



Issue date: 22 March 2006

BUDGET 2006 COMMENT ON CHANGES ON CHANGES TO VCT TAX RELIEFS - ALASTAIR CONN, NVM

The Chancellor's decision to reduce the headline rate of income tax relief on investment in VCTs from 40% to 30% was widely predicted – the 40% rate was introduced two years ago as a temporary measure to stimulate the market and was always likely to be reduced this year. It would have been surprising if the Chancellor had done anything more radical, as VCTs have had a tremendously beneficial effect on the UK enterprise economy over the past ten years.

However there is a sharp edge to the smaller print. The Chancellor has announced that from 6 April 2006 onwards, investors in VCTs will have to hold their shares for five rather than three years to lock in the tax relief. Inevitably the prospect of 30% tax relief and a five year holding period after 6 April will lead to a marked reduction in fund-raising in 2006/07, whilst by contrast the next few days will see investors rush to take their final chance to get their money into VCT funds under the existing rules.

The Chancellor has also slashed the size limit for the companies VCTs are allowed to invest in, from £15 million of assets to only £7 million – much less than the £10 million limit when VCTs were first introduced in 1995. This change will not affect funds raised up to 5 April 2006, but is likely to prove a major disincentive to future fund-raising. AIM VCTs will be particularly affected by a further restriction on the range of companies they can invest in.

In the light of these changes it seems very likely that after two buoyant years, the VCT new issue market has some lean times ahead. In the short term most VCT managers have plenty of funds available for investment, but looking to the future they will have to adapt to a weaker inflow of new funds and a narrower range of potential investments. This is likely to benefit those firms which are already well established in the market, with substantial "pre-April 2006" funds (which are barely affected by the Budget changes) under management, and may lead to some consolidation among the other ranks.

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For further information please contact:

Lansons Communications

- Alison Boucher - 0207 294 3616 alisonb@lansons.com
- Caroline Macleod-Smith – 0207 566 9702 carolinems@lansons.com

NVM

- Liberty Bollen - 0118 951 7000 liberty.bollen@nvm.co.uk

NOTES TO EDITORS

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