a number of different companies thereby spreading the investors' risk. With an EIS investment, the investor is very often putting all his eggs into one basket and if that particular company fails, the investor is very unlikely to see a return of his capital investment.

32.4 Clawback of relief

There is a **withdrawal of income tax relief if the investor disposes of his shares in the VCT within five years of issue.** HMRC will collect the withdrawn relief by issuing an assessment for the tax year in which the relief was originally given. ITA 2007, s.266 ITA 2007 s.270

A disposal by way of a gift within five years of the share issue will result in a clawback of all of the income tax relief originally obtained. Gifts between spouses do not result in a clawback of relief.

A sale of the shares within five years will result in a clawback of relief equal to 30% of the sale proceeds.

As with EIS, this clawback is limited and cannot exceed the original tax reducer. This means that if the investor sells the VCT shares within five years at a profit, HMRC will simply withdraw all of the income tax relief originally obtained.

If the shares were sold at a loss within 5 years, the income tax relief withdrawn is the sales proceeds, multiplied by 30%.

Income tax relief will also be withdrawn if the Venture Capital Trust loses its HMRC approved status within five years. In these circumstances, all of the income tax relief originally obtained will be withdrawn. A VCT will lose its approved status if it fails to invest at least 70% of its funds in qualifying unquoted trading companies or those trading companies begin to carry out non-qualifying activities. ITA 2007 s.268

Example 1

Bernice invested £10,000 in shares in a VCT in June 2008. She obtained full income tax relief in respect of the subscription. She sold the shares for £8,000 in September 2010.

Calculate the amount of relief that will be withdrawn as a result of the disposal of the shares.

Example 2

Claire invested in 3 qualifying Venture Capital Trusts in 2010/11 as follows:

	Amount invested	Date	Dividend received
	£		£
Lemon plc	175,000	1.5.10	8,000
Apple plc	35,000	1.6.10	7,000
Banana plc	20,000	1.7.10	2,500

Calculate the total net dividends chargeable to tax in 2010/11.

Answer 1

£8,000 @ 30%	£2,400

Note
Shares were sold at a loss so the clawback is restricted to 30% of the sales proceeds.

Answer 2

Dividends on first £200,000 invested are tax free.

	£
Lemon plc: all tax free	Nil
Apple plc: $\frac{10}{35}$ x £7,000 taxable	2,000
Banana plc: all taxable	2,500
Total taxable net dividends	**£4,500**