



Venture Capital Trusts (VCTs) Accelerated Pension Funding

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WITH THE FESTIVE PERIOD FIRMLY BEHIND US WE NOW FIND THAT OUR FOCUS ONCE AGAIN TURNS TO FINANCIAL PLANNING AND THAT INFAMOUS DATE IN APRIL THAT SIGNALS THE END OF THE TAX YEAR. ENTHUSIASTICALLY AIMING TO MAKE AN EARLY START AND AVOID THE PANIC SO OFTEN EXPERIENCED IN THE RUN UP IN PREVIOUS YEARS, WE LOOK TO MAKE FINAL USE OF TAX-EFFICIENT PLANNING OPPORTUNITIES THROUGH ISAS, PENSIONS, VCTS AND OTHER TAX VEHICLES.

While we are all generally familiar with ISAs and pensions, VCT investment (Venture Capital Trust) is one of the least understood investment products in the market and yet one that can provide substantial tax benefits both on their own, or in retirement planning.

[So what is Venture Capital Trust \(VCT\) and what opportunities exist?](#)

Introduced by the government in 1995 to encourage individual investment in UK smaller companies through attractive tax benefits, more than £3.2billion has been invested in VCTs between 1995 and 2007.

VCTs are companies listed on the main market of the London Stock Exchange and will typically seek to raise between £10m and £30m from a pool of individual investors. The VCT manager will then invest the money, over time, in a diversified portfolio of between 20 and 40 companies. VCTs are subject to stringent investment criteria; one being, that the VCT manager has up to three years to invest at least 70% of the funds in UK qualifying companies (unquoted or AIM listed and not one of the excluded sectors).

The three year investment period means that a high proportion of capital will initially be held in low risk assets such as cash or cash equivalents, while suitable investments are sought.



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While it is important not to be driven by tax alone, VCTs are one of the most tax efficient investment products available to UK investors. Assuming investors hold their VCT shares for five years, they are entitled to:

- 30% income tax relief on investments up to £200,000
- Tax-free dividends
- Tax-free capital growth

Market turbulence through 2008 and continued pessimism for the UK economy through 2009 may not automatically lead you to favour investment in UK smaller companies, but we believe VCTs offer the right investor an attractive investment opportunity. This does, however, assume that an experienced VCT manager is carefully selected given the higher risk nature and current economic climate.

It could be argued that the risks associated with VCT investment (if carefully managed) are outweighed by the generous tax breaks. Further still, they are an effective investment vehicle in alternative or complimentary retirement planning, particularly given the tax-free dividend stream that can be provided while the shares are held.

As we are all aware, a range of investments are available for building tax-efficient retirement funds and it is likely that clients will utilise a variety in reaching their end objective. But what if certain products could be combined to further enhance the tax breaks and the net effect of retirement funding! For example, we all appreciate the income tax relief afforded to pension contributions and we have now learned of the reliefs associated with VCT investment.

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Have you ever considered making an initial investment into a VCT, attracting 30% income tax relief and then subsequently transferring the fund into a Self Invested Personal Pension (SIPP) after the qualifying period? This would further attract both basic rate and higher rate tax relief (if applicable) subject to HMRC limits and the SIPP provider's contractual terms.

The diagram below explains this scenario and the overall net effect of an initial £10,000 investment for a higher rate tax payer. This is a simplistic analysis and takes no account of investment performance and charges, but is a useful illustration that the net cost of holding £12,500 (no gain/loss) in a SIPP is only £4,500 for a higher rate tax-payer!

Inevitably, there are advantages and disadvantages with this planning and while it sounds appealing, we mustn't forget that VCT investment generally carries inherently higher risks than other typical vehicles such as collectives, large cap shares and life insurance funds. The major risks associated with VCT investment are;

- Unquoted companies (UK Smaller Companies)
- Liquidity issues (ability to sell shares)
- Fund management company risk
- Fund size
- Market timing risk
- 'Deal Flow' for chosen manager

While mindful of the risks, there is a compelling argument for considering the use of VCTs as complimentary investments in effective retirement and tax planning, providing care is exercised!

In summary, the use of VCT's in accelerated pension funding will appeal to two types of investors:

- Existing VCT investors (those already through their qualifying period of 3 or 5 years who can roll their VCT over into a SIPP now, or shortly)
- Potential VCT investors (those who can benefit now from the initial tax breaks and consider rolling the proceeds into a SIPP in five years time).

VCTs are higher risk investments and are not suitable for all investors. We strongly recommend that financial advice is taken in further consideration of VCTs as an effective investment product.

The above information is a brief overview and should you wish to discuss VCTs in more detail, please call your usual iimia representative for expert and intelligent advice.

Accelerated Pension Funding

