



Venture Capital Trusts – new primary condition

Summary of legislation

Finance (No. 2) Act 2015 introduced three new primary conditions into section 274 of the Income Tax Act 2007 – the investment limits condition, the permitted maximum age condition and the no business acquisition condition. These new conditions do not apply to holdings in certain liquid investments – namely shares or units in alternative investment funds and undertakings for collective investment in transferable securities (UCITS) which meet certain requirements; and ordinary shares or securities in a company which are acquired on a regulated market. A regulated market in this context does not include AIM. There are powers for this list to be amended by regulation. Clause 31 of Finance (No. 2) Bill 2016 tweaks the wording of that legislation to make it easier to read.

However, Clause 31 also introduces a new, additional, primary condition to section 274 – the **non-qualifying investments condition**. From 6 April 2016, Venture Capital Trusts (VCTs) will no longer be permitted to make **any** non-qualifying investments which are not one of the liquid investments listed above. Many VCTs currently have non-qualifying elements to what are otherwise qualifying holdings in unlisted (or AIM-listed) companies; for example where the VCT has acquired some shares otherwise than by subscription. Making any new such acquisitions on or after 6 April 2016 will cause the VCT to lose its qualifying status.

Other changes to the VCT legislation were expected and include the exclusion of energy generation activities and minor changes to the permitted maximum age condition and the definition of 'knowledge-intensive companies'.

Timing

The measure has effect in relation to investments made on or after 6 April 2016.

Our view

This is a measure which was unexpected, although the explanatory notes to the Finance Bill suggest that the draft legislation merely "puts beyond doubt that VCTs may invest only in qualifying holdings or the investments specified in section 274(3A)".

However, in our view the legislation introduced by Finance (No. 2) Act 2015 continued to permit investments in non-qualifying holdings which were not on the list of liquid investments, so long as the investment limits condition, the permitted maximum age condition and the no business acquisition condition were met in respect of that investment (and subject to the over-riding requirement that at least 70 percent of the portfolio of the VCT must be in qualifying holdings). This change represents a further restriction on the permitted use of funds raised by VCTs and introduces a new risk that managers will need to be aware of.



VCT managers should take care to ensure that **no** non-qualifying investments are made on or after 6 April 2016 which do not fall into the definition of liquid investments in section 274(3A), otherwise the VCT would be at risk of losing its tax-favoured status.

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