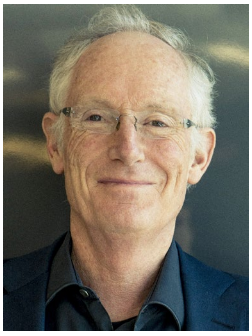
investors

A guide to Venture Capital Trusts

Tax-efficient investing

Introducing EQ



EQ is an award-winning boutique wealth manager with over 60 staff, based in the City of London. We act for private clients, small companies and charities. Our aim is to be the best, not the biggest.

Quality is our cornerstone

We aim to make your investments work as hard as possible and support that with advice that helps you achieve your objectives. We do that by employing the best staff and supporting them in an environment that celebrates quality over quantity. Our portfolio managers are Chartered Financial Analysts and our firm has Chartered Financial Planning status.

Commitment to service

The interests of our clients always rank ahead of other considerations. We aim to win awards for the quality of our service and our investment performance, not our rate of growth.

Clear communications

We will always try to communicate with you in plain English, avoiding unnecessary jargon. Our objective is to inform, not confuse.

Control of our destiny

Unlike many of our competitors we have no external shareholders, nor do we have any intention of ever selling the business. That means we can make long term decisions, unhindered by the need to meet short-term financial targets. It also means that you can be confident that there will not be a change of ownership in the future.

Sense of community

At EQ we have a strong sense of being a member of a wider community. We are proud to be one of the first UK companies to be awarded B Corporation status, an internationally recognised standard for companies that believe in business as a force for good. We operate a Matched Giving programme to help our clients and staff raise extra funds for their favourite causes and we have set up the EQ Foundation as a registered charity.

I look forward to welcoming you as a client of EQ.

John Spiers

John Spiers
Chief Executive

Financial Planners CII Chartered

Certified B Corporation

New Model Adviser TOP 100 2015

Investing in Venture Capital Trusts

Venture Capital Trusts (VCTs) are tax efficient investment vehicles made available by the UK Government. They were initiated in 1995 to promote funding for small and medium-sized companies who may otherwise struggle to raise capital in the market. Since then they have raised nearly £6 billion from private investors.

VCTs incentivise investors to pool their investment into a tax efficient closed-ended fund by offering a number of tax reliefs. The structure of the tax reliefs means that they are particularly suited to investors who require an income.[1]

VCTs are only suitable for experienced investors

Should I consider investing in VCTs?

VCTs are not a suitable option for everyone, but can be appropriate for experienced investors who are willing to take on a degree of risk within a diversified portfolio. We consider them to be a complementary option for investors who:

- are Higher Rate (40%) or Additional Rate (45%) Income Tax payers
- wish to supplement their portfolio having fully contributed to both their pension and ISA
- currently own a diversified portfolio and are willing to invest in an inherently risky asset class, with the added incentive of tax breaks
- are comfortable with a long holding period
- are resident in the UK

To compensate for their higher risk they offer a range of tax breaks

How have VCTs performed in the past?

Below we show the VCT share price total return data published by the Association of Investment Companies (AIC). Investors should also be aware that these figures represent averages and there is considerable disparity between individual VCTs.

	1 year	3 years	5 years	10 years
Return on £100	£106	£133	£157	£179

Source: AIC website.[2] Performance data to 30 November 2015

VCTs tend to pay out realised capital gains over time. The figures above represent the sum of cumulative dividends and current share price, but exclude the upfront income tax relief that is available to investors. Since all VCT dividends and capital gains are tax free, these returns are in effect net of tax. Of course there is no guarantee that past returns are indicative of the future.

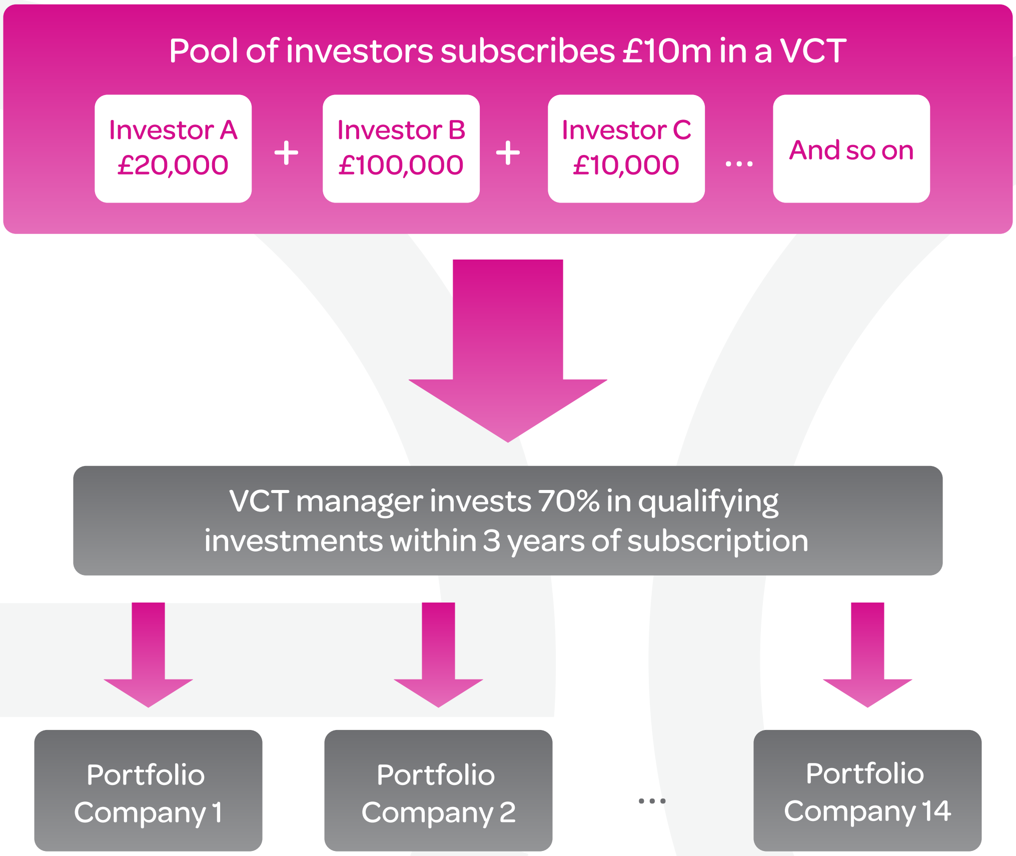
Past performance alone is not a sound basis for making investment decisions

1 See p.6-7 for more details on risks and benefits of investing in VCTs
2 www.theaic.co.uk/aic/news/press-releases/smaller-companies-lead-investment-company-performance-in-2015

Risk warning: past performance is not a guide to future performance. The value of investments and the income derived from them can go down as well as up, so you could get back less than you originally invested. Venture Capital Trusts should be regarded as higher risk investments, suitable only for experienced investors who are able to withstand losses.

What is a Venture Capital Trust?

A Venture Capital Trust is a type of investment company, sharing all the same features including listing on the London Stock Exchange and a closed-ended structure with a limited number of shares. An independent board of directors is responsible for appointing the manager and monitoring performance.



The differentiating factors of a VCT can be attributed to the restrictions imposed by HMRC, which must be adhered to in order to gain VCT status and offer tax breaks.

More specifically, a VCT must have at least 70% of capital invested in qualifying investments[1] within three years. In practice, the more mature VCTs will typically have a higher allocation.

A VCT can invest the remaining capital in non-qualifying investments, where the focus will differ for each trust. Some VCTs will invest this portion to reduce risk, typically through holding cash, gilts or other fixed income instruments. Others will actively manage it to enhance returns, often through investing in open-ended funds and listed equities.

VCTs must invest at least 70% in qualifying companies

1 HMRC guidance on the requirements for qualifying investments can be found online at: http://www.hmrc.gov.uk/manuals/vcmmanual/VCM55010.htm

The EQ research approach

VCTs invest in small UK companies. There are inherent risks in doing this, so careful selection is crucial for investors. EQ's research team conducts full due diligence on each VCT share offer, including both qualitative and quantitative analysis, and our reports are made publicly available online:

Management team

An experienced and committed manager is an essential requirement. We will assess the length of relevant management experience, as well as the quality, structure and depth of resources within the team. We also seek evidence of the manager's commitment to both the firm and the VCT.

It is crucial that the VCT has a strong pipeline of investment opportunities. By analysing previous tax year fundraises and subsequent investment activity, coupled with idea generation capabilities we can make judgements about the ability of the VCT manager to find appropriate opportunities that are in line with the mandate.

Track record

To determine the skill and track record of a VCT manager in generating profits, we assess the Net Asset Value total return (the return of the underlying portfolio, without taking into account the discount or premium at which the shares trade). In addition, a key determinant of success is the ability of the manager to exit an investment, which we analyse through various quantitative measures such as Internal Rate of Return (a measure of investment return) and other metrics.

Dividend policy

Income generation is often a key consideration for VCT investors. For existing VCTs, we assess the dividend history, as well as the maturity of the underlying portfolio and its composition in respect of equity and loans. In addition, we evaluate whether the dividend is sustainable, ensuring it will not be to the detriment of capital preservation or growth of the net asset value.

Investment strategy

We ensure that there is a clearly defined risk / return objective and an investment process in place to achieve this. This includes evaluating the investment policy and structure, the type of investments made within the qualifying portfolio and the objective and composition of the non-qualifying portfolio. This allows us to gain an understanding of the portfolio construction and any diversification benefits.

Discount management policy

The majority of VCT providers have initiated buyback policies with an aim to control the discount to net asset value. The ability to exit a VCT at a competitive price is an important consideration during our due diligence process. We assess the level that each VCT provider targets, and look at their track record in achieving this.

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Benefits of investing in VCTs

Through investing in VCTs, investors can gain pooled exposure to higher-risk small UK companies. Any decision to invest in VCTs should be based on the underlying investment merits and not solely on the generous tax reliefs.

1

30% upfront tax relief

Investors receive 30% tax relief on VCT subscriptions, subject to a **maximum of £200,000 per person per year**.

As this is tax relief, the amount cannot exceed the investor's overall tax liability for the respective tax year. The relief can be claimed immediately but is **subject to the underlying shares being held for a minimum of five years**.

2

Tax-free dividends

The **dividends paid by VCTs are exempt from income tax**. This is especially important given that income generation is often a key consideration for VCT investors.

To understand the impact of tax-free dividends, **please see the case study below**.

3

Tax-free capital gains

Realised capital gains within VCTs are exempt from Capital Gains Tax and can be distributed to investors.

Conversely, as gains are not liable, capital **losses cannot be offset against Capital Gains Tax**.

Case study

Mr Smith and Ms Jones both invest £10,000 in a VCT and receive 10,000 shares. The VCT pays a dividend of 4p per share. After accounting for the 30% income tax relief, their net cost of investment is £7,000 each, increasing the effective dividend yield from 4% to 5.7%. Mr Smith is a Higher Rate (40%) tax payer, but since VCT dividends are tax-free, his dividend yield is equivalent to a gross interest yield of 9.5%. As an Additional Rate (45%) tax payer, Ms Jones' dividend yield is equivalent to a gross interest yield of 10.4%.

Investment		Income		Equivalent gross interest yield	
Gross	Net of tax relief	Dividend paid	Effective yield (net of tax relief)	40% higher rate tax payer	45% additional rate tax payer
£10,000	£7,000	4p	5.7%	9.5%	10.4%

This example is for illustrative purposes only. Dividends payable by VCTs depend on their investment returns.

EQ Tip: *Recent changes in regulations have reduced the ability of newer VCTs to pay a dividend. Therefore those investors who are considering investing in VCTs as a source of income generation should focus on the more mature VCTs that are raising capital through a top-up offer.*

Disadvantages of investing in VCTs

VCTs invest in small, private companies and are therefore deemed higher risk investments, hence the provision of tax breaks for investors. While the VCT manager will seek to address these risks through portfolio diversification and a high level of due-diligence, investors should be aware of the following characteristics when choosing their investment:

Illiquidity of the underlying investments

VCTs provide capital to small private companies, an inherently risky asset class where the underlying investments are typically difficult to sell or value. As such, the closed-ended nature of VCTs is appropriate, but investors should be aware that there is an unpredictability associated with the timing and value that the investment manager may achieve at exit. Furthermore, smaller companies tend to be more vulnerable to failure during tough economic conditions.

Illiquidity of VCTs themselves

The minimum five year holding period to qualify for 30% income tax relief means that trading in VCT shares tends to be light. Demand for VCT shares on the secondary market is also relatively thin because this initial tax relief is not available to secondary purchasers. The implication of this is that VCTs will typically trade at a discount to their Net Asset Value (i.e. the value of the underlying investments).

In an attempt to control this discount, the majority of VCT providers have initiated buyback policies for shareholders to realise their holdings. However, there is no guarantee that these will be available in the future, as they depend on the VCT having adequate liquidity. This may be difficult in adverse economic circumstances which inhibit successful exits from portfolio investments. Furthermore, VCTs need to sustain a viable absolute size to prevent fixed costs becoming too onerous.

VCT management fees

The majority of VCTs will charge an annual management fee of 2-3% per annum, which is in excess of what an investor may pay for a conventional investment. In addition to this, most will charge a performance fee and a standard initial charge – all of which should be taken into account prior to investment.

Withdrawal of tax status

VCTs are required to follow certain regulations put in place by the HMRC. If, for any reason, a VCT fails to meet requirements there is a possibility that investors will lose both the income and capital gains tax relief.

Holding period

In order to qualify for 30% income tax relief the VCT shares must be held for a minimum of 5 years.

How VCTs invest your money

Venture Capital Trusts can have a wide range of investment strategies. It's important to look beneath the bonnet and understand how each trust makes its investment decisions.

A common misconception is that VCTs invest mainly in pre-profitable start-up companies. In reality, many VCTs will predominantly invest in mature and profitable smaller companies, which require funding to expand an already successful business. The risks involved in making this kind of investment decision are quite different to those taken by regular investors in the stockmarket.

The Association of Investment Companies identifies three broad types of VCT investment approach:

Generalists

Generalist VCTs are the most common and represent quite a broad category. They can invest across any sector, and will finance companies at different stages of development: from early-stage high growth prospects to mature, more established and profitable companies. While some will indeed invest across the whole spectrum, others will focus on specific sectors, themes or types of company.

The investment structure may be pure equity (shares) or a combination of equity, loans, or preference shares. This is likely to impact both the expected risk and return of the investment. Structuring an investment partially as debt will typically provide an income to the VCT, which is beneficial to distributing dividends.

In addition to the structure of the investment, the VCT may further attempt to reduce risk by making an asset backed investment, essentially taking first charge on assets owned by the investee company.

Specialists

Specialist VCTs is a catch-all term for any VCT that targets a specific sector, for example investing solely in biotech, environmental, healthcare, media or technology. The specific focus of these VCTs increases their risk profile, due to their lack of diversification. This can in part be addressed by structuring part of the investment in the form of loan notes, or securing the investment with an asset or income stream (asset-backed investment).

Alternative Investment Market (AIM)

AIM VCTs focus their investment on companies quoted on the Alternative Investment Market (AIM) – the London Stock Exchange's junior market. Only certain AIM share issues meet HMRC requirements for inclusion in VCTs. Because these investments tend to be structured mainly in equity rather than loans, this increases their risk profile.

One benefit of investing in an AIM VCT is the opportunity for greater liquidity of underlying investments, as these holdings can be sold – either in part, or in full – in the secondary market. Another implication of investing in listed stocks is that prices can fluctuate daily, which will increase the price volatility relative to a Generalist VCT.

Hybrid VCTs are Generalists that invest in AIM companies alongside unquoted private companies.

Exiting from a VCT investment

VCTs can be classified as either Evergreen or Limited Life which governs the type of investment it undertakes and its risk profile:

Evergreen

An Evergreen VCT does not have a specified wind-up date, and will therefore in theory exist in perpetuity. When an investment within the VCT is sold any profits will usually be distributed as part of a tax free dividend and the remaining proceeds will be recycled and invested in a new investment. The implication for investors is that if they wish to exit the VCT they must sell their shares in the secondary market, invariably at a discount to net asset value. There may also be inadequate liquidity unless the VCT is conducting a share buyback. However, they should also receive a return via dividends.

Limited Life

Limited Life VCTs have a target wind-up date, which is typically between five to seven years from inception. This structure was introduced in an attempt to counter the issues in the secondary market, but has become less common as HMRC has increased regulatory requirements surrounding "qualifying investments" over the years.

The benefit of this structure is a clear exit route for investors, who can be assured of a more predictable time frame in which cash will be returned to shareholders following the sale of the underlying investments. However, given the commitment to return cash to investors in this timely fashion, the VCT manager is restricted in the investments available and will typically focus more on capital preservation at the lower end of the VCT risk spectrum. In many cases, these investments will also involve an element of asset-backing.

Claiming tax relief

Tax relief is available on a maximum subscription of £200,000 per tax year and is restricted to your income tax liability.

Investors will receive a certificate of entitlement to income tax relief for each VCT subscription. These will be issued by the VCT registrar and should be retained for future reference. Investors should enter the gross subscriptions on their tax return.

Where an investor does not receive a tax return, they may apply to their tax office for income tax relief by the following means:

- Tax code adjustment: copy of tax certificate sent to tax office, accompanied by a letter requesting a tax code change to reflect VCT subscription.
- Reduction in payments on account: investor can apply for a reduction to their payment by completing form 'SA303 – claim to reduce payments on account' which can be downloaded from the HMRC website.

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How to invest

There are three possible ways of offering new shares in a VCT:

1 Top-up offer

This is the issue of new shares into an existing VCT share class. Investors who subscribe for these shares will immediately gain exposure to an existing and often mature VCT portfolio, which can be beneficial in terms of reducing the impact of fixed costs. However, these benefits must be viewed in conjunction with any dilutive impact on existing shareholders given this form of raising capital increases the cash weighting, which can cause a “cash drag” on performance.

Top-up offers have better potential for early dividends

2 New share class

This is a method of cash raising that is used to ensure existing shareholder positions are not diluted. A new share class is created with a separate pool of money, and once fully invested will typically merge with the existing ordinary share class. This is most likely to occur when a VCT is raising a large amount of money relative to its existing assets.

3 New launch

This is very rare because it is difficult to achieve the minimum viable fund size (usually £10m+) in an initial offer. If you subscribe prior to the VCT reaching its minimum subscription there is a risk that your money may be returned too late to find alternatives.

New VCTs are only launched rarely

Important information

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VCTs in a changing pension landscape

We believe it is likely that an increasing number of investors will be affected by pension caps, due to:

- The reduction in the annual allowance to £40,000 and even lower levels for higher income investors
- The reduction in the lifetime allowance to £1 million in April 2016 from £1.25 million

The implication is that more investors than ever should be thinking about efficiently managing their personal tax liabilities. **However, it is important that investors consider VCTs on the merit of the underlying investment itself and are willing to gain exposure and participate in the venture capital market – not just invest for the tax benefits.**

Benefits of investing through EQ

EQ conducts a detailed review of each VCT and this is published on our website. We also indicate which VCTs we rate most highly in each sector, to help you make selections. In most cases we can discount the standard charges, saving you money and enhancing your future returns.

In summary, by investing through EQ you gain the benefit of:

- *Detailed, independent research*
- *Discounted charges, partly by foregoing some of the commission that is paid to EQ*
- *Assistance with the application process*
- *Ongoing information*

EQ's online VCT portal

View our up-to-date list of VCT offers at:

eqinvestors.co.uk/vct/offers

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VCTs currently open for subscription

We expect demand for VCTs to outstrip supply for the forseeable future as the number of opportunities for tax efficient investing by hig rate taxpayers reduces.

All application forms should be sent to EQ Investors in order to qualify for the discounts. Please note that information on closing dates is provided by the VCT Managers.

In practice offers may be over-subscribed earlier, or may be extended. During the two months prior to the end of the tax year we strongly recommend that applications are submitted to us as soon as possible to avoid disappointment.

Please note that tax rates and bases can change without notice. VCTs should considered to be high risk investments suitable only for experienced investors who can afford to incur losses.

Name	Issue type	Closing Dates	Min Investment	Raised/ Sought	*Discount	Prospectus	Revi
Evergreen VCTs - these have no formal plan to provide an exit							
Albion VCT	Top-up	5 April 2016 30 June 2016	£6,000	£12.0m / £25.5m	0%	Apply now	
The six Albion VCTs within this top-up offer invest in asset-backed and growth opportunities across a range of sectors.							
Amati VCT 1&2	Top-up	30 March 2016 15 July 2016	£3,000	£1.4m / £7.0m	2%	Apply now	
The Amati VCTs invest in both high growth potential and mature companies that are listed, or expected to list, on the AIM market.							
Calculus VCT (D Share)	New share class	1 April 2016 29 April 2016	£3,000	£0.6m / £8.0m	New Investor: 2% Existing Investor: 2.5%	Apply now	
Calculus VCT has launched a new share class, raising funds for the first time since 2011. The D Share will follow the same Calculus investment strategy , invest in mature and profitable companies.							
Downing ONE VCT	Top-up	5 April 2016 29 April 2016	£5,000	£2.0m / £15.0m	2.75% (26 Feb 2016) / 2.25%	Apply now	
Downing ONE VCT offers investors access to a mature and diversified portfolio of asset-backed, renewable energy and AIM listed companies							
Foresight VCT	Top-up	5 April 2016	£3,000	£0.59m / £30.0m	Existing investors 4.5% (29 Feb 2016) / 3.5% New Investors 4.0% (29 Feb 2016) / 3.0%	Apply now	
This is Foresight's flagship private equity VCT that has transitioned to a Generalist VCT having launched with a technology focused mandate.							
Hargreave Hale AIM VCT 1&2	Top-up	5 April 2016 16 November 2016	£5,000	£6.0m / £25.0m	1%	Apply now	
The Hargreave Hale AIM VCTs predominantly invest in AIM listed stocks, typically in secondary issues rather than IPO opportunities.							
Octopus AIM VCT 1& 2	Top-up	5 April 2016 16 August 2016	£5,000	£1.5m / £30.0m	New Investor 2.5% Existing Investor 3.0%	Apply now	
The Octopus AIM VCTs predominantly invest in companies listed on AIM, and offer investors access to mature and diverse portfolios							
Octopus Apollo VCT	Top-up	5 April 1 November 2016	£5,000	£9.9m / £30.0m	New Investor 2.5% Existing Investor 3.0%	Apply now	
Octopus Apollo is a mature VCT, targeting a combination of long term capital growth and income.							
Octopus Titan VCT	Top-up	5 April 2016 1 September 2016	£5,000	£34.7m / £50.0m	New Investor 2.5% Existing Investor 3.0%	Apply now	
A large private equity VCT investing in early stage companies, with a legacy bias to the technology sector.							
Pembroke VCT (B Share)	New share class	5th April 2016 29 April 2016	£3,000	£1.8m / £15.0m	2.75%	Apply now	
Pembroke VCT B Share sits within Oakley Investment Management, a private equity specialist. The VCT is generalist, investing in companies with a focus on consumer brands							
Proven VCT	Top-up	5 April 2016 31 May 2016	£5,000	£3.5m / £30.0m	2.5%	Apply now	
Proven VCT follows a growth orientated investment strategy, focusing on established companies that require capital to enhance their growth prospects.							
Unicorn AIM VCT	Top-up	1 April 2016	£2,000	£0.0m / £10.0m	Existing Investor 0.75% Until 29 Feb 2016	Apply now	
Unicorn AIM VCT is the largest single AIM VCT and offers investors exposure to a mature and established portfolio of companies listed on AIM							
Limited Life VCTs - these plan to wind up within a defined period to provide an exit for investors							
Downing TWO VCT (K Share)	New share class	5 April 2016 29 April 2016	£5,000	£1.3m / £15.0m	2.75% (26 Feb 2016) / 2.25%	Apply now	
This is a new limited life VCT, following a relatively lower risk strategy of investing in asset-backed investment opportunities.							
Puma VCT 12	New VCT	5 April 2016 30 June 2016	£5,000	£7.7m / £30.0m	1%	Apply now	

Other websites for VCT information

The Association of Investment Companies
www.theaic.co.uk

British Private Equity and Venture Capital Association
www.bvca.co.uk

HM Revenue & Customs
www.hmrc.gov.uk

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Aiming to be the best, not the biggest

Next steps:

For further information please contact us:

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View current VCT offers online:

eqinvestors.co.uk/vct/offers

money management Financial Planner Awards 2015 20th Anniversary
Winner Ethical Investment planner of the year

INVESTMENT WEEK Sustainable Investment Awards 2015 HIGHLY COMMENDED

ifp PARAPLANNER AWARD WINNER 2014 PARAPLANNER OF THE YEAR

New Model Adviser TOP 100 2015

Financial Adviser Top 100 IFAs

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