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Newer Venture Capital Trusts: A Stronger Option for Clients

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Established Tax Planning Tool

2020 was a silver anniversary for Venture Capital Trusts (VCTs). It's 25 years since the UK Government launched these tax-efficient vehicles to encourage support for new and growing firms. To offset investment risk, VCTs offer 30% Income Tax relief (minimum holding period five years); gains exempt from Capital Gains Tax on sales of shares; and no Income Tax on any dividends.

Over the years, they've become popular with investors, reflected in fundraising amounts. In the tax year 2019/20, VCTs raised £619 million. While, due to the impact of the coronavirus pandemic, this was lower than in 2018/19, it reflects the continued appetite for VCTs. (Source: The Association of Investment Companies, 2020). With tax mitigation always high on the agenda, VCTs continue to feature in client portfolios.

Benefits of Newer VCTs

Within the VCT investment landscape there is a wide range of offerings. Investors can select from older VCTs, with many operating since the 1990s, through to newer VCTs launched in the last two years. With VCTs so well established, and all subject to HMRC's strict criteria, investors can consider the benefits of newer offerings.

These may offer greater growth potential through a more concentrated portfolio of high-quality early stage companies. Firms' adaptability and resilience in the face of the pandemic are now integral to investment teams' considerations.

Shares in innovative new firms, that are well positioned for the future, can help to deliver excellent growth. This is alongside creating more diversification in a client's portfolio. These kinds of investments can also make for a greater positive environmental, social and governance (ESG) impact. It's worth exploring these aspects in more detail.

High Performance Hurdles

Older VCTs will contain a portfolio of mature holdings which might, on first glance, appeal to investors. However, one possible drawback of investing in these vehicles are fees which could dilute future returns.

Many of these VCTs will have long ago passed through their hurdle for performance fees, which could dilute future growth for both existing and new investors. In contrast, newer VCTs will need to surpass their hurdle before a performance fee is payable, rewarding those investors with a greater share of the growth.

Unlisted, Technology Enabled Companies

There's also a question around how well equipped older VCTs' investee firms are for the pandemic, and the post-pandemic world.

This is another reason to consider newer VCTs. They will likely be focused on pioneering early stage, unquoted companies (which are not directly correlated to the listed companies/market volatility).

Newer VCTs may also be investing in technology enabled firms. As these business are often web-based, offering their services online, they're able to meet the pandemic head on. They could in some cases even benefit from upheavals. As customer trends evolve due to social distancing they can start to serve new requirements.

One effect of the pandemic has been to accelerate the adoption of digital technologies by several years. Technology-enabled firms have therefore typically been least impacted by global lockdowns, and quite often the beneficiaries of them. Newer VCTs, especially those with a technology focus, are likely to have a much higher concentration of such firms in their portfolios than older ones.

It's useful to note that a new VCT has three years to deploy a minimum 80% of its capital into qualifying companies, with 30% of this needing to be invested within its first two financial years. This gives the investment managers time to assess deals over time, and gradually build a diverse portfolio of firms with strong post-pandemic growth prospects.

Prospect of Dividends

Investing in a newer VCT can therefore bring the prospect of dividends. These could include special dividends from early exits, along with the objective of paying regular dividends in the future as the VCT matures.

In-built Diversification

An important aspect of newer VCTs is that they can help bring greater diversification into an investor's portfolio. Most VCTs will have this effect, by giving investors exposure to smaller companies.

However, with many newer VCTs investing in tech-enabled firms, investors can increase diversification through holding technology-related investments in their portfolios. Such investments these days can be in almost any sector. As teams invest at varying stages of growth, and across sectors, this can help to add more layers of diversification.

Adding a VCT of this kind to a portfolio of existing mature VCTs can also increase diversification. This is through holding investments at different stages of maturity, with different VCT managers, employing different strategies.

Positive ESG Impact

As investor demand for ESG-focused solutions grows, another benefit of newer VCTs is that they're a way in, enabling people to support firms making a positive impact. Within the realm of tech-enabled firms, companies are often more likely to score well on ESG factors.

Many of these firms, spanning sectors from health to education, offer solutions that can change the way we live and work for the better. And in terms of their own operations, they will be working with ESG at their core.

Beyond individual firms' output, there's also a positive ESG impact more generally from supporting new, growing UK companies. They can strengthen the future UK economy through creating jobs and generating tax payments. They can also help to ensure that the UK remains a world leader in business, particularly in the area of innovation.

Selecting a Newer VCT

In considering newer VCTs to present to clients, advisers can look at providers that are taking a fresh approach. Those that offer value-based fee structures, clear technology mandates, tax-efficient expertise and a commitment to ESG, will be best placed to support advisers. This can help advisers in selecting from newer VCTs to find strong solutions for their clients.

Solutions for Investors and Support for Advisers

Blackfinch is a tax-efficient investment specialist working in partnership with advisers to meet clients' requirements.

To find out more please speak to one of our team on **01452 717070** or email **enquiries@blackfinch.com**.

IMPORTANT INFORMATION

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