Venture capital trusts

An Octopus guide

octopus investments
A brighter way

About this guide

For UK investors only

This guide has been written for UK residents who are interested in finding out more about Venture Capital Trusts (VCTs). It's not our intention to offer tax or investment advice. You should always seek professional advice before investing. The information contained in this guide is correct at the time of publication.

- A VCT is an investment that places your money at risk. This means the value of an investment, and any income from it, can fall as well as rise and you may not get back the full amount invested.
- Please note that tax reliefs available on VCT investments depend on individual circumstances and may change in the future. Tax reliefs also depend on the VCT maintaining its VCT-qualifying status.
- VCT shares could fall or rise in value more than other shares listed on the main market of the London Stock Exchange. They may also be harder to sell.

Issued by Octopus Investments Limited, which is authorised and regulated by the Financial Conduct Authority. Registered office: 33 Holborn, London EC1N 2HT. Registered in England and Wales No. 03942880. We record telephone calls. Issued: December 2020. CAM009861-2012

Since they were introduced, Venture Capital Trusts (VCTs) have helped a generation of UK smaller companies to grow. And they can provide investors with an easy way to access the growth potential of these smaller companies, with a number of attractive tax reliefs.

Find it fast

Since their inception, VCTs have created more than 27,000 jobs and driven over £1.4 billion of exports.

Source: The economic and environmental benefits of VCTs, AIC, Feb 2020.

Introducing Venture Capital Trusts

The UK is one of the world's most successful markets for entrepreneurial small companies. But companies that start small usually need investment capital to help them grow and develop.

Recognising that investing in such companies involves taking more risk than investing in larger listed companies (for example, BP or Vodafone), the government introduced Venture Capital Trusts (VCTs) in 1995 as a way of encouraging investment into Britain's exciting, entrepreneurial businesses. In the two decades since they were introduced, VCTs have helped to create jobs, reward innovation and bolster the UK economy.

Some companies that started off with funding from VCTs have grown to become household names in their own right. Some have achieved a listing on the London Stock Exchange and some have been sold to global brands, such as Microsoft, Amazon and Twitter.

As well as providing investors with an easy way to access these small, unlisted or AIM-listed companies, VCTs offer a number of tax reliefs. VCTs offer up to 30% upfront income tax relief, tax-free dividends and an exemption from capital gains tax on the shares should they rise in value. It's important to understand that smaller companies can struggle in their early years, and some will not be successful. Therefore, the tax incentives are there to help compensate investors for the risk they take with their money.

Having launched our first VCT in 2002, Octopus is now the UK's largest provider. We currently manage over £1 billion of VCT money on behalf of over 30,000 investors (Octopus, June 2020). We think VCTs offer great investment potential, with some exciting tax benefits attached. However, VCTs are not suitable for everyone, which is why we always recommend talking to a financial adviser before deciding to invest.

If you have any questions after reading this guide, please call our Investor Support team on **0800 316 2295** or visit **octopusinvestments.com**. We're always happy to hear from you.

Why invest in a VCT?

There are several reasons why you might want to consider investing in a VCT. We've outlined some of these below. But before you make any investment decision, we recommend you talk to a financial adviser who can explain whether the investment is right for you.

VCTs offer growth potential

VCTs invest in smaller, VCT-qualifying companies that are not listed on the main market of the London Stock Exchange. Smaller companies have the potential to grow much faster than their larger listed counterparts. By offering investors access to an instantly diversified portfolio of smaller companies, established VCTs can offer an attractive way to gain exposure to this sector. However, investing in small, VCT-qualifying companies means VCTs are high-risk investments, and you may not get back the full amount you invest.

REMINDER: You should never invest in a VCT solely for the tax benefits. Tax reliefs depend on the VCT maintaining its VCT-qualifying status, and the tax benefits available to you will depend on your own personal circumstances and can change. For more information on the key risks, please see pages 8 and 9.

VCTs offer tax incentives

When you invest in new VCT shares, you are entitled to claim a number of tax incentives on investments up to £200,000 each year. These include:

- **Income tax relief** – You can claim up to 30% upfront income tax relief on the amount you invest, provided you keep your VCT shares for at least five years. So if you invest £10,000 in a VCT, £3,000 can be taken off your income tax bill, although the amount of income tax you claim cannot exceed the amount of income tax due.
- **Tax-free capital gains** – If you decide to sell your VCT shares and you make a profit, the proceeds won't be liable for capital gains tax.
- **Tax-free dividends** – If your VCT pays dividends, there is no tax to pay, and you won't need to declare them on your tax return.

VCTs can help you to diversify your investments

The share price of listed companies can be affected by national and international events and global market conditions. Smaller companies on the other hand, can follow a different investment cycle from other parts of the market, and are often more reflective of the underlying performance of an individual company. This means VCTs can help to add useful diversification to an overall investment portfolio.

VCTs help support British innovation and the economy

Investing in a VCT means you can feel confident that you are helping innovative smaller companies to create jobs, prosperity and economic growth across the country.

VCTs can complement other investment arrangements

While VCTs typically carry a higher risk profile, they can be a useful addition to your investment portfolio if you are looking to complement existing pension plans or other long-term investments, such as Individual Savings Accounts (ISAs). Recent changes to pension rules have placed further restrictions on the amount you can invest into a personal pension, both annually and over your lifetime. This means that VCTs could become a valuable part of retirement planning if your pension limits are at risk of being breached.

As with any investment, please ensure that you are comfortable with the associated risks before making any investment decisions.

VCTs can help to generate additional income

The tax-free dividends paid by VCTs can provide an attractive, supplementary income, which could be useful, especially if you're approaching or in retirement.

Understanding the risks

All investments contain an element of risk, and VCTs are no exception. In fact, because they invest in small, unlisted or AIM-listed companies, VCTs should be considered as high-risk investments.

We've outlined some of the risks below, but you should always refer to a specific VCT's product literature and talk to a professional financial adviser about how the risks could apply to you.

Your capital is at risk and you could lose money

There's no guarantee that the amount you invest will be returned to you.

Investing in smaller companies is considered a high-risk investment

VCTs invest in smaller companies that are often not listed on the main market of the London Stock Exchange. Investments in smaller companies can fall or rise in value much more sharply than shares in larger, more established companies. They also have a higher rate of failure.

This is a long-term investment

You should be prepared to hold VCT shares for a minimum of five years. If you decide to sell your shares before then, you will be required to repay to HM Revenue & Customs (HMRC) any upfront income tax relief you've claimed.

Your shares may be difficult to sell

There isn't an active market for VCT shares in the way there is for shares in bigger listed companies. This means that if you decide to sell your VCT shares, it may take time to find a buyer, or you may have to accept a price lower than the net asset value (NAV) of the VCT. Please refer to **page 16** for more information on how to sell your shares.

Tax rules can change

The VCT tax benefits we've described in this guide are correct at the time of going to print. However, rates of tax, tax benefits and tax allowances do change. In addition, the tax benefits available to you through this investment depend on your own personal circumstances. To ensure that VCT money continues to support government policy objectives, HM Treasury can also change the definition of a VCT-qualifying investment in the future. This could impact the nature of new investments a VCT can make over time.

The VCT's qualifying status could end

There is no guarantee that VCTs will maintain their VCT status. If VCTs lose their qualifying status, tax advantages will be withdrawn from that point. Additionally, if a VCT loses its status within five years of your initial investment, you will be asked to repay any upfront income tax relief that you have already claimed.

"At Octopus we believe in being totally transparent and honest with our customers. We want them to fully understand how their money is being invested, and the importance of reviewing the risks before making an investment."

John Averill
Head of Compliance and Risk
Octopus Investments

Some useful statistics

The first VCT was launched in 1995, and the VCT industry has grown remarkably since then. VCTs can offer significant benefits for investors, but they also provide a valuable source of funding for hundreds of UK smaller companies. The statistics show there's a clear and positive impact for many companies that obtain VCT funding.

1995

The year that VCTs were launched.

£619 million[1]

The amount raised by VCTs in the 2019/20 tax year.

£900 million[2]

The total amount invested in small UK companies by VCTs during 2018 and 2019.

£8.7 billion[1]

The total amount raised by VCTs since inception.

£395 million[2]

The total sales of VCT-backed businesses in 2019.

181[2]

Number of businesses invested in by VCTs with high potential for growth since November 2017.

[1] AIC, April 2020. [2] AIC report, April 2020.

33%[2]

The percentage of VCT-backed businesses exporting internationally.

62%[2]

The percentage of investee companies that reported sales of up to £5 million in the last financial year.

28%[2]

The percentage of VCT-backed businesses that are knowledge intensive.

"VCTs play an active role in supporting the next generation of UK businesses, as well as giving investors the opportunity to access some of the UK's most exciting growth companies."

Paul Latham
Managing Director
Octopus Investments

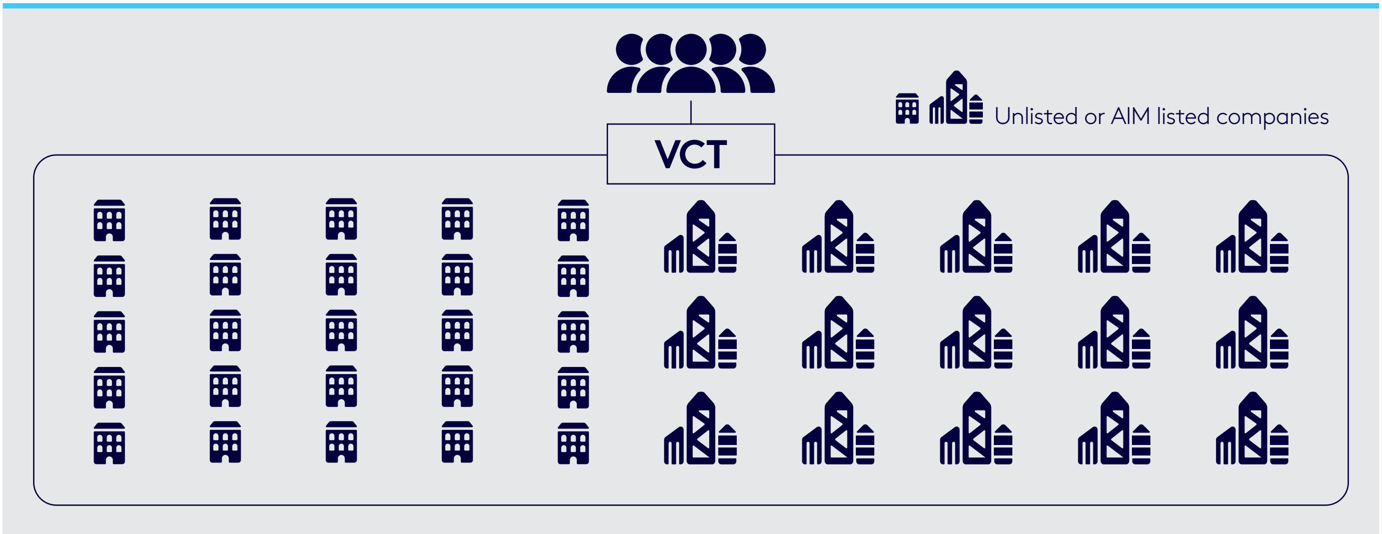
How do VCTs work?

A VCT works in a very similar way to a standard investment trust, one of the oldest forms of collective investment.

A VCT is a listed company in its own right that pools together money from investors and uses it to buy stakes in VCT-qualifying, often privately owned companies. It's important to note that if you invest in a VCT, you hold shares in the VCT itself, rather than shares in the underlying companies the VCT invests in. If you choose to invest, you will receive a share certificate for the amount you've invested. You will also receive a tax certificate that allows you to claim the 30% upfront income tax relief from HM Revenue & Customs (HMRC).

As listed companies, VCT shares are traded on the London Stock Exchange. A VCT must:

- Publish its own annual report and accounts.
- Have an independent Board of Directors to look after the interests of shareholders.
- Hold general meetings for shareholders, including an annual general meeting (AGM).
- Meet standard corporate governance requirements, just like any public company.



What types of VCT are available?

1 Generalist VCTs

Around three quarters of all VCTs belong to this category. Generalist VCTs invest in companies spread across a range of different industries and sectors. The ambition is to create a diversified portfolio of investments which aim to fulfil the mandate of the VCT. Each VCT will have its own set of objectives. Some may focus on early stage companies that are yet to make a profit, while some could invest in more established businesses with an element of maturity. It's therefore important to find out a VCT's investment strategy before deciding if it's right for you.

2 AIM VCTs

The Alternative Investment Market (AIM) is the junior market for the London Stock Exchange. It was launched in the same year as VCTs with a similar purpose: to help the growth of UK smaller companies. Unlike other VCT-qualifying companies, AIM-listed companies have a daily market price and have to meet certain regulatory requirements to continue to be listed on AIM. As AIM is a stock exchange, VCT-qualifying shares listed on AIM are easier to buy and sell than shares of privately owned, unlisted companies.

3 Specialist VCTs

As the name implies, specialist VCTs have much more focused investment objectives. They invest in specific industry sectors such as energy, infrastructure or bio-technology. Concentrating on a single sector typically involves more specific investment risk, but it could also offer higher returns if the chosen sector does particularly well.

The lifespan of a VCT

In terms of investment lifespan, there are two types of VCTs. Some are set up to last indefinitely, and are often called 'evergreen'. These VCTs aim to provide long-term capital growth and/or a steady stream of dividends. The alternative is a 'limited life' VCT, which will be closed as soon as possible after the VCT's minimum holding period of five years has ended. At this point, the VCT will sell its assets and distribute the proceeds to its shareholders.

Which companies can be included in a VCT?

There are a number of rules in place to determine which companies can qualify for VCT funding and be included within the portfolio. HM Treasury sets these rules to make sure that VCTs continue to meet the Government's policy objectives, with money being directed to those companies most in need of finance to grow.

Allowable business activities

To receive VCT funds, a company must have a permanent establishment in the UK and carry out what HM Revenue & Customs calls a 'qualifying trade'. Most trades are allowed, but with a number of exceptions that HM Treasury do not believe are in need of additional financing support. Some examples of these currently include land dealing, financial activities, forestry, farming, running hotels and energy generation.

Company size

A company can qualify for VCT investment if it has gross assets of £15 million or less at the time of the investment, or £16 million immediately afterwards. The company must have fewer than 250 full-time employees when the investment is made.

Investment amounts

A VCT can invest up to 15% of its money in a single company. Each company is allowed to receive up to £5 million of VCT or other tax-efficient funding in any twelve-month period, with a cap of £12 million over its lifetime.

Age of company

VCTs are expected to invest in companies that are less than seven years old from the date of their first commercial sale. However, there are exceptions for 'follow-on' investments and where an established company is looking to raise a significant amount of capital to enter a new product or geographic market.

Knowledge-intensive companies

To support Government policy objectives, the funding rules are expanded for companies that have a large proportion of highly skilled workers or meet certain innovative conditions. These 'knowledge-intensive companies' can have up to 500 employees, up to ten years in which to receive their initial VCT funding from their first commercial sale and a more generous lifetime investment cap of £20 million.

A note on portfolio management

There are also rules that dictate how a portfolio of VCT investments should be constructed and managed. For example, after a VCT has raised money from investors, it has three years in which to invest it. Also, at least 80% of a VCT's portfolio must be invested in VCT-qualifying companies. The remainder can be held as cash or invested into cash equivalents which can be readily realised within seven days – such as money market funds or shares listed on the FTSE.

Frequently asked questions

How can you buy VCT shares?

There are two ways to buy VCT shares:

1. You can invest by applying for shares when a VCT is open for new investment (known as a 'new share offer'). This involves:
   - **Reading the new share offer prospectus.**
   - **Completing an application form.**
   - **Sending a cheque or electronic payment.**
2. You can invest directly, through an online discount broker or through a financial adviser. But because VCTs are high-risk investments, here at Octopus, we always recommend you talk to a financial adviser before making any investment decision.

   As a VCT is a listed company, you can also buy VCT shares on the open market, usually through a stockbroker. These are 'second-hand' shares that have already been owned previously. As a result, they do not offer the same upfront income tax relief that is available with new VCT shares. However, you will still be able to take advantage of any tax-free income and growth. You should note that second-hand VCT shares will still count towards your £200,000 tax-free limit for VCT shares per tax year.

Whichever route you choose, you should read the information provided carefully and make sure you understand the risks involved. You should also consider any costs and charges associated with making a specific investment, and make sure you are happy with them.

How can you sell VCT shares?

As second-hand VCT shares do not offer upfront income tax relief, the market for second-hand shares is very limited, which can make it difficult to sell VCT shares at a fair price. To solve this, the Board of Directors for most VCTs offer to 'buy back' VCT shares from existing investors at a small discount to the NAV of the shares.

However, VCTs are under no obligation to offer buybacks to shareholders, and will only do so if they have sufficient cash reserves to meet their obligations. Discounts to NAV can vary by VCT and are typically around 5–10%, so it's worth looking for a VCT with an established track record of buying shares back from its investors at a small discount to NAV. As the price of VCT shares is quoted on the London Stock Exchange, the alternative way to sell your VCT shares is through a stockbroker or via a share dealing account. However, it is worth noting that the price you are quoted to buy or sell VCT shares may not reflect their underlying NAV.

You can choose to sell your shares at any point but if you sell your shares before the five-year minimum holding period has ended, you will have to tell HMRC and repay any upfront income tax relief claimed.

How do I claim my income tax relief?

After you invest in a VCT, you will receive two certificates.

1. Your **VCT share certificate** shows how many shares you own. You need to keep this safe, as you'll need it when you decide to sell your shares.
2. Your **VCT tax certificate** enables you to claim your upfront income tax relief from HMRC.

If you pay tax under PAYE, then you have two options depending on the timing of the purchase. You can call HMRC and have your tax code adjusted immediately and start paying less tax. Otherwise you can simply claim your income tax relief through your Self-Assessment form at the end of the tax year.

What happens to my VCT shares when I die?

When you die, your investment will form part of your estate and will be passed on to your beneficiaries, who can choose to sell the shares or transfer the investment into someone else's name. Your estate will not have to repay any upfront income tax relief already claimed if you die within five years of holding the investment. The dividends paid by your VCT will still be tax free, and there will be no capital gains tax to pay on the growth of the investment when your beneficiaries choose to sell it.

About Octopus

We invest in the sectors we know inside out. And we've built investments that make a real difference to your financial planning.

Renewable energy

We're the largest solar investor in Europe. We also invest in landfill gas sites, wind farms and biomass plants.

Smaller companies

We turn small businesses into big ones, driving the economy and creating jobs.

Healthcare

We help build state-of-the-art care homes and retirement communities.

Property

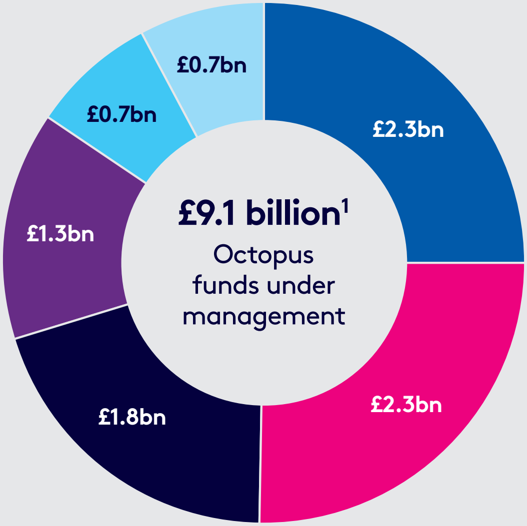
We provide award-winning finance for property investment and development.

Seen us before?

You may be wondering 'Is this the same Octopus?' Octopus Energy is part of the Octopus family, and the UK's only Which? Recommended energy provider three years running.

A trusted fund manager

We look after substantial assets on behalf of investors and large institutions.



- Renewable energy
- Real Estate
- Quoted Smaller Companies
- Ventures
- Multi-manager
- Development Capital & other

[1]Octopus, 30 September 2020. Funds under management data includes funds under advisory mandates, funds monitored and the Octopus Cash service.

20 years of Octopus

We launched Octopus in 2000, wanting to create an investment company that put its customers first. We looked at what didn't work well, and found ways to do things differently.

Along the way, we've become the largest manager of venture capital trusts and investments that qualify for relief from inheritance tax. And we're still looking for new ways to improve people's financial lives. Today we have more than 750 employees and manage £9.1 billion on behalf of tens of thousands of investors.

WINNER FIVE TIMES Investment Life & Pensions Moneyfacts Awards 2016-2020
Best Tax and Estate Planning Solutions Provider

GROWTH INVESTOR 2019 | AWARDS
WINNER BEST VCT INVESTMENT MANAGER

WINNER THREE TIMES Investment Life & Pensions Moneyfacts Awards 2018-2020
Best Venture Capital Trust Provider

GROWTH INVESTOR 2019 | AWARDS
WINNER TEAM OF THE YEAR AWARD

Have a question?

We've done our best to avoid small print and unhelpful jargon in this brochure, but we do have to include some detailed information. Your financial adviser should be able to answer any questions you might have. But we're always happy to hear from you too.

We're ready for your call

We can't give you financial or tax advice, but we can answer questions about us and our investments. You can call us on **0800 316 2295** or email **investorsupport@octopusinvestments.com**.

0800 316 2295
investorsupport@octopusinvestments.com
octopusinvestments.com

Octopus Investments
33 Holborn
London EC1N 2HT