

CHAPTER 28

VENTURE CAPITAL TRUSTS

28.1 VCT reinvestment relief

[TCGA 1992, Sch 5C](#)

Up until 5 April 2004, it was possible for a taxpayer to claim VCT reinvestment relief to defer a capital gain on the sale of any asset if the taxpayer subscribed for VCT shares in the preceding or following 12 months. To this end, VCT reinvestment relief worked in a very similar way to EIS reinvestment relief.

VCT reinvestment relief was abolished with effect from 6 April 2004, so taxpayers making capital gains can no longer elect to defer those gains on subscribing for VCT shares. We shall not cover the conditions for VCT reinvestment relief.

A VCT subscription will, however, continue to obtain income tax relief by way of a tax reducer at 30% up to a maximum subscription of £200,000.

28.2 The frozen gain

VCT reinvestment relief worked by "freezing" a gain on any asset when the taxpayer subscribed for VCT shares.

A gain which was frozen under VCT reinvestment relief will crystallise on a happening of a "**chargeable event**". The most common chargeable event is the **sale** by an investor of his shares in the Venture Capital Trust. You may therefore be required to deal with the **crystallisation of a frozen gain when VCT shares are disposed of**.

[TCGA 1992, Sch 5C para 3](#)

A gift of VCT shares is also a chargeable event. This does not include inter-spouse disposals.

If the VCT company is **taken over by a non-VCT company**, this will also trigger the chargeable gain.

The frozen gain will also crystallise if HMRC **withdraws VCT approval** from the shares. This may be the case, for example, if the company does not invest at least 70% of its funds in qualifying companies, or fails to satisfy the rules with regards to the distribution of its profits etc.

Illustration 1

Vernon subscribed £50,000 for newly issued shares in Horizon plc a qualifying VCT, on 29 January 2004.

On 16 March 2004, Vernon sold an investment property for £200,000. His capital gain was as below:

	£
Proceeds	200,000
Cost (September 1988)	(40,000)
Indexation	<u>(20,000)</u>
Gain	<u>140,000</u>

Vernon claims £50,000 VCT reinvestment relief to defer part of the above gain.

	£
Gain 2003/04	140,000
Less: VCT reinvestment relief	<u>(50,000)</u>
Gain remaining	<u>90,000</u>

The gain of £50,000 is "frozen" until the year of a "chargeable event" (e.g. the sale of the VCT shares).

As with the deferral of a gain prior to 6 April 2008 in respect of an EIS investment, if the original disposal would have qualified for entrepreneurs' relief, a claim for the relief can be made when the gain comes back into charge.

28.3 Sales of VCT shares

If VCT shares are sold at a profit, the capital **gain is exempt** from CGT. Unlike EIS shares, the ownership period is irrelevant.

[TCGA 1992, s. 151A\(1\)](#)

Similarly, any **losses** incurred on a sale of VCT shares will **never be allowable** for capital gains tax purposes. Shares in a qualifying Venture Capital Trust can therefore be added to your list of exempt assets, alongside cars, wasting chattels, QCBs etc.

However, the above exemption only applies to the first £200,000 of shares acquired in the year. This ceiling was £100,000 before 6 April 2004. Any shares acquired in excess of this threshold will be chargeable assets for CGT purposes.

In the case of shares acquired on the same day, shares **above** the ceiling are deemed to have been sold **before** those **below** the ceiling - i.e. chargeable shares are sold before exempt shares.

[TCGA 1992, s. 151A\(4\)](#)

Illustration 2

In May 2006, Luther subscribed for 140,000 new £1 shares in Hi-Growth plc, a qualifying VCT. In February 2007 he acquired a further 100,000 shares at a cost of £120,000.

On 21 December 2010, Luther sold 160,000 shares for £400,000.

1. Match first with shares acquired May 2006.

These are within the £200,000 exemption for 2006/07. Therefore the disposal is exempt.

2. Match next with shares acquired February 2007.

£140,000 of the £200,000 limit was used by the May 2006 subscription:

	<i>Shares</i>	<i>Cost (£)</i>
February 2007 subscription	<u>100,000</u>	<u>120,000</u>
Within limit	50,000	60,000
Non-qualifying	50,000	60,000

	£
Shares sold 21.12.10	160,000
Acquired May 2006	<u>(140,000)</u>
	20,000
Non-qualifying shares acquired Feb 2007	<u>(20,000)</u>
	<u>Nil</u>

The non-qualifying shares are deemed to have been sold first thereby triggering a chargeable gain:

	£
Proceeds $(\frac{20000}{160000} \times £400,000)$	50,000
Less: cost $(\frac{20000}{50000} \times £60,000)$	<u>(24,000)</u>
Gain	<u>26,000</u>

28.4 Withdrawal of approval

If a Venture Capital Trust loses HMRC approval, two things will happen.

First, the investor is treated as having sold his shares in the Venture Capital Trust, acquired within the permitted maximum for a tax year, for their **market value** on the day that HMRC withdraws their approval. Because qualifying VCT shares are exempt, there is no chargeable gain at this point. The investor is then treated as having bought back the shares for their market value on the same day.

The investor now has shares in a non-VCT, with a base cost equal to their value on that date. This is important, because shares in a non-VCT are chargeable assets for CGT purposes, so any **subsequent increases** in value after this date, will be **chargeable** to capital gains tax.

At the end of this chapter there is a summary to re-cap on the income tax and capital gains tax implications of both subscribing for and selling VCT shares.

Example 1

Katie sold a painting in August 2003 making a gain of £60,000.

In September 2003 she had subscribed for £40,000 of shares in a VCT. Full reinvestment relief was claimed.

Katie sold the VCT shares in December 2010 for £45,000.

Calculate Katie's chargeable gains in 2010/11.

Answer 1

<i>2003/04</i>	£
Gain on business asset	60,000
Less: VCT reinvestment relief (max) (note)	<u>(40,000)</u>
Gain remaining	<u>£20,000</u>
 <i>2010/11</i>	£
Sale of VCT shares:	
Gain on VCT shares	Exempt
Frozen gain crystallises	<u>40,000</u>
Chargeable gains	<u>£40,000</u>

Note:

VCT reinvestment relief was available as shares issued before 6.4.04.