



HM Treasury

# **Social investment tax relief:** **enlarging the scheme**

---

July 2014





HM Treasury

# Social investment tax relief: enlarging the scheme

---

July 2014

© Crown copyright 2014

You may re-use this information (excluding logos) free of charge in any format or medium, under the terms of the Open Government Licence. To view this licence, visit [www.nationalarchives.gov.uk/doc/open-government-licence/version/2/](http://www.nationalarchives.gov.uk/doc/open-government-licence/version/2/) or email [psi@nationalarchives.gsi.gov.uk](mailto:psi@nationalarchives.gsi.gov.uk).

Where we have identified any third party copyright information you will need to obtain permission from the copyright holders concerned.

Any enquiries regarding this publication should be sent to us at [public.enquiries@hmtreasury.gsi.gov.uk](mailto:public.enquiries@hmtreasury.gsi.gov.uk).

You can download this publication from [www.gov.uk](http://www.gov.uk)

ISBN 978-1-910337-16-5

PU1686

# Contents

---

	Page	
Foreword	3	
Chapter 1	Introduction	5
Chapter 2	Criteria for policy proposals	9
Chapter 3	Extending the de minimis scheme	11
Chapter 4	Indirect investment	17
Chapter 5	Summary of consultation questions	25
Annex A	Call for evidence	27
Annex B	Legislation to include Social impact bonds (SIBs) in SITR	29



# Foreword

---

Social enterprises are a vital and expanding field of business in the UK, which answer a wide variety of social problems whilst contributing to local and regional economies and UK gross domestic product (GDP). The government introduced the social investment tax relief from April this year to give ambitious social enterprises the help they need to leverage in private investment to expand and grow.

The government acknowledged that more would need to be done to achieve its vision for social investment by individuals and set out further actions in the [social investment roadmap](#). This consultation is a pivotal part of moving to a bigger scheme which meets organisations' and investors' needs. Your responses will help us build a case for a larger scheme to take to the European Commission. This is a novel and unique scheme in Europe and will be considered carefully and with interest so we need to have the best evidence to back up the case for a state support of this nature.

We also need your views on how we should support social investment through personal tax in the future, in particular by allowing investment via an intermediary. Some of these issues are complex and require expert knowledge and experience.

Your knowledge, experience and engagement have helped us to launch the social investment tax relief. I would like to thank all the organisations and individuals who have contributed so much. And to thank you in advance for your continuing support, via this consultation, to take us to a bigger scheme.



David Gauke,  
Exchequer Secretary to the Treasury

July 2014





# 1

## Introduction

### Background

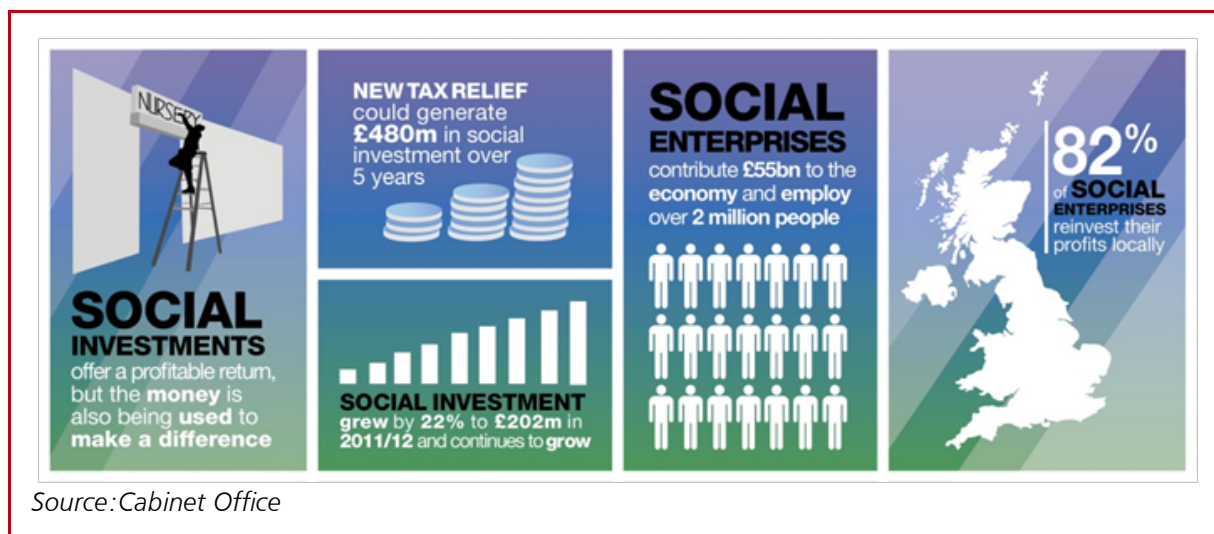
**1.1** The new social investment tax relief (SITR) is intended to encourage private investment in social enterprise and is being introduced in this year's Finance Bill for investments from 6 April 2014. SITR complements other government initiatives such as Big Society Capital, the world's first social investment bank, and the Investment and Contract Readiness Fund, set up to help charities and social enterprises secure investment and deliver public services contracts. All of these aim to support the sustainable long term growth of the social enterprise sector.

### Aim of the consultation

**1.2** This document sets out proposals for the expansion of SITR and a new tax relief for social investment via an intermediary. The consultation aims to gather views on the most appropriate and effective way to increase the investment limit and bring in a wider range of investors, while keeping the relief well targeted and effective and minimising opportunities for tax avoidance. It also asks for views on the approach to community farms, renewable energy and social impact bonds.

### Policy context

**1.3** The UK's social enterprises contribute about £55 billion to the economy and employ over 2 million people. The government places great value on the ability of social enterprises to improve communities, people's life chances and the environment by combining business practices with social purpose. Social enterprises are more likely than commercial businesses to be based in deprived areas, reinvest their profits into those local areas employ those furthest from the labour market, and to use innovative approaches to tackle social problems. With the right access to capital, social enterprises can help reduce demand on the state and create more jobs – often in the most challenging areas.



Source: Cabinet Office

**1.4** The government is committed to helping social enterprises access investment so that more people can benefit from their skills and knowledge, and their volunteering and employment opportunities.

**1.5** Social enterprises cannot usually benefit from tax breaks to support investment in small companies because they do not issue shares. SISR is intended to address this problem and put social enterprises on an even footing with other small businesses when it comes to investment.

**1.6** The government anticipates that SISR in its current form, with a relatively small investment cap per investee organisation, will increase the flow of capital to social enterprises. But it recognises that there is more to do to ensure the relief works as effectively as possible in helping the social investment market achieve its potential scale. In January 2014 the government published the [social investment roadmap](#), which set out its plans in this area for the medium term – including expanding the options for indirect investment, seeking approval from the European Commission to introduce a higher investment limit, and making investment in a wider range of social impact bonds eligible for the relief.

**1.7** In its current form, SISR gives a range of tax reliefs to individuals who invest in qualifying social enterprises. SISR can be summarised as follows:

- Investors making an eligible investment can deduct 30% of the cost of their investment from their income tax liability. They can also defer capital gains reinvested in a social enterprise until the social investment is sold, and no capital gains tax is due on any gains on the qualifying investment. The minimum investment period is three years. Income tax is paid in the normal way on dividends and interest arising from the investment.
- Eligible organisations (charities, community interest companies and community benefit societies) must be carrying out a qualifying trade and have fewer than 500 employees and gross assets of no more than £15 million.

## Policy aim

**1.8** Operating within the government's wider growth and tax agendas, the policy aim of expanding SISR is to complement other government initiatives in encouraging private investment in social enterprise and helping it to become self-sustaining in the long term.

**1.9** The government intends to design and implement changes to this relief and any new personal tax relief for social investment via an intermediary in a way that is consistent with fiscal sustainability, simplicity and ease of administration within the tax system.

**1.10** On indirect investment, the majority of stakeholders have asked for an indirect investment scheme similar to the scheme for Venture Capital Trusts (VCTs). The document considers options both for changing current VCT rules and for introducing a new scheme specific to social enterprises. The government will ensure that existing or new venture capital trusts set up under VCT legislation will be unaffected by any policy changes for social enterprises. The government believes that the venture capital trust (VCT) regime plays a key role in facilitating access to finance for smaller businesses with growth potential. The government is supportive of the VCT regime and wants to ensure that it can continue to work effectively, alongside the introduction of a regime to facilitate indirect investment into social enterprises.

## Structure of the document

**1.11** The remainder of the document is set out as follows:

- Chapter 2 sets out the criteria for policy proposals
- Chapter 3 sets out options for extending the de minimis scheme
- Chapter 4 sets out the options for providing for indirect investment
- Chapter 5 provides a list of all the questions
- Annex A sets out a call for evidence
- Annex B summarises the legislation extending SITR to social impact bonds

## Stage of the consultation

**1.12** The proposals in this document are at stage 1 (setting out objectives and identifying options) of the government's tax consultation framework.

## Implementation

**1.13** The government intends to introduce the changes to SITR and any new personal tax relief for social investment via a separate legal entity in a future Finance Bill. Any changes will depend on discussions with the European Commission.

## How to respond

**1.14** Please send comments by 18 September 2014 to:

Social Investment Tax Relief Consultation  
Enterprise and Property Tax Team  
HM Treasury  
1 Horse Guards Road  
London  
SW1A 2HQ

Or by email to: [socialinvestmenttaxreliefconsultation@hmtreasury.gsi.gov.uk](mailto:socialinvestmenttaxreliefconsultation@hmtreasury.gsi.gov.uk).



# 2

## Criteria for policy proposals

---

**2.1** The government wants to ensure that SITR in its extended form, and any new relief for social investment via an intermediary, deliver additional investment without unnecessarily distorting behaviour, adding undue complexity to the tax system, or exposing social enterprises to undue financial risk.

**2.2** The criteria that the government proposes to use in evaluating proposals for extending SITR are included in the box below. When deciding on the final policy design it will be necessary to consider and balance these, sometimes competing, factors.

### Criteria for evaluation of policy proposals for extending the social investment tax relief

- **Effectiveness.** Evidence from responses will be used to ensure that the proposals achieve the policy aim and support the social enterprise sector in the UK.
- **Affordability.** The changes must be affordable, in line with the government's objective for long term sustainability in the public finances, and represent value for money for the taxpayer.
- **Simple and straightforward to administer.** The government is committed to simplifying the tax system. The new reliefs should not result in unnecessary administrative burdens for social enterprises or those administering the relief.
- **Sustainable and not open to abuse.** This relief should be designed to be effective for the longer term by reflecting, as far as possible, the business models of the social enterprise sector both now and in the future. The relief should not create substantial additional avoidance opportunities or expose social enterprises to undue risk.
- **Compliance with State aid rules.** The new relief will need to gain State aid approval from the European Commission in line with the guidelines in this area. As part of any State aid application, evidence (requested at Annex A) will be needed.

**Question 1:** Do you agree with the proposed criteria for assessing options for the social enterprise tax relief? Please provide comments as appropriate.



# 3

## Extending the de minimis scheme

---

**3.1** The government decided to introduce the social investment tax relief with a low investment limit per investee organisation, because this would not need EU State aid approval. Under the EU rules governing State aid, enterprises can only receive a certain amount of government subsidised investment. The limit for SITR is €344,827 (about £275,000 at the time of publication of this document) over 3 years, with the exact amount in sterling dependent on the prevailing exchange rate.

**3.2** Stakeholders have said that **this investment limit is too low** to have a transformative effect on the social investment market. They have said that commercially run, sustainable and investment-ready organisations are likely to be seeking larger amounts, and the current limit is not high enough to provide an adequate return to investors, given the costs of investing. Consultation responses suggested that £5 million per year, the same as the Enterprise Investment Scheme (EIS), was a more appropriate limit.

**3.3** The government intends **to expand the scheme** and the scope for tax-advantaged social investment. This will include increasing the investment limit and, subject to consultation, introducing an indirect investment option allowing investors to make their investment via a separate legal entity. The government has begun the process of seeking the approval of the European Commission which it needs to make these changes.

**3.4** In order to gain this approval the government will need to provide argumentation and evidence about all aspects of the scheme such as, for example, eligible organisations and employee numbers. It might also be necessary for the government to make changes to the design of the scheme to get Commission approval.

### Investment limit per investee organisation

**3.5** Social enterprises have been able successfully to access bank and other finance in some circumstances. In order to keep the relief well targeted and make a convincing case to the European Commission, the government will need robust, detailed and concrete evidence of **market failure** and of the **gap** between the amount of investment that social enterprises want and the amount of investment that they are able to access (the “funding gap”). State aid rules are clear that the amount of aid provided should be proportionate to the relevant market failure – so the investment limit will depend on evidence and not on an analogy with EIS, i.e. £5 million per year for three years.

**3.6** It is also worth bearing in mind that recently introduced EU risk capital guidelines for SME investment state that it is more appropriate to set a **total cap** on the tax-advantaged investment an organisation can receive rather than a yearly cap. The new rules propose that overall government support to a company is no greater than €15 million in total. For the purpose of comparison, EIS and VCT allow companies to benefit from up to £5 million of tax-incentivised investment a year. The venture capital consultation “Tax-advantaged venture capital schemes: ensuring continued support for small and growing businesses” asks questions about the application of the new guidelines to EIS and VCT – for example, the impact of a total limit of €15m rather than an annual limit. The government believes that the current venture capital

scheme annual limits achieve the same outcomes as the new guidelines, and is seeking to gather more evidence about the impact and effectiveness of the current rules as well as views on the potential impacts of the approach proposed by the European Commission.

**3.7** Existing research gives some indication of the size of the funding gap.

**3.8** It shows, for example, the amounts currently being invested in social enterprises. [Lighting the touch paper: growing the social investment market in England](#)<sup>1</sup> says that total social investment in 2010/11 was £165 million and that over four-fifths of this was secured lending. [Growing the social investment market: the landscape and economic impact](#)<sup>2</sup> says that in 2011-12, the average size of investment for social banks was £723,000; for a large social investment financial intermediary it was £71,000 and for a small social investment financial intermediary it was £56,000. The average investment size for all investors was £264,000.

**3.9** A survey of 1,255 voluntary, community and social enterprise organisations described in *Investment readiness in the UK*<sup>3</sup> showed that 21% had successfully secured repayable finance, 7% had unsuccessfully tried to do so and 8% were actively seeking to do so. 43% were not interested in doing so. The main demand was for long-term loans. Respondents to this survey were **primarily interested in investment between £10,000 and £100,000**. Investors responding to the survey identified most demand for investment at amounts **below £500,000**. Fewer than 10% of respondents were looking for investment of amounts between £1 million and £5 million, and fewer than 5% for amounts over £5 million.

**3.10** Other pieces of research have predicted **future demand** for social investment. *The First Billion, a forecast of social investment demand*<sup>4</sup> **estimates demand for social investment in 2015 at £750 million**, comprising equity-like demand of £112 million and the rest in unsecured debt. The report predicts that this will occur because:

- the total market size of socially oriented economic sectors is likely to rise;
- the market share of social organisations in various sectors will increase; and
- there will be an increase in the share of social investment within social organisations' total investment needs.

**3.11** The government notes that the above figures do not take account of any behavioural impact on investors and investee organisations of the social investment tax relief, or a possible future increase in the current investment limit.

**3.12** The information above suggests that many social enterprises might be satisfied with investments that fit within the current investment limit of approximately £275,000, and that a **future upper limit of £1 million in total of tax advantaged investment** would include the vast majority of social investments. Yet many responses to the government's consultation in summer 2013 said that a limit of £5 million per year would be appropriate.

**Question 2:** What would be a suitable investment limit per investee organisation for an expanded SITR? Please give reasons and evidence if possible.

**3.13** This consultation seeks from stakeholders both (a) evidence on the trends in investment amounts in the social investment market as a whole, and (b) specific examples of social

---

<sup>1</sup> Boston Consulting Group and Young Foundation, 2011

<sup>2</sup> City of London, Big Lottery Fund, Big Society Capital, and HM Government 2013

<sup>3</sup> Clearly So, New Philanthropy Capital, 2012

<sup>4</sup> [Boston Consulting Group, Big Society Capital, 2012](#)



enterprises that are eligible for SITR and need more than £275,000 of investment. The questions on the finance gap are set out in the call for evidence at **Annex A**.

**3.14** The government will also require an analysis of the individual markets impacted by the measure (eg theatres, health services, education, acquiring employment skills) and whether these markets are local, regional, national or international in order to estimate the impact of any tax-advantaged investment on rival businesses not eligible for the relief. The analytical questions are set out in **Annex A**.

## Other elements of an expanded SITR

**3.15** The government has tried to design SITR in a scalable way so that its current design will work for a higher investment limit. The government took policy decisions on the initial design of SITR with this in mind, and does not intend to revisit design elements unless absolutely necessary to ensure the relief works as it should. Respondents should bear in mind in answering Question 3 that approved State aids generally tend to be concentrated on the organisations in most need of help to access finance. These tend to be small and medium-sized organisations, which in the EU definition have 250 or fewer employees.

**3.16** As a reminder, the main features of SITR are as follows:

- The relief is available for investment in CICs, charities and Bencoms carrying on a qualifying trade, which have fewer than 500 employees and no more than £15 million in gross assets;
- The relief is not available for investment in the wholly owned subsidiaries of eligible organisations. However, the funds raised from an investment may be used for the purposes of a trade carried on by a qualifying social subsidiary which is itself a CIC, Bencom or charity;
- Excluded trading activities are:
  - trading activities excluded by EU rules including agriculture, aquaculture and road haulage;
  - trades that attract Feed in Tariffs for the generation or export of electricity from renewable sources, because they are already receiving government subsidy;
  - banking, insurance, money lending, debt factoring, hire purchase financing or other financial activities except where the funds are lent to charities, CICs or Bencoms;
  - property development and dealing in land, shares, futures and commodities, as these are lower-risk activities that may not merit tax relief.
- The relief is available for investments with the following characteristics:
  - there is no security or guarantee over repayment of the investment;
  - the investment must be the lowest-ranking and/or principal loss absorbing instrument on wind-up – at least equal to other lowest-ranking instruments;
  - the investor has no right to require early repayments;
  - early repayment (for example, through amortisation) will be subject to similar conditions to EIS investments – that is, tax relief is withdrawn on the proportion repaid early;

- the return must not exceed a commercial rate of return;
- Investors may each invest up to £1 million per year in eligible organisations;
- The relief offers 30% up front income tax relief, and capital gains tax relief.

**Question 3:** Would any of these features interfere with the operation of the relief with a higher investment limit than the current £275,000 over three years?

## Community agriculture

**3.17** Agriculture and market gardening are excluded under EU state aid rules for de minimis schemes on the grounds that they already receive substantial public money through the common agricultural policy. However, the government is aware that some social enterprises whose main trade is the production of agricultural or other grown products will not receive significant payments under the common agricultural policy from next year. This is because holdings of less than 5 hectares in England (3 hectares in Scotland) will be ineligible for direct subsidies under CAP.

**Question 4:** Do you think community farms and similar enterprises that have less than the threshold amount of land for CAP payments should be eligible for SITR? Please give reasons. Do they have the same difficulties in raising finance as other social enterprises? Please provide evidence to support your answer.

## Renewable energy schemes

**3.18** The government announced at Budget that companies benefiting from Renewable Obligation Certificates (ROCs) and Renewable Heat Incentives (RHIs) would no longer be eligible for the Enterprise Investment Scheme, Seed Enterprise Investment Scheme and Venture Capital Trusts.<sup>5</sup> Community schemes which were also CICs, bencoms or cooperatives were excluded from the change.<sup>6</sup> This change was made to ensure the schemes continued to be effective and well-targeted at higher-risk businesses, and that they provide value for money for the taxpayer.

**3.19** The social investment tax relief excludes organisations whose trades attract Feed-in Tariffs but, in line with the tax-advantaged venture capital schemes at the time, it did not exclude organisations receiving ROCs and RHIs. In practice those organisations were judged unlikely to seek SITR investments because of the cap on the amount of tax advantaged investment under the de minimis rules.

**3.20** If a larger scheme is approved, it is possible that some organisations receiving government support for the production of heat or power from renewable sources that are not currently excluded, would seek SITR investment.

**3.21** The government is considering a more principled approach to address the issue of low-risk investment opportunities and is consulting on the rules for excluded activities in the venture capital consultation "Tax-advantaged venture capital schemes: ensuring continued support for small and growing businesses". The consultation explores options for more a more principled approach to determine qualifying companies to ensure that the schemes continue to support risky, innovative and high-growth potential companies. For example, some exempted activities within the exclusions for renewable energy companies are now arguably lower risk than they were in 2012, or may now receive other income guarantees that significantly reduce the

---

<sup>5</sup> [Part 2.79 of the Budget document, 2014](#)

<sup>6</sup> [Update on changes to venture capital schemes, 2014](#)

investment risk. This may be the case for some community schemes that now receive additional forms of government support. On the other hand, new, untested and risky sectors within the energy sector have developed since the legislation was introduced.

**3.22** The EU Commission is also concerned that where State aid exists it is properly targeted on genuine market failure and common European goals.

**3.23** In moving to a larger scheme, the government will seek to remain consistent with the general approach to low-risk investment opportunities and other tax advantaged venture capital schemes. It will be using the outcome of the consultation on venture capital schemes and this consultation to inform its decision. If it were decided to exclude other schemes receiving energy subsidies from SITR, the current de minimis SITR would not be changed, but the changes would be made when a larger scheme was introduced.

**Question 5:** What impact, if any, would the absence of SITR for investment in companies receiving energy subsidies together with removal of tax relief under EIS and VCT, have on community energy schemes?<sup>7</sup>

## Social impact bonds (SIBs)

**3.24** Social impact bond (SIB) contracts are contracts entered into by public sector bodies (“commissioners”) with contractors to deliver social outcomes. Payment under the SIB contract is made by the commissioner according to performance, ie ‘payment by results’. Examples are getting homeless people into accommodation; reducing days in care for children at risk; achieving lower rates of reoffending for a group of prisoners. The contractor or special purpose vehicle (SPV) may (and usually will) sub-contract the performance of the service to a third party, which is often a charity or other voluntary or community organisation, in return for a fee.<sup>8</sup>

**3.25** SITR legislation in Finance Bill 2014 will allow investment in only one form of social impact bond (SIB), though there are a number of structures SIBs could take. As the SIB market expands, the number of structural forms continues to increase and the government would like to make sure that SITR works for SIBs in the future. This consultation seeks views on:

- expanding the number or type of SIBs eligible for SITR in principle;
- ways in which SITR requirements summarised below would not work for particular SIBs; and on
- how these issues might be addressed.

**3.26** SITR currently allows tax relief for investment in the SPV entering a SIB contract where the SPV meets a number of conditions :

- 1 It must be a company limited by shares (CLS);
- 2 It has entered into a contract with a Commissioning Authority which meets the criteria set out in Regulations;
- 3 It has at all times been established for the purposes of carrying out the contract, and its activities will not consist substantially in excluded activities (as described at paragraph 3.12 above);

---

<sup>7</sup> This question (and related questions on current rules to target tax reliefs) appear in chapter 4 of the consultation on venture capital schemes “Tax-advantaged venture capital schemes: ensuring continued support for small and growing businesses”. Answers to this specific question will be collated so it is not necessary for organisations to respond twice.

<sup>8</sup> More information on SIBs is available on the Cabinet Office website – see link [here](#).

- 4 It meets other accreditation criteria and other requirements of the accreditation scheme run by the Cabinet Office. These will be set out in secondary legislation and are summarised in Annex B.

**Question 6:** What are the benefits and risks of including a wider range of SIBs in SITR?

**3.27 Spot purchase models.** These are SIBs that allow commissioners to buy services one at a time, as they need them. Rather than designing and procuring a SIB for an entire service cohort, the commissioner is able to select the users of a particular service that could benefit from a different, more intensive model and purchase that SIB service for the users who need it. This type of SIB is not excluded from SITR but it may have particular needs that are not addressed fully by SITR. Spot purchase models are an opportunity for the voluntary sector to develop SIBs and sell the same SIB to multiple commissioners.

**Question 7:** a) How does the funding cycle differ for spot purchased SIBs and how does this affect the ability of SIB investors to gain SITR? b) How should the accreditation scheme treat multiple contracts with multiple commissioners? c) Can the accreditation process be streamlined so only one contract needs to be fully accredited and the other contracts with new commissioners go through a shortened accreditation process?

**3.28 Sub-contracted SIBs.** These operate in the same way as other SIBs except that the commissioner is a contractor with a public sector body rather than being the public sector body itself. It is a way to offer social organisations an opportunity to participate in Transforming Rehabilitation, the Department for Work and Pensions' Work Programme and other large scale programmes.

**3.29** The department contracts to pay a private sector organisation (the prime contractor) on achievement of specified social outcomes. These are typically for very large, regional contracts – much larger than a social enterprise could deliver. The prime contractor then issues sub contracts to delivery bodies who deliver services locally. In the case of an outcomes-based programme, like the Work Programme, the prime contractor makes an outcomes-based subcontract to deliver a much smaller part of this contract, often through a social enterprise. The social enterprise can raise investment to deliver these contracts and share risk through a SIB arrangement. While it could raise money through general SITR, it might wish to use a SIB in order, for example, to limit the liability of investors.

**Question 8:** a) How would the legislation need to be changed to allow for these sub-contracted structures? b) What is the risk that this could be misused and what protections would be needed? c) To what extent could the tax relief and accreditation process encourage fair sharing of risk throughout the supply chain?

# 4

## Indirect investment

---

**4.1** The government recognises that social enterprise investment may be attractive to individuals who are willing to provide funding but do not want to have to make investment decisions personally, instead preferring decisions to be made by a fund manager operating a collective investment fund. The current SITR rules allow for “nominee investment” where a nominee has legal ownership of the shares or debt but the investor retains beneficial ownership.

**4.2** The responses to the summer 2013 consultation on the design of SITR suggested that stakeholders also wanted a VCT-like indirect investment option for social enterprises. The reasons given were that:

- Fund managers and investors are familiar with VCTs;
- VCTs tend to have a lower investment threshold than the nominee schemes currently permitted under SITR would be likely to set. That would allow a wider range of investors to participate, with less money, investment expertise and risk appetite;
- VCTs offer greater consumer protection and are more popular with Independent Financial Advisers because they are required to go through a listing process;
- Cornerstone investors like Big Society Capital or big foundations can invest in VCTs, boosting the confidence of other investors; and
- If ‘hybrid’ commercial and social VCTs were possible, fund managers could create VCTs with broader appeal.

**4.3** This chapter considers options for indirect investment via a Venture Capital Trust (VCT)-like scheme; the level of demand for a VCT-like scheme; and whether there are other options the government should consider.

**4.4** Any new indirect investment scheme or change to VCT legislation will require European Union State aid approval. The government has to ensure that the rules for EIS and VCT continue to meet the requirements for State aid.

### Venture Capital Trusts

**4.5** The existing VCT regime works by investors purchasing shares in a company (the VCT). The VCT company then makes qualifying investments in small and medium unquoted trading companies. The investors in the VCT benefit from the value of those investments indirectly by owning shares in the VCT company, and the investors can claim income tax relief on their purchases of the VCT shares subject to certain rules. The VCT pays no tax on increases in value of the qualifying investments but does pay corporation tax on any other income. Dividends to shareholders in the VCT are tax free up to a permitted maximum.

## A new tax relief for social investment via an intermediary

**4.6** In designing the social investment tax relief that is currently in place, the government took the existing venture capital schemes as a basis and considered **which elements needed to be adjusted** in order to take account of the particular requirements of the social enterprise sector. For example, the employee numbers limit for the Enterprise Investment Scheme and VCT is 250, and the government raised this to 500 for SITR to take account of the labour intensity of social enterprises.

**4.7** In considering the design of an indirect investment option for social enterprises, the government will need to go through a similar process. This time, the government will need to ask **whether the conditions in the VCT scheme are appropriate** for social enterprises, or whether it should adopt the conditions in **the social investment tax relief** in some areas.

**4.8** The government needs to consider the rules for (a) the **structure and operation of the fund**, (b) the **investments** and (c) the **investee organisation** in order to ensure the scheme is well targeted and effective and complies with the European Union's rules on State aid. The rest of this section sets out questions about the design of the relief under the above headings.

**4.9** The government sees two main ways of putting in place an indirect investment tax relief for social enterprises: **amending the existing VCT scheme** or **setting up a new relief altogether**. At the end of this section there is a question about which approach would be preferable.

**4.10** In the policy design section, the document uses the term "social investment VCT" for convenience. The term is not intended to imply that the new relief would be implemented by amending the existing VCT regime.

**4.11** In considering the questions in this chapter, it is important for stakeholders to note that the government is supportive of the VCT regime and wants to ensure that it can continue to work effectively, alongside the introduction of a regime to facilitate indirect investment into social enterprises.

**4.12** The terms of the **tax reliefs** for investors are the same for VCT and SITR. Broadly, they allow 30% income tax relief and capital gains tax relief on qualifying investments. The government does not anticipate changing these terms for a social investment VCT.

## Policy design

### The structure and operation of the fund

#### a) Structure and approval

**4.13** The government expects the majority of rules governing approval and structure of a VCT would apply to a social investment VCT scheme. These rules include:

- HMRC can provisionally approve a company which has not yet met the conditions but satisfies HMRC that it intends to meet them within the time allowed;
- Breach of the approval conditions will lead to a withdrawal of approval. The regulations allowing a VCT in liquidation to maintain its status as an approved VCT and the rules ensuring tax relief is maintained despite the liquidation;
- A VCT can merge with another VCT and there are regulations ensuring that both the investors' and the VCT's tax relief are unaffected;

- VCTs must make a return to the Small Company Enterprise Centre which includes additional details about the approval conditions.

**Question 9:** Would any of these areas around the structure and approval of VCTs, or any others not mentioned, cause problems in a social investment VCT? If so, which?

### **b) Operation**

**4.14** Of the conditions that apply to a Venture Capital Trust itself, the government thinks those below could be applied to investment via social investment VCTs:

- The VCT's shares must be admitted to trading on a regulated stock market;
- The VCT must not retain more than 15% of its gross income;
- No holding in a single company may exceed 15% of the value of all the VCT's investments;
- At least 70% by value of its investments must be "qualifying holdings", that is shares or securities that meet the conditions of the scheme.

**Question 10:** Do you agree that these conditions would be appropriate for a social investment VCT? If not, please give reasons. Are there any other rules on the operation of the VCT which would not be appropriate for investment in social enterprises via a social investment VCT?

## **Investments**

### **a) Individual investments by the intermediary**

**4.15** A further set of rules applies to a VCT's investments, 'qualifying holdings', in individual companies. The below appear to be applicable to social enterprises:

- Where a holding includes securities there can be no guarantee that part or all of it will be repaid in the event of a default;
- The money raised must be used wholly for the purposes of the trade and all of it must be used within two years from the start of trading;
- The company cannot receive more than the investment limit and a VCT is prohibited from investing in a company if it will mean the investment limit is exceeded.<sup>1</sup>

**Question 11:** Do you agree that these conditions would be appropriate for a social investment VCT? If not, please give reasons.

### **b) The requirement to invest 70% of qualifying holdings in ordinary shares**

**4.16** The VCT rules require at least **70% of the VCT's qualifying holdings** to be in **ordinary shares**. This is because equity capital is typically less easily accessed by companies and carries a higher risk for investors than debt. Equity also offers potential for "upside" returns, which means that it is often a suitable instrument for investors into small and growing businesses. VCTs are designed to help fill the so-called "equity gap"; to support businesses in accessing finance in the area where they find it most difficult to do so.

---

<sup>1</sup> as discussed in chapter 3, the investment limit under an expanded Sitr may be different from the investment limit for a VCT. The investment limit in this case would be the investment limit for Sitr

**4.17** The government recognised in designing SISR that **many social enterprises do not issue shares** and that **most social investment currently occurs by way of debt**. For this reason, both debt and equity investments are eligible for SISR provided they fulfil certain conditions.<sup>2</sup>

**4.18** The government envisages that a social investment VCT would have the same requirements as SISR for the investment instrument – i.e. both unsecured debt and equity investments would be eligible.

**Question 12:** Do you agree that a social investment VCT should allow investment in equity and in unsecured debt that meets the criteria for SISR?

### **c) Requirement for 10% equity in each investee company**

**4.19** The VCT scheme requires 10% of each of the VCT's investments in investee organisations to be in equity. The government recognises that social investments tend to be via debt rather than equity and would consider leaving this condition out of a social investment VCT.

**Question 13:** Should the requirement for a 10% minimum equity holding in each investee company be omitted from a Social Investment VCT? Please give reasons.

**Question 14:** What would be the impact on existing VCTs if this type of change were made?

## **Investee organisations**

### **a) Legal form**

**4.20** For a social investment VCT, the government proposes to apply the eligibility rules used in SISR to the investee organisation, i.e. that it must be a **charity, community benefit society or community interest company**. It would not be a **limited company** as required by VCT legislation. It would also apply the **same size tests and list of eligible activities** for investee organisations as SISR – i.e. up to £15 million gross assets and fewer than 500 employees.

**Question 15:** Do you agree that a social investment VCT should be required to invest in charities, community benefit societies or community interest companies with up to £15 million gross assets and fewer than 500 employees?

**4.21** The government thinks the VCT conditions below would also apply to investment in social enterprises as well as in commercial companies, and would not propose to make any changes to them for a social investment VCT:

- The business must have a UK permanent establishment at all times;
- The business must be unquoted: none of its shares, stocks, debentures or other securities can be listed on a recognised stock exchange. Listings on AIM and ofex are regarded as unlisted;
- The financial health of the business could not be described as 'in difficulty' for the purposes of the European Community Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty (2004/C244/02);
- The relevant company must not control any company other than a qualifying subsidiary;

---

<sup>2</sup> The debt must be in the form of a debenture which must not carry any charge over assets and must not offer more than a commercial rate of return. The debt must also be subordinated to all other debts of the social enterprise and must rank equally with shares that do not rank above any other shares so far as the law allows.



- The company must not be under the control of another company.

**Question 16:** Do you agree that these conditions could be applied to investment in social enterprises via a social investment VCT? If not, please give reasons.

### b) Qualifying trades

**4.22** VCT rules prevent eligible companies from substantial involvement in certain trading activities that are asset-backed, low risk, and increase the risk of tax avoidance. Other activities are excluded in keeping with the European Commission’s approach to particular industry subsidies and the State aid guidelines. The full list of excluded activities is available in [HMRC guidance on VCTs](#) and in more detail in the relevant section of the [HMRC manual](#).

**4.23** The government introduced a **shorter list of excluded trading activities for the social investment tax relief** because the eligible investee organisations are regulated social sector organisations so investment in, for example, nursing homes and social care housing may be eligible (see paragraph 3.12 above).

**Question 17:** Do you think a social investment VCT should use the shorter list of excluded trading activities used in SITR, or the longer list used in VCT?

### c) Organisation size

**4.24** A VCT’s “qualifying holdings” are restricted to unquoted companies with gross assets not exceeding £15 million and which have **fewer than 250 full time equivalent employees**. As described above, the government decided to retain the same gross assets test but impose a higher limit of **500 employees** for SITR.

**Question 18:** Which approach to employee numbers do you think is preferable for a social investment VCT – fewer than 250 or fewer than 500 employees?

## Implementation

**4.25** The government wishes to allow for indirect investment in social enterprises in the **most straightforward and least disruptive way**, ensuring that existing VCTs can continue to operate effectively. The government could provide a VCT-like scheme for indirect investment in one of two ways:

- 1 **Set up an entirely new tax relief modelled broadly on the existing VCT regime** but with some adjustments to take into account the organisational structures and types of investment instrument commonly used in the social enterprise sector. The advantages of this approach are that it would allow the government to make more radical changes and create a bespoke regime more closely tailored to the needs of social investment. It would also avoid the need to seek EU approval for changes to VCT legislation while or shortly after VCT was being re-approved or renotified to the EU;
- 2 **Amend the existing VCT legislation** in various ways to cater more specifically for investments in social enterprises. Amending the VCT scheme would be complicated – for example, it might involve providing for two separate approaches to organisation size – one for investments in commercial companies (fewer than 250 employees) and one for investment in social enterprises (fewer than 500 employees), and two separate approaches to excluded activities. Stakeholders might also have views on the impact of any changes on the wider venture capital industry.

**Question 19:** Do you think the tax relief should be introduced by setting up a new tax relief scheme or by amending the existing VCT scheme? Please give reasons.

## Hybrid VCTs

**4.26** Most potential indirect social investment providers may wish to offer funds consisting purely or mainly social enterprise related investments. However **hybrid VCTs** offering a mix of commercial and social investments would also be possible and might be desirable, for example, to appeal to a broader range of investors, or spread risks more widely.

**Question 20:** Do you think it is desirable in principle to allow hybrid VCTs, including both social and commercial investments? Please give reasons.

**4.27** The government would envisage that, in a hybrid VCT, the commercial investments would be subject to existing VCT rules and social investments to rules which applied to investments in a social investment VCT. The differences are likely to be in the eligibility criteria for, and size of, the investee organisations, qualifying trades, limits on maximum investment per organisation, and imposition or absence of minimum equity holdings in individual and overall investments.

**Question 21:** Could a hybrid VCT work by offering investments under the present VCT regime and investments under a new social investment VCT in one trust? Would there be particular problems in using a social investment VCT to achieve that? If so, please describe.

## Other issues

### Take-up and implementation

**4.28** The government recognises that any new indirect investment option will only be valuable to the sector if fund providers and investors use it.

**Question 22:** If you are a VCT provider, would you anticipate adding social investment via an independent intermediary to your existing product offering? Please give reasons.

**Question 23:** Do you think the cost of a listings process, including for example issuing a prospectus, would affect the take-up of social investment via an intermediary?

**Question 24:** If you are an investor, would you be more likely to invest in a social investment VCT rather than a fund that can invest in both social and commercial enterprises (i.e. a hybrid VCT)? Please give reasons.

## Other types of indirect investment

**4.29 Crowd funding:** The government anticipates that online crowd funding and other platforms will offer investments that qualify for SITR. These will be able to use the existing nominee provision within the SITR legislation and no further legislative support is required. It is expected that crowd funding, as it has done in other sectors, will serve the mass retail market.

**Question 25:** How much SITR investment do you think there will be via crowdfunding in the next three years? Please give reasons.

**Question 26:** If you are an investor, would you be more likely to invest via a crowdfunding provider or in a VCT-like arrangement? Please give reasons.

**Question 27:** What types of investor do you think would invest in crowd funding, and what types might not?

**4.30 Partnerships:** Some stakeholders have suggested that a partnership structure would be preferable to a limited company as an indirect investment vehicle. The government would be concerned to ensure that there was no scope for the partnership generating large losses that the investors could then set against other income, in addition to having tax relief on their investment. The European Commission would also be interested in the levels of management fees paid to fund managers.

**Question 28:** What are the advantages and disadvantages of the partnership vehicle versus the limited company vehicle? Please describe what the partnership structure would typically look like; and what sorts of restrictions might be necessary (for example on how the partnership used its funds, or on the level of management fees).

## Conclusion

**4.31** The creation of a new regime for social investment via an intermediary would put social enterprises on a level playing field with commercial enterprises. However, it is good policy making to probe more closely demand for such an option and perceived advantages, and see how it can be achieved in the most straightforward and least disruptive way.

**4.32** This chapter suggests that a new bespoke regime for social enterprises to complement SITR may be preferable to amending VCT legislation. The carrying over of aspects of EIS to create SITR was a comparable exercise. This generated significant interest among investors and social enterprises and provides a precedent in terms of the process. Not amending VCT legislation would also keep the integrity of the existing VCT legislation and make renotification to the EU simpler.

**4.33** The government would value your views on these proposals. The government will examine all responses carefully and announce final decisions in the autumn with a view to introducing legislation in a future Finance Bill.



# 5

## Summary of consultation questions

---

**Question 1:** Do you agree with the proposed criteria for assessing options for the social enterprise tax relief? Please provide comments as appropriate.

**Question 2:** What would be a suitable investment limit per investee organisation for an expanded SITR? Please give reasons and evidence if possible.

**Question 3:** Would any of these features interfere with the operation of the relief with a higher investment limit than the current £275,000 over three years?

**Question 4:** Do you think community farms and similar enterprises that have less than the threshold amount of land for CAP payments should be eligible for SITR? Please give reasons. Do they have the same difficulties in raising finance as other social enterprises? Please provide evidence to support your answer.

**Question 5:** What impact, if any, would the absence of SITR for investment in companies receiving energy subsidies together with removal of tax relief under EIS and VCT, have on community energy schemes?

**Question 6:** What are the benefits and risks of including a wider range of SIBs in SITR?

**Question 7:** a) How does the funding cycle differ for spot purchased SIBs and how does this affect the ability of SIB investors to gain SITR? b) How should the accreditation scheme treat multiple contracts with multiple commissioners? c) Can the accreditation process be streamlined so only one contract needs to be fully accredited and the other contracts with new commissioners go through a shortened accreditation process?

**Question 8:** a) How would the legislation need to be changed to allow for these sub-contracted structures? b) What is the risk that this could be misused and what protections would be needed? c) To what extent could the tax relief and accreditation process encourage fair sharing of risk throughout the supply chain?

**Question 9:** Would any of these areas around the structure and approval of VCTs, or any others not mentioned, cause problems in a social investment VCT? If so, which?

**Question 10:** Do you agree that these conditions would be appropriate for a social investment VCT? If not, please give reasons. Are there any other rules on the operation of the VCT which would not be appropriate for investment in social enterprises via a social investment VCT?

**Question 11:** Do you agree that these conditions would be appropriate for a social investment VCT? If not, please give reasons.

**Question 12:** Do you agree that a social investment VCT should allow investment in equity and in unsecured debt that meets the criteria for SITR?

**Question 13:** Should the requirement for a 10% minimum equity holding in each investee company be omitted from a Social Investment VCT? Please give reasons.

**Question 14:** What would be the impact on existing VCTs if this type of change were made?

**Question 15:** Do you agree that a social investment VCT should be required to invest in charities, community benefit societies or community interest companies with up to £15 million gross assets and fewer than 500 employees?

**Question 16:** Do you agree that these conditions could be applied to investment in social enterprises via a social investment VCT? If not, please give reasons.

**Question 17:** Do you think a social investment VCT should use the shorter list of excluded trading activities used in SITR, or the longer list used in VCT?

**Question 18:** Which approach to employee numbers do you think is preferable for a social investment VCT – fewer than 250 or fewer than 500 employees?

**Question 19:** Do you think the tax relief should be introduced by setting up a new tax relief scheme or by amending the existing VCT scheme? Please give reasons.

**Question 20:** Do you think it is desirable in principle to allow hybrid VCTs, including both social and commercial investments? Please give reasons.

**Question 21:** Could a hybrid VCT work by offering investments under the present VCT regime and investments under a new social investment VCT in one trust? Would there be particular problems in using a social investment VCT to achieve that? If so, please describe.

**Question 22:** If you are a VCT provider, would you anticipate adding social investment via an independent intermediary to your existing product offering? Please give reasons.

**Question 23:** Do you think the cost of a listings process, including for example issuing a prospectus, would affect the take-up of social investment via an intermediary?

**Question 24:** If you are an investor, would you be more likely to invest in a social investment VCT rather than a fund that can invest in both social and commercial enterprises (i.e. a hybrid VCT)? Please give reasons.

**Question 25:** How much SITR investment do you think there will be via crowdfunding in the next three years? Please give reasons.

**Question 26:** If you are an investor, would you be more likely to invest via a crowdfunding provider or in a VCT-like arrangement? Please give reasons.

**Question 27:** What types of investor do you think would invest in crowd funding, and what types might not?

**Question 28:** What are the advantages and disadvantages of the partnership vehicle versus the limited company vehicle? Please describe what the partnership structure would typically look like; and what sorts of restrictions might be necessary (for example on how the partnership used its funds, or on the level of management fees).

**Annex A** seeks additional information.

# A

## Call for evidence

---

**A.1** The European Commission is interested in the markets affected by SITR, the size of organisations that will benefit and the nature of the market failure or funding gap that the relief is seeking to address. Answers to the following questions will inform presentation of the case for expansion of the scheme.

### **Name of organisation**

### **Type of organisation**

Representative organisation

Investment body (eg community finance institution, foundation)

Social enterprise

Law, accountancy, or professional finance firm

Individual

Local council

Other [Please state]

### **General**

- 1 What is the nature of the market failure in the social investment market? Please provide evidence eg of which size of organisations receive bank finance at what rates and for what purposes (e.g. capital investment, working capital, upscaling to win a contract), what other sources of finance are available and on what terms.
- 2 How has this changed in the last five years? What is the future trend and evidence for this?
- 3 What investment limit do you think is appropriate for SITR? Please give a total rather than a yearly limit and provide evidence.
- 4 What markets are most likely to be impacted by SITR? E.g. health, arts, manufacturing.
- 5 What proportion of social enterprises in these markets operate at a local, regional, national and international level?

### **Questions for social enterprises**

- 6 Are you a charity, community interest company or community benefit society?
- 7 What goods or services do you provide? E.g. training, sports facilities and classes.
- 8 How would you describe your sector? E.g. arts (specify theatre, music, art or other), health, retail, social care, or other (please state).

- 9 Please give a sentence describing your social purpose.
- 10 When was your organisation established (e.g. date of incorporation)?
- 11 Is your business conducted at a local, regional, national or international level?
- 12 What sources of funding do you currently use, and why?
- 13 Have you been refused funding? Please say funding for how much and why it was refused.
- 14 Do you receive any EU or government subsidy (e.g. Rural Development Funds, Common Agricultural Policy payments)? If so, please give details.
- 15 What size is your organisation (if part of a group, refer to group size):
  - a Turnover
  - b No. of employees
  - c Gross assets
- 16 Do you think you would qualify for SITR under published guidance?
- 17 What size of investment would your social enterprise ideally want and be able to service over a period of years using an expanded SITR? And for what purpose? Please provide details, with evidence if possible, eg any examples of amounts of investment that you have sought and either succeeded or failed to secure. Please also state whether your social enterprise is currently seeking investment and what amount your organisation would like to secure and would be capable of servicing.
- 18 Are you are willing for this information to be shared on a confidential basis with Commission officials?



# B

# Legislation to include Social impact bonds (SIBs) in SITR

---

## Primary legislation

**B.1** [Amendments 15 to 41 of the Finance Bill](#) laid on 2 July 2014 allow SITR for social impact bond investment. The legislation provides that:

- tax relief will only apply **where a company has been accredited as a social impact contractor having entered into a qualifying payment-by-results contract with a commissioning public body;**
- the company must be a company limited by shares;
- the accreditation process will be administered by Cabinet Office; and
- the detail of that process will be set out in regulations, supplemented if appropriate by guidance published by Cabinet Office.

## Secondary legislation

**B.2** The secondary legislation or regulations is likely to include some or all of the following:

- Requirements as to the social purpose of the company and the contract entered into, by reference to defined socially beneficial outcomes
- Requirements as to how those outcomes are to be measured
- Requirements as to the types of public body which may award qualifying contracts
- Provision about how applications for accreditation are to be made
- Provision about the scope for varying an accreditation
- Provision about the consequences of a failure to comply with any requirements imposed by the regulations, including withdrawal of accreditation or imposition of penalties
- Provision about the consequences of an early termination of a contract
- Provision for the right of appeal against a refusal to accredit, a withdrawal of accreditation, or the imposition of penalties

## Consultation on secondary legislation

**B.3** The regulations will not be laid immediately after the primary legislation is enacted (mid-late July). The intention is to consult key industry stakeholders over the summer on the detail of the draft regulations, with a view to bringing those regulations into force in September. The amendments to the Finance Bill allow accreditation to be given retrospectively (although not for a period before 6 April 2014), so allowing time to consult on the draft regulations should not delay take up of the scheme.

**B.4** If you or your organisation would like to comment on the regulations in draft, please contact Kathryn Robertson at HMRC, [kathryn.robertson@hmrc.gsi.gov.uk](mailto:kathryn.robertson@hmrc.gsi.gov.uk) as soon as possible and before **31 July 2014**.



## **HM Treasury contacts**

This document can be downloaded from  
[www.gov.uk](http://www.gov.uk)

If you require this information in an alternative  
format or have general enquiries about  
HM Treasury and its work, contact:

Correspondence Team  
HM Treasury  
1 Horse Guards Road  
London  
SW1A 2HQ

Tel: 020 7270 5000

E-mail: [public.enquiries@hmtreasury.gsi.gov.uk](mailto:public.enquiries@hmtreasury.gsi.gov.uk)