HM Treasury

Social Investment Tax Relief:

summary of responses to the call for evidence

March 2021

HM Treasury

Social Investment Tax Relief:

summary of responses to the call for evidence

March 2021

This publication is available at www.gov.uk/government/publications

Any enquiries regarding this publication should be sent to us at public.enquiries@hmtreasury.gov.uk

ISBN 978-1-911680-63-5 PU3101

Contents

Chapter 1

Introduction

1.1 The Social Investment Tax Relief (SITR) is the government's tax relief for investment in trading social enterprises. Organisations receiving SITR investments must have a defined and regulated social purpose or be an accredited social impact contractor. Regulated social enterprises must take the form of a community interest company, community benefit society or a charity. Individuals investing through SITR may benefit from a range of tax reliefs, including 30% Income Tax relief on the value of their investment. Investment can be made in the form of equity or debt.

1.2 In April 2019, the government published a Call for Evidence on SITR, in line with a commitment to review the scheme, made when it was enlarged in 2017. The consultation received 80 responses from a variety of stakeholders, including social enterprises and investors, fund managers, trade bodies and associations, advisers and intermediaries, and registered charities and voluntary organisations. The consultation period closed in July 2019 after 12 weeks.

1.3 The government recognises the need to monitor and evaluate existing tax reliefs regularly, and to ensure that any new reliefs introduced are justified and appropriately targeted. While tax reliefs are an important facet of a functioning tax system, they need to be fiscally sustainable and represent value for money for the taxpayer. The government will continue to monitor their use and act where appropriate.

1.4 The government is grateful to all those who responded to the consultation, both in writing and through engagement with officials in person.

1.5 SITR was introduced in 2014 because many social enterprises struggle to raise finance, they are often ineligible to receive investments under existing tax-advantaged schemes, such as the Enterprise Investment Scheme (EIS), and because their legal form prevents enterprises from raising equity investments. In addition, social enterprises may experience difficulties in securing investment due to the perception that their social mission might compromise their intention to make profits.

1.6 To date, around 110 social enterprises have raised £11.2 million through SITR. In 2018-19, around 30 social enterprises raised £4.5 million through SITR, up from 2017-18, when 20 social enterprises raised £1.5 million.[1] This

[1] HMRC provisional statistics, May 2019 & 2020. The total number of enterprises raising finance since 2014 is an estimate, as enterprises may have raised funds in more than one year. The policy expansion period from 2016-17 to 2017-18 included new legislative changes to SITR: the amount of investment social enterprises could receive through the policy was capped at £1.5

take-up has been lower than anticipated, though the original assumptions were subject to significant uncertainty about the level of investment into social enterprises and the behavioural response to the new relief.

1.7 The Call for Evidence sought views from a range of stakeholders to better understand the state of the social enterprise investment market and the effect SITR has had on social enterprises' access to finance. This includes the responses of active investors and enterprises about how or whether the scheme affected their investment decisions, in addition to social enterprises who cannot fully access the scheme on account of their corporate structures.

1.8 At Budget 2021, the Government announced that SITR will be extended for two years, in order to continue supporting investment to social enterprises in most need of growth capital. The evidence gathered in this consultation has helped inform that decision.

1.9 This document summarises the responses received to the Call for Evidence, both those addressing the 16 questions asked and those providing additional views. The answers given were broad and varied. Though a proportion of responses were identical, most of the answers given represented a broad range of views and themes.

1.10 The 2019 Call for Evidence pre-dated the ongoing Covid-19 pandemic, so respondents did not, of course, reflect on the effects of the pandemic on social enterprises and social investment. Since then, social enterprises have been carrying out vital work to support their communities through the difficult times, and the government accepts that the funding landscape for social enterprises themselves may now be different compared to 2019.

1.11 The government is committed to supporting social enterprises through Covid-19, which is why it has accelerated the release of previously committed dormant bank accounts money to establish and capitalise a Resilience and Recovery Loan Fund in partnership with Big Society Capital. This aims to improve access to the Coronavirus Business Interruption Loan Scheme (CBILS) for social enterprises.

million however the annual funding limit was removed for younger social enterprises; restrictions on employee numbers and qualifying activities were introduced to ensure State Aid compliance and appropriate policy targeting.

Chapter 2

The social enterprise market and SITR

2.1 This section asked about the demand for finance from social enterprises and posed questions about how SITR's rules and structures interact with this demand. Questions were aimed at all respondents and we received responses from all types of stakeholders.

Question 1 – If you are a social enterprise, are you interested in or planning to scale-up? How do you intend to achieve this and how much do you hope to raise in investment?

Question 2 – Other than individual investors, what sources of finance do trading social enterprises seek and acquire?

2.2 Most respondents felt that social enterprises typically have ambitions to grow, though some commented on their limited ability to do so because of limited access to funding options.

2.3 However, views on the exact proportion of social enterprises looking to scale up varied. One respondent stated that *all* social enterprises seek growth in order to expand their social impact, whereas another respondent cited research that found 66% of 413 interviewees had growth ambitions.

2.4 Some respondents reported seeking finance for capital expenditure projects, such as funding for a new building or redevelopment, rather than for scaling up trading activities. These respondents felt that using capital for these purposes were possibly deterring would-be investors, and in turn increasing the enterprise's reliance on grants and donations.

2.5 Research by one respondent suggested that access to finance, while still a barrier to growth for social enterprises, has become less of a barrier in recent years. The respondent's 2011 survey found that "44% of social enterprises found lack of access to finance as a barrier to their sustainability. By 2017, only 17% of social enterprises reported that obtaining debt or equity finance was a barrier to their sustainability."[1]

Sources of investment

2.6 A range of possible investment sources were reported. Some respondents also gave evidence on the proportion of funding provided by each source.

---

[1] Social Enterprise UK (SEUK) – *The Future of Business - State of Social Enterprise 2017 Report*

2.7 One common theme was that many social enterprises preferred blended finance strategies: a mixture of public funding and private investment options. These included crowdfunding, sponsors, individual investors, SITR investors, loans, grants, Lottery funding, community donations and Section 106 grants.

2.8 Many respondents viewed investments through SITR as an important funding option, though many reported relying on intermediaries to assist them.

2.9 Grants featured frequently in responses, with many respondents presenting them as an important source of growth finance, particularly at an early development stage; one respondent's research found 82% of the enterprises it represented applied for a grant within their first year. Local Authority and National Lottery grants were also popular, particularly for community heritage projects. However, many commented that grants were becoming increasing scarce, and the burden of relationship management with grantors meant loans were becoming more important. Though one respondent stated that social enterprises are typically willing to diversify their sources of finance and explore other income streams, others responded that small enterprises simply cannot do this beyond donations and grants.

2.10 Debt-based bank financing was another commonly cited investment source, though it was largely viewed as undesirable due to high interest rates. A handful of respondents stated small social enterprises struggle with the high fees and interest on commercial bank loans less than £150,000. Many respondents felt that there were considerable costs to securing loans, either through hiring advisors or employing staff with a capital raising skillset.

2.11 Equity investments in the form of community shares were also popular, though respondents reported that the administration costs of this can be high: for example this sometimes requires the business to be restructured. One respondent's research found 8% of its represented enterprises use equity investments. Community shares were reported as particularly popular with energy companies.

2.12 Other sources listed by some respondents included: friends and family donations or investments; legacies and wills; social impact bonds; and retained profits.

Amount of investment sought

2.13 Responses varied greatly on the value of typical investment sought by social enterprises. Several early-stage social enterprises reported relying on grants of less than £150,000, though the highest amount cited by a respondent was up to £3 million. Higher amounts were typically associated with larger scale projects such as renewable energy. This range was reflected by responses from social investment intermediaries, with one such respondent reporting a range from £10,000 to £2 million, and another from £50,000 to £5 million.

Question 3 – How difficult or easy is SITR to access for social enterprises?

2.14 There were mixed views on SITR's accessibility. Around a quarter of respondents reported that the process is easy. Many of these respondents felt that low awareness of SITR is the greatest issue behind poor take-up. Around three-quarters of respondents reported difficulty in using SITR. Reasons given varied and included a lack of capital supply (even with the offer of tax relief) for the levels of demand; a lack of or unclear guidance; complex eligibility restrictions; and limited resources within social enterprises to manage SITR processes and investments. A handful of respondents stated the process is difficult, without further elaboration.

2.15 Some respondents noted that intermediaries and advisors were very helpful in supporting the SITR application process, especially if the enterprise lacked experience or knowledge in-house. However, a few respondents felt there is a shortage of appropriate intermediaries and advisors, and that some advisors were unaware of SITR or lacked detailed knowledge of the scheme. One professional advisory body found 0 out of 100 members surveyed were aware of the scheme. Another respondent's 2015 research found that just above 20% of UK financial advisory firms offered any form of philanthropy advice to their clients. They concluded that the majority of advisers in the UK currently do not provide advice to their clients on philanthropy and social/impact investment, including tax-efficient social investment using charitable and social investment tax reliefs.

2.16 A common theme was the perceived lack of transparency of HMRC's advance assurance (AA) service. Some respondents felt that where HMRC refuses to give AA, it should provide more information on the reasons for this decision. A few respondents felt the time taken to receive an AA decision is too long. Another respondent had experienced a longer AA decision time with SITR than a different EIS investment and suggested this may create uncertainty for potential investors.

2.17 Many respondents who reported difficulties accessing SITR did so on the basis they were ineligible for the scheme. These answers typically called for a relaxation of excluded activities and charity subsidiary rules, and the abolition or relaxation of the seven-year age limit. One respondent noted that even when social enterprises are mature and have track records, they find it difficult to raise capital. Some enterprises reported that the 2016 changes to SITR, particularly the exclusion of asset-leasing, made it difficult to access the scheme.

2.18 A few respondents suggested that the government should introduce some form of intermediary to support SITR investments, including provision of free help to source investments.

Question 4 – What are the factors that lead to a successful trading social enterprise?

2.19 Most respondents felt that the same success factors apply to both traditional, commercial enterprises and social enterprises. Cited factors included: good leadership with sound, flexible financial management; a strong product or service; the ability to access a range of finance options; good customer supply; and a good understanding of the market and customer base.

2.20 Answers given on factors specific to social enterprises included the ability to maintain social objectives; customer 'buy-in' of the social purpose; and strong communities and support networks. Many respondents also stressed the importance of volunteers, including the experience and culture of workers. Some suggested that a successful social enterprise must regularly assess its delivery of social objectives. One respondent believed that maintaining low operating costs is important to ensure low service costs for communities and members.

Question 5 – Do you think social enterprises need private investment and for what purposes?

2.21 All respondents felt that private investment is important for social enterprises, with many noting that these businesses are interested in investment from any and all possible sources. Private investment was thought to be particularly central for development, working capital and supporting the diversification of enterprises' revenue streams. A few responses noted private investment is particularly important as it more likely to be patient capital.

2.22 A handful of responses suggested that the value of private investment goes beyond capital-generating purposes, since investors may provide their expertise and networks, which may be unavailable with institutional or public capital.

2.23 Some respondents believed that private investment into community-owned enterprises by members of those communities deepened relationships within communities and aligned social interests. The responses also highlighted some concern that external investors may not share the same social values, which may dilute the enterprise's social mission.

2.24 As set out above, respondents reported that private investment is often sought because more traditional forms of funding for social enterprises are becoming increasingly scarce, harder to secure, or are expensive.

2.25 Some respondents considered private capital particularly important for early development, arguing public funding is often difficult to secure in the start-up stage. However, some respondents thought investors may be deterred from start-up stage investing by the higher levels of expenditure and risk.

2.26 A handful of respondents suggested that private investment is necessary for social enterprises with a niche or unique social function, which may not qualify for public funding or grants.

2.27 Some respondents considered private investment to be particularly important to the community-owned energy sector due to the discontinuation of Feed-In Tariffs. Others felt that SITR's application to only community-based enterprises means it offers a unique incentive for increasing locally owned renewable energy.

Question 6 – Is tax the most appropriate government lever for supporting funding for social enterprises?

2.28 Most respondents felt that tax is an important lever for supporting social enterprise funding, though opinions varied on whether it is the *most* appropriate lever. Around a quarter of respondents felt that tax relief on investment is the most appropriate form of support, particularly given the limited availability of grant funding and the high interest typically charged on loans.

2.29 A popular response was that tax reliefs are a good lever to divert funds from mainstream channels, by de-risking and subsidising social investment; where investors are less motivated by the social aspects of enterprises, the relief provides an added financial incentive. As above, respondents suggested that tax-motivated investors could provide experience and networks unavailable through other funding sources.

2.30 Around a quarter of the respondents found that tax is not necessarily the best lever but that it is nonetheless important in the wider policy environment for supporting social enterprises. These respondents felt tax should be used in conjunction with other funding options such as grants, business development loans and matching crowdfunding capital.

2.31 Some respondents were unsure about how far tax incentives would influence investor behaviour, with many emphasising that investors were more interested in other issues, such as how the social enterprise was legally structured, its growth and development plans, and the attractiveness and social purpose of the investment.

2.32 A handful of respondents felt tax is of no particular importance to incentivising social investment, pointing to the dominance of non-tax advantaged investment in the current social impact market.

2.33 Some respondents believed that tax reliefs encourage investors with a more local focus and understanding than the awarding bodies of national grants. Contrarily, one respondent argued that social enterprises will always look to grants first when sourcing funding.

2.34 Other responses pointed to the importance of tax levers other than SITR, including Gift Aid and Stamp Duty. Some respondents felt that as a large number of their investors did not claim SITR's income tax relief, the government should allow them to 'gift' the equivalent relief to the social enterprise as a Corporation Tax relief.

Question 7 – What criteria would be the best measure of success for SITR?

2.35 Many answers centred around judging the success of the scheme by assessing the annual growth in the total amount of SITR investment; and the number of social enterprises and investors using the scheme. A few respondents believed SITR should be judged by comparing the aggregate amount of investment in social enterprises with pre-policy levels prior to 2014, alongside changes to social enterprises' cost of capital.

2.36 Around a third of the respondents felt success should be measured by the level of social value and return created through SITR-backed investments, not purely by financial success; respondents noted the complexity of measuring this. Others felt that both financial and social returns generated from SITR investments should indicate policy success.

2.37 A few respondents from small or community-centre based social enterprises stated that success lies in the survival and sustainability of the business, alongside increasing community participation.

2.38 Other answers included: increased awareness and access to SITR at local/regional levels; the level of job creation in social enterprises; the level of diversity among enterprises using SITR; an increase in the proportion of social investments that are SITR-backed and social enterprises that receive SITR; the amount of capital diverted from the mainstream investments to social enterprise market; and SITR's growth and participation figures in comparison with EIS and SEIS

Question 8 – Is this SITR limit of £1.5 million appropriate?

2.39 Views were divided on whether the current limit is appropriate.

2.40 Respondents supporting the current limit noted that most social enterprises seek less than £150,000 in private investment, and so felt that only a few investments could require a higher limit. Some expressed concern that, if the current limit were raised, this might divert investment away from small, riskier social enterprises towards a smaller number of larger investments with higher or more predictable returns.

2.41 Of those respondents who felt the limit is not appropriate, most called for it to be increased to £5m to bring SITR more in line with EIS. These respondents often linked a higher limit to some social enterprises' capital-intensive plans, such as building acquisition for community centres or social housing.

2.42 Some respondents called for the government to abolish the limit altogether.

Chapter 3

Use of SITR to date

3.1 This section asked about experiences with SITR and similar investment tax reliefs. As questions were aimed at investors who have made previous impact investments and at social enterprises interested in using SITR to raise capital, there were fewer responses to questions in this section.

Investor behaviour and expectations

Question 9 – If you are an investor, have you made an investment that was eligible for SITR? If not, why not?

Question 10 – Would you invest in a social enterprise without the relief?

3.2 Around half of respondents had made SITR investments, with a few investing through SITR funds. Of those responding investors who had not used SITR, some felt put off by the fees and minimum investment levels set by intermediaries. Some respondents reported concern that SITR is rarely used due to investors being deterred by asset-locking and low investment gains despite the tax relief.

3.3 Some respondents stated that they would not invest in social enterprises without the relief, as they believed SITR acts as an important up-front offset of investment risk and justifies the lower financial gains typical with social investments.

3.4 A handful of respondents stated that they would invest into a social enterprise without relief it the investment helps to generate a community or social benefit.

Question 11 – What are your expectations when you invest in a social enterprise? For how long do you expect to invest? Would you expect or prefer to invest in equity or debt?

3.5 A common response was that investors expected to make a social difference and that some thought of the investment as somewhat philanthropic rather than purely financial.

3.6 A few respondents felt that many investors using SITR are attracted by the social purpose first, and that the tax relief is more 'nice to have' than the primary motivator. These respondents noted that these kinds of investors will normally earmark funds within their portfolio for impact investing and seek to redeploy funds into new schemes as they mature. In addition, one respondent noted that many investors, though seeking a return, may be willing to treat the investment in effect as a charitable donation if the venture failed.

3.7 Most respondents expected return of their investments within seven to 10 years, following an investment period of three to five years. Where answers differed, some investors expected investments to be repaid over a 10 and 20-year period. One respondent had issued social bonds with maturities ranging from 18 months to 20 years, though 5 years was most common.

Debt or equity

3.8 A few investors stated that they prefer to invest through debt instruments rather than equity, as they felt that this had lower risk, a greater certainty of returns due to bond maturity and yield, and more transparency in investment than through an equity fund.

3.9 Where investors preferred equity investments, this was on the basis that they felt debt-investing is only available to those with a large amount of capital, especially for community-based investors. Additionally, some answers noted that loans cannot benefit from downside risk protection measures like share loss relief.

3.10 Some respondents expressed interest in using a combination of both debt and equity investment as a way to diversify their portfolio.

Understanding SITR's use to date

Question 12 – Have you used, or considered using, the Enterprise Investment Scheme or Seed Enterprise Investment Scheme?

3.11 Most respondents had not used or considered EIS or SEIS, with some noting this may be because social enterprises rarely seek equity. Some responding enterprises expressed interest in using EIS/SEIS but were unsure of their eligibility.

3.12 A few respondents had already used EIS, with fewer using SEIS and VCTs.

Question 13 – If you are a social enterprise, would you use SITR? If not, why not?

Question 14 – As an investor, enterprise or interested party, do you have a view as to why the take up of SITR has been less than expected?

3.13 Around two-thirds of responding social enterprises either had or felt they would use SITR if eligible. However, other respondents felt that they would only use SITR if they had existing in-house expertise or a guaranteed supply of investors. One respondent reported that only one of the 74 social enterprises in which it had invested in the last six years had also used SITR to raise capital. Another respondent felt that SITR is unlikely to ever be a relief used widely by social enterprises, and that government's focus on SITR is distracting from other priorities for the sector.

3.14 A clear theme in answers to this question was that poor awareness of SITR among investors and social enterprises is a major driver of the scheme's low take-up. One respondent's survey found that, of 168 enterprises responding, 70% did not understand what SITR is, 97% had never tried to use SITR and 70% did not intend to use in the next 12 months. Other respondents felt demand from social enterprises outstrips the supply of capital from investors. Others felt that they were simply too small or early-stage to benefit from SITR.

3.15 Several respondents also suggested that more time is needed for SITR to bed into the social investment market; these respondents drew parallels with trends from the early years of EIS, suggesting wider market adoption for EIS also took several years.

3.16 Other respondents felt low take-up is driven by the scheme's restricted eligibility criteria and called for changes to rules concerning age limits, company structures and excluded activities such as asset-leasing and property development. Some respondents noted that community renewables are a significant proportion of the non-tax advantaged social investment market, and that many forms of social enterprise rely on asset-leasing to generate income; these respondents argued that SITR's take-up would remain low if tax relief continues to be unavailable for investments in social enterprises that carry out these activities.

Question 15 – Are you aware of any international examples of similar tax reliefs that have experienced greater take up than SITR?

3.17 Of the few respondents to this question, none were aware of directly comparable international examples of tax reliefs similar to SITR. One answer cited the 'Opportunity Zones' scheme introduced in the United States in 2017, noting it had wider eligibilities than SITR.

Question 16 – How did you hear about SITR?

3.18 Respondents were aware of SITR through a range of sources. These included the original Budget announcement, word of mouth, internet research on funding options, newsletters, marketing and direct communication from intermediaries and funding bodies, conferences, workshops, and networking events.

Other responses

3.19 In addition to responses given to questions, some respondents provided additional evidence and information. Common or notable responses included:

- SITR should be restricted exclusively to charities or Community Interest Companies wholly owned by an asset-locked Community Benefit Society as this would make the sector easier to regulate, and could help reduce any government concern with abuse;

- The income tax relief should be raised to 50% to align with SEIS, or a 'Seed-SITR' should be introduced to increase SITR's attractiveness;
- SITR should be allowed to refinance debt;
- Advanced assurances should be priced to fund faster decision periods;
- Asset-leasing and property development should be permitted activities if they have a genuine social function, alongside regulated social residential care homes;
- SITR should be extended to credit unions and other cooperative structures in addition to Community Benefit Societies where the cooperative has a clear social purpose non-distributable assets;
- Social enterprise funds are sitting on investment capital due to a lack of enterprises seeking SITR;
- Withholding tax is an administrative burden and resource-consuming;
- Inheritance tax should be incorporated into SITR investments; and,
- The sunset clause of the scheme has put off some long-term investors and should be extended or removed.

Chapter 4
Next steps

4.1 The government welcomes the responses received to the consultation. The responses provided a wide range of perspectives on the issues explored in the consultation, reflecting the differences in experiences with SITR and the wider social investment market more generally.

4.2 The government has considered all responses to the Call for Evidence carefully and also recognises that, due to the ongoing effects of Covid-19, that now is a difficult time for social enterprises, many of which are supporting communities across the UK through the pandemic.

4.3 As such, at Budget 2021 the government announced it would extend SITR in its current form beyond its sunset clause of April 2021, for two years, in order to continue supporting investment to social enterprises in most need of growth capital. The government continues to monitor the social investment market and assess the most appropriate form of support for the policy objectives that SITR was introduced to achieve.