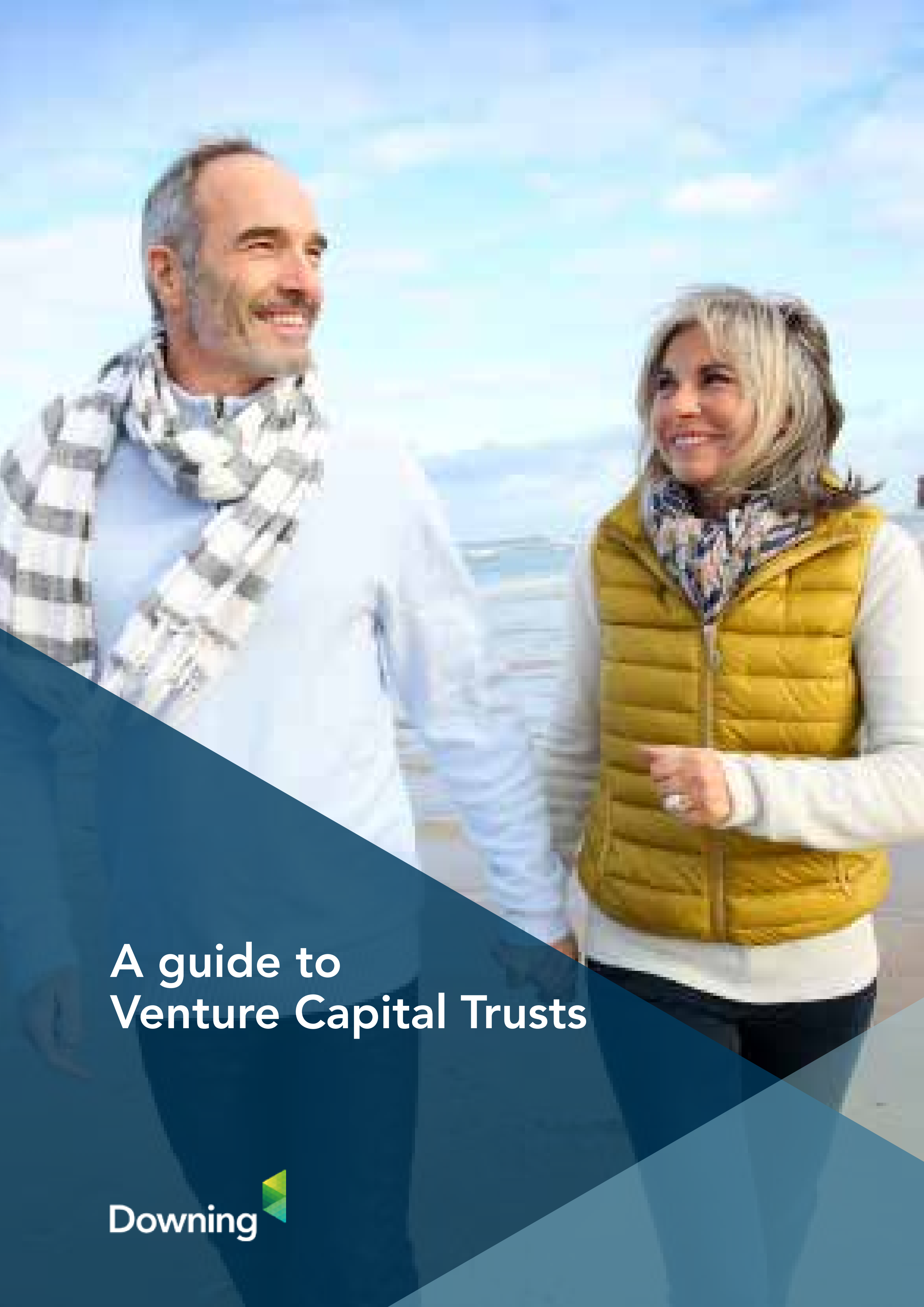

A guide to Venture Capital Trusts

Downing

Important notice

This guide has been designed to provide general information about Venture Capital Trusts (VCTs) and is based on our understanding of the current legislation and HMRC practice. The information herein should not be regarded as investment or taxation advice. Tax rules are complicated. This guide does not cover all the tax rules. In many cases, certain personal circumstances may affect how a rule works for you. The availability of tax reliefs is subject to personal circumstances and relies on the VCT maintaining its qualifying status.

You should only make an investment on the basis of the information provided in the relevant product literature, and we always recommend that you take professional independent financial and taxation advice before making any decisions to invest.

Investments in unquoted companies are higher risk by nature and therefore may not be appropriate for everyone. Find out more about the key risks on page 7.

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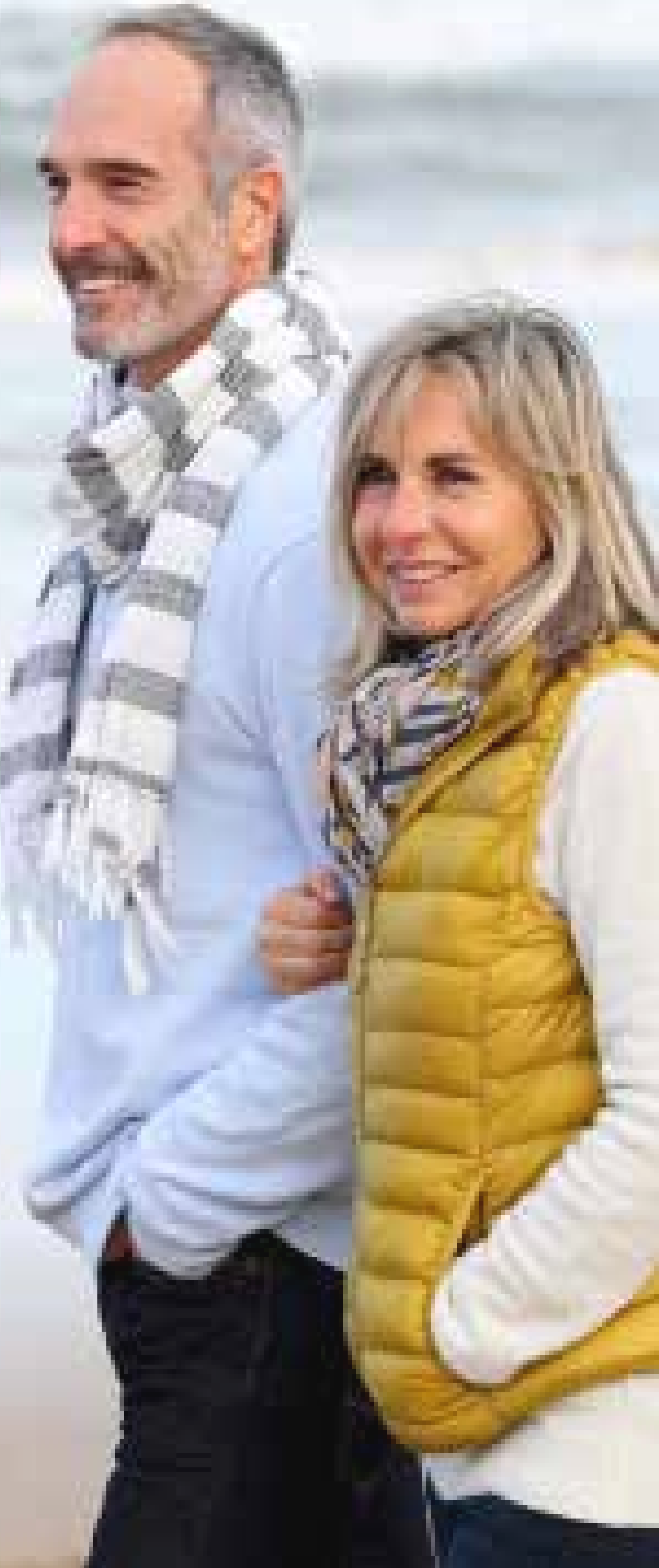


Introduction

Venture Capital Trusts (VCTs) are a tax-efficient way of investing in the growth of small UK companies.

VCTs are publicly-listed companies that invest funds in small UK businesses that are not quoted on a main stock exchange. They were introduced by the government in 1995 to encourage investment in this vital area of the economy and, since then, some 20,000 new jobs have been created by VCT-backed companies[1]. To date, VCTs have raised approximately £7 billion of funds - £570 million of which was raised in 2016/17[2].

VCTs offer the following attractive tax reliefs:

- 30% income tax relief on subscriptions up to £200,000 per tax year (as long as shares are held for at least five years).
- Tax-free dividends.
- Tax-free capital gains.

If you pass away within the first five years of investing, any income tax relief you have claimed doesn't have to be repaid by your estate and any dividends and capital gains will remain tax-free.

How does a VCT work?

When you subscribe for new VCT shares, the VCT pools your funds with other individuals' subscriptions and invests them in a portfolio of smaller unquoted businesses.

In order for a VCT to retain its government-approved status, at least 70% of the VCT's funds must be invested in 'qualifying holdings' within three years of being raised. Qualifying holdings are shares or securities in unquoted companies that undertake a qualifying trade. A qualifying holding can also include loans that have a minimum term of five years.

The remaining 30% of a VCT's funds can be invested in alternative, non-qualifying holdings.

There are three main types of VCT available on the market:

Generalist VCTs	Specialist VCTs	AIM VCTs
Invest in a range of unquoted companies across several sectors, which helps to diversify the portfolio and manage risk. Some generalist VCTs invest in AIM-quoted businesses.	Focus on specific industries, such as healthcare, technology or infrastructure. This increases the investment risk but offers higher potential returns if that sector does particularly well.	Primarily invest in companies that trade on AIM, the London Stock Exchange's junior market. AIM VCTs tend to be more diversified than other types of VCTs but are restricted to new AIM listings.

The lifespan of these VCTs is classed as either 'evergreen' or 'planned exit' (also known as 'limited life'). Evergreen VCTs are designed to last indefinitely and aim to provide income through tax-free dividends. In comparison, planned exit VCTs seek to wind up after the five-year holding period, offering tax reliefs over the shortest period possible. However, planned exit VCTs have become rare in the marketplace which we believe is due to the difficulty in maximising value within such a short timeframe.

It's important to discuss the type of VCT that may be suitable for you with a professional adviser.

[1] *VCT Industry Report 2016/17, Intelligent Partnership.*

[2] *VCT Statistics, HMRC, 19 October 2017.*

Why invest in a VCT?

As well as the attractive tax reliefs, VCTs can also offer growth, income and diversification for your portfolio.

Supporting smaller companies in the UK

VCTs support smaller companies that may find it hard to get traditional finance, such as from banks. Backing these businesses helps create jobs, contribute to the UK's economy and can offer the potential for long-term growth.

Smaller UK businesses are vital to the UK's economy - over 99% of all private sector businesses are small and medium sized enterprises (SMEs), employing 15.7 million people[3]. The combined annual turnover of SMEs in 2016 was £1.8 trillion, accounting for almost half of all private sector turnover in the UK[4].

Additionally, VCTs are funding innovation: 75% of VCT-backed companies have undertaken some form of research and development, with VCT-backed companies investing £181 million in this during 2015 alone[3].

Tax-free income and growth

Many VCTs also offer the potential to earn income via dividends; as income on VCTs is not taxed, reinvesting any dividends could provide a significant return for investors. Some VCTs also enable investors to save on a monthly basis, providing a useful supplement to retirement income.

This is particularly attractive in the current low interest rate environment for those investors seeking tax-free income and are comfortable with the additional risk associated with VCTs.

Diversification

Investors can potentially add extra diversification to their portfolios by investing in VCTs, as they provide exposure to smaller UK companies.

Changes to pensions legislation have encouraged more investors and their advisers to consider VCTs, particularly higher earners or those close to maximising their annual allowances and seeking tax-efficient alternatives.

[3]*Business Population Estimates for the UK and Regions 2016, Department for Business, Innovation and Skills.*

[4]*VCT Industry Report 2016/17, Intelligent Partnership.*

Example

You earn £210,000 p.a. and pay tax at the 45% additional rate. You have fully funded your pension each year in order to maintain your current lifestyle in retirement, and therefore can't carry forward unutilised pension contributions.

Historically, you have set aside at least £40,000 a year for your retirement planning. However, due to the tapered annual allowance, your annual pension contribution is now restricted to £10,000 p.a.

A potential solution is to invest the remaining £30,000 in a VCT, reinvesting dividends while you work to take tax-free in retirement.

Set out below is an example of investing £30,000 in a VCT over five years, and reinvesting dividends (at a rate of 4% p.a. paid from the fourth year onwards). It assumes no gains or losses on the VCT or any adviser charges and that you choose not to reinvest your tax relief. **This example is set out for illustrative purposes only.**

	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Investment	£30,000	£30,000	£30,000	£30,000	£30,000	£150,000
Tax relief (30%)	£9,000	£9,000	£9,000	£9,000	£9,000	£45,000
Dividends	-	-	-	£1,200	£2,448	£3,648
Tax relief on reinvested dividends	-	-	-	£360	£734	£1,094
Value carried forward	£30,000	£60,000	£90,000	£121,200	£153,648	
Total return (including tax relief)						£199,742

Which companies qualify for VCT investment?

In 2015 alone, VCTs provided some £225 million of funds to 115 small UK businesses[5].

The main conditions for a company to qualify for VCT funding are:

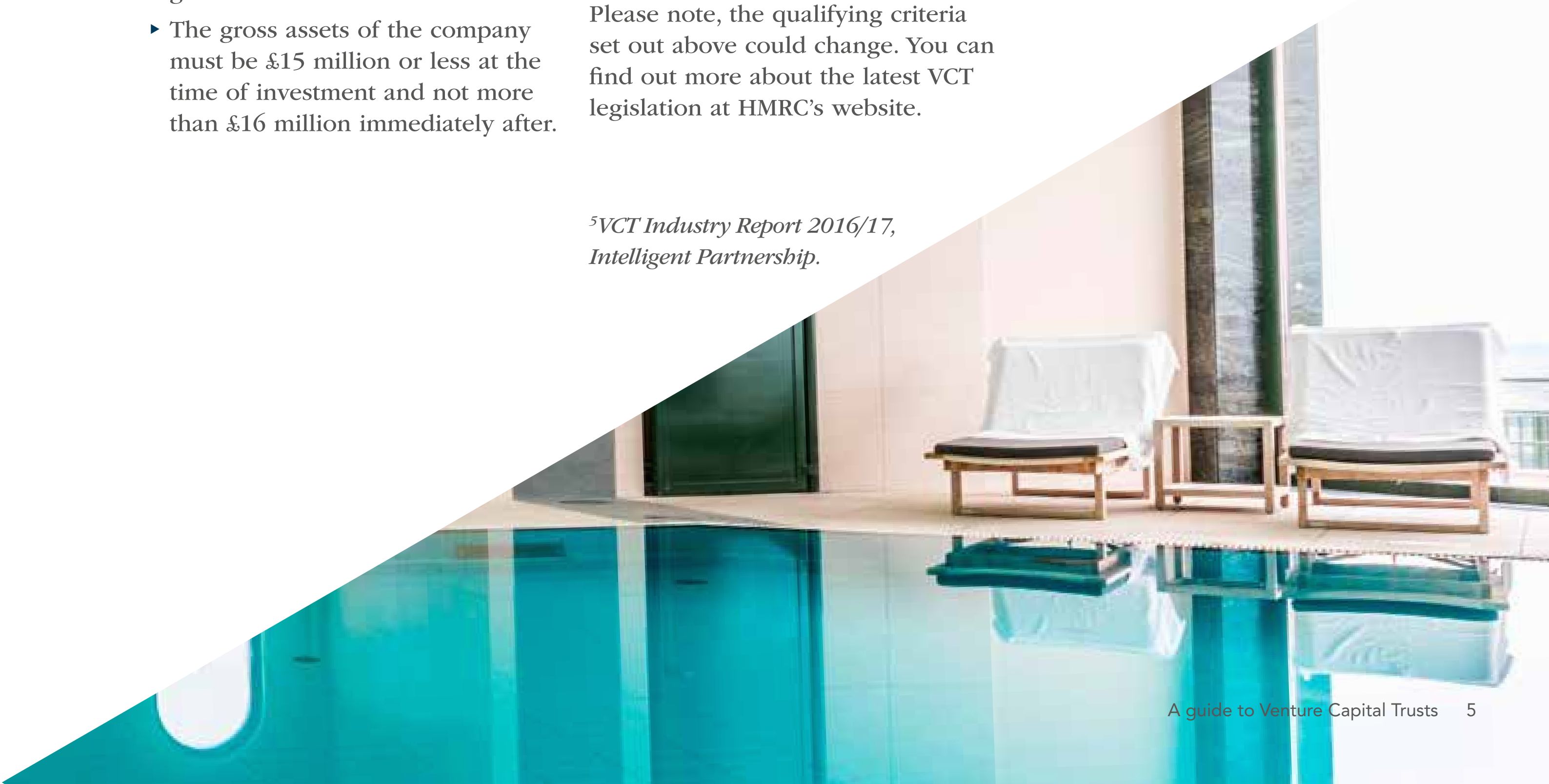
- The company must be unquoted i.e. not listed on a main stock exchange (companies whose shares are traded on the Alternative Investment Market or the NEX Exchange Growth Market are traded as unquoted).
- At the time of investment, the company must have less than 250 full-time employees.
- A VCT can invest up to 15% of its funds into a company, although a company can only receive a total of £5 million of funding in any 12-month period from any source classed as 'aid'. Aid includes VCTs, Enterprise Investment Schemes, Seed Enterprise Investment Schemes and any other government incentive scheme.
- The gross assets of the company must be £15 million or less at the time of investment and not more than £16 million immediately after.

In addition, the company must carry out a 'qualifying trade' to receive VCT funding. Most trades are qualifying, although there are some exceptions including land dealing, property development, financial activities, farming and the management of hotels and nursing homes. If non-qualifying trades make up more than 20% of the company's activities, it isn't eligible for VCT funding.

For VCT investments made after 6 April 2018, the government has introduced a new 'risk to capital' condition when providing advance assurance. HMRC will consider whether there is a significant risk of loss of capital and encourage VCT investment into early-stage high risk companies.

Please note, the qualifying criteria set out above could change. You can find out more about the latest VCT legislation at HMRC's website.

[5]*VCT Industry Report 2016/17, Intelligent Partnership.*



How do I claim tax relief?

Once your VCT subscription has been processed and you have been allotted new VCT shares, you are entitled to claim 30% income tax relief on the amount invested.

After your shares have been allotted, you will be issued with a share certificate and your tax certificate, which you'll need to claim your income tax relief.

This tax relief is available on a maximum investment of £200,000 per tax year and is restricted to your income tax liability. You must hold your shares for at least five years or the initial tax relief will be withdrawn.

Self Assessment Returns

You can apply for tax relief by completing the Additional Information (SA101) form issued by HMRC, entering the total value of your VCT investment in the equivalent of Box 1 in the section titled 'Other tax reliefs'.

Claiming your tax relief this way will reduce the amount of tax that you will need to pay. If you have paid too much tax, the excess can be repaid by HMRC directly into your bank or building society account by entering the details in the relevant section of the form.

Changing your PAYE code

For investments made in the current tax year, you can ask HMRC to change your tax code. Your income tax will be reduced on a monthly basis until your tax relief is used up.

You will need to include your national insurance number, a P60 form and a copy of your VCT tax certificate. Please note that it could take approximately a month to process a PAYE code change.

Reducing payments on account

If you estimate that your total tax bill for 2019/20 will be lower than your payments on account, you should complete form SA303 to reduce these payments, which is available online at the HMRC website.

Remember, if you reduce your payments on account below the correct level, you will be charged interest.

If you don't complete Self Assessment Returns

You should send your VCT tax certificate, along with a copy of your P60 (if you have one), to your local tax office.

You should then either receive tax relief by way of a PAYE code change or a tax refund.

For further details on how to claim tax relief, please contact HMRC directly on **0300 200 3300.**

Key risks

VCTs are higher risk products. It's important to understand those risks before making any decision to invest. VCTs may not be suitable for all investors.

Please read any product literature issued at the time of a VCT launch for a full list of risk factors. If you are in any doubt about your tax position or the suitability of an investment in a VCT you should take specialist advice.

We have set out the key risks that you should be aware of below:

- **Capital is at risk:** a VCT invests in small unquoted or AIM-quoted companies which are higher risk by nature than larger companies. The value of your VCT investment may go down as well as up and you may not receive back the full amount invested. In addition, there is not certainty as to the level of income.
- **Tax reliefs and maintaining VCT status are not guaranteed:** VCT tax rules, or their interpretation, can change. The availability of tax reliefs is subject to personal circumstances and if a VCT does not maintain VCT-qualifying status, investors could lose the tax reliefs. A VCT's ability to obtain maximum value from its investments may be limited by the VCT rules. Changes in the VCT rules may be applied retrospectively and may reduce the level of returns by investors.
- **VCTs are long-term investments:** you should be prepared to hold VCT shares for a minimum of five years to qualify for the available tax reliefs.
- **Past performance is not a reliable indicator of future results.**

About Downing

At Downing, we design and manage investment products that help investors look after their financial wellbeing, while our investment partnerships support businesses in their ambitions. In uniting the two, we build lasting relationships that become the foundation of our investment community.

Since 1986, over 35,000 investors have been a part of what we do, and we are proud to have raised more than £1.7 billion in supporting the growth of small UK businesses. We currently have some £216 million of VCT funds under management.

If you have any questions, or would like to find out more about our VCTs, please call us on **020 3758 9299** or visit **www.downing.co.uk/investors/vct.**

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