
VCTs 2008/09 – Avoiding the marketeer's siren call

The tax advantages available to venture capital trusts are exceedingly attractive at first sight:

- 30% income tax relief on annual investments up to £200,000 per person.
- Tax-free dividends.
- No capital gains tax within the VCT or on the eventual disposal of VCT shares after 5 years.

Investors will rarely find a more attractive investment from a tax point of view. However, investors should carefully consider the nature of the underlying investments rather than be lulled by the seductive call of the VCT marketing brochure. Previously, I have felt that few VCTs provided a suitable investment because the high risk, high charges, illiquidity and poor diversification outweighed the tax benefits. In 2008/09 however, I believe a very attractive VCT is available – **The Triple Point TP5 VCT**, which offers the following benefits:

- 50% of the VCT capital on a time-weighted basis will be invested in low risk fixed interest investments.
- The VCT qualifying investments are structured to provide steady secure returns using contractually guaranteed cashflows with high credit quality customers.
- A quick exit after the five year qualifying period is expected.
- Targeted total post-tax annualised returns of 9 -10%¹ equivalent to a pre-tax return of 15 -16% p.a.

Background

The unique investment proposition of TP5 sets it apart from normal VCTs. TP5 is structured to minimise investment risk rather than purposefully investing in high risk venture capital start-ups. TP5's aim is to harvest the VCT tax reliefs with the lowest possible risk and return monies to investors without jeopardising the VCT qualifying status. This will be accomplished by paying a tax-free 5p dividend per share and returning capital to shareholders after the five year qualifying period has elapsed.

What is the investment structure of TP5?

A key element of VCT tax qualification is that at least 70% of the value of the VCT must be invested in qualifying investments within three years.

The non-qualifying assets will be managed by Goldman Sachs Asset Management, whose remit is to invest in a diversified portfolio of low risk fixed interest investments, with the aim of providing returns of 3 month LIBOR plus 0.75% per annum. At outset, the non-qualifying investments will comprise 100% of the value of the VCT, with a gradual reduction down to 30% of value within three years.

Triple Point Investment Management (TPIM) will manage the qualifying assets in accordance with their unique investment proposition. They specialise in sourcing small but simple companies whose revenues are guaranteed by contracts with financially sound counterparties, such as the NHS and Local Government Authorities. In most cases, a new company is established to hold the contract, allowing TPIM to arrange the optimal equity and debt split for repayment of the contractual cashflows.

The straightforward nature of TPIM's investment process and continued availability of suitable investment opportunities provides considerable reassurance that the qualifying investment element of the VCT should meet expectations. It should be noted that because these investments are lower risk then the likely returns will also be correspondingly low. TPIM has a conservative aim of achieving returns equivalent to 3 month LIBOR (with a 5% floor) from the portfolio of underlying qualifying investments.

¹ These returns assume 3 month LIBOR at 5.75% and pre-tax returns assume higher rate tax at 40%.

What is Triple Point's record?

TPIM has offered VCTs since 2005, being the most successful fund raiser in recent years. The qualifying investments will follow the same concept as their previous VCTs. The non-qualifying investments are slightly different to their recent offerings, which have utilised hedge fund investments. However, the first Triple Point VCT had similar non-qualifying investments and successfully returned capital to qualifying investors in 2008, providing a 15% annualised return or 62% total return over three years after taking into account the initial tax relief (VCT income tax relief was at 40% and only required a three year holding period). TP5 will not be able to replicate this level of annualised return because the tax relief is now lower and the minimum holding period is longer.

The targeted post-tax annualised returns of 9-10% quoted in the Triple Point Pathfinder document were based upon 3 month LIBOR continuing at 5.75%. The three percentage point fall in the Bank of England base rate since October has impacted upon LIBOR. The current 3 month rate is now 2.21% and the targeted annualised post-tax returns for TP5 would be **7 – 8%** if LIBOR were to continue at this level.

Risks

Although TP5 is structured to offer a much lower risk investment proposition than standard VCTs, there are a number of risks that investors should be aware. Therefore, you should always receive advice from a professional adviser before you invest in any VCT shares. This article is for information purposes only.

Much of the expected return comes from the initial 30% income tax relief. If shares are sold before the 5 year point, or the VCT loses qualifying status, then this relief would be lost. Investors should only consider TP5 if they are happy to leave their capital invested for over five years.

Alternative options

Investors looking for a higher risk/return profile than that offered by TP5 could consider TP70 2009, which whilst following the same investment concept for the qualifying investments as TP5, will invest 30% of the VCT value to generate returns in line with the GAM Diversity 2.5 hedge fund. This provides access to the higher risk/return characteristics of hedge funds and TP70 2009 is targeting a post-tax annualised return of 10-15% (assuming 3 month LIBOR at 5.75%) per annum.

Conclusion

Investors looking to invest between £25,000 and £200,000 and gain access to VCT tax breaks without the normal risk inherent to venture capital investments will find TP5 very attractive. TP5's unique low risk investment proposition provides an excellent risk return profile, even in these difficult economic times. I think the nature of this VCT offering opens up VCT investment to a much broader investor universe.

For further information contact Christian Ward via christian.ward@collinsward.com or at either office.

Token House
11/12 Tokenhouse Yard
LONDON
EC2R 7AS
T: 020 7073 2956
www.collinsward.com

Worting House
Church Lane
BASINGSTOKE
RG23 8PX
T: 01256 345629

© Collins Ward Capital Management Ltd 2008. Collins Ward is a registered trademark of Collins Ward Capital Management Ltd, which is authorised and regulated by the Financial Services Authority. Registered in England & Wales No: 5702350. Registered office: 145-157 St John Street, London, EC1V 4PY. All reasonable care has been taken to ensure that the material and information in this paper is accurate and up-to-date. This paper is for information purposes only, and you should consult a qualified adviser before you make any investment decision. No liability can be accepted for any errors or omissions, or for any loss arising from the use of this information. Tax legislation is subject to change. Past performance is not a guide to future performance. The value of any investments, and the income from them, can go down as well as up, and you may not receive back the amount originally invested.