Thompson Taraz

Ten things you need to know about:

Social Investment Tax Relief

SITR

Background - An introduction

Social Investment Tax Relief ("SITR"), launched in 2014 in the UK, aims to encourage investment in enterprises providing a social benefit by offering tax relief to investors. It works in a similar way to the Enterprise Investment Scheme ("EIS") which has encouraged investment in early stage companies.

SITR was introduced in the Finance Act 2014 and applies to investments made on or after 6 April 2014 providing certain conditions are met by the social enterprise and the investor. The tax reliefs available consist of: income tax relief on investment, a deferrable capital gains tax ("CGT") reinvestment relief and an exemption from CGT on disposal.

"A social investment tax relief would be attractive to wealthy people making venture capital investments, and would bring new finance to charities and social enterprises. Now is the time for investors to seize this opportunity to invest for social good and benefit from tax relief that is equivalent to existing schemes."

Nick O'Donohoe - Chief Executive Officer, Big Society Capital

1 The aims and purpose of the scheme

The aim of the initiative is to increase private investment in social enterprises - commercial businesses that help charities and people or communities. These organisations might otherwise struggle to obtain finance due to a lack of assets or reserves, greatly restricting their development. The availability of SITR will not only help social enterprises to become self-sustaining, it will allow investors to enjoy a sense of involvement with the communities which the enterprise benefits, enabling them to share in the 'social dividend'.

2 Debt

Unlike many venture capital tax reliefs, SITR is available for debt as well as equity investment. There are conditions attached in order to qualify for SITR:

- the amount lent, and any interest on the loan, must not be secured on any asset;
- the interest may not exceed a 'reasonable commercial rate';

- there must be no arrangements in place which would protect the investment; and
- the debt must rank behind other debts of the social enterprise and rank equally with the lowest ranking share capital in the event of the social enterprise being wound up.

3 The tax reliefs - Income tax relief

Individuals making an eligible investment can deduct 30% of the amount of their investment from their income tax liability for the year in which the investment is made. There is an annual investment limit of £1m with scope to carry some or all of this back to the previous tax year. To qualify, the investment must be held for three years.

4 The tax reliefs - CGT reinvestment relief and CGT exemption

If individuals have chargeable gains they can also defer their CGT liability if they invest their gain in a social investment qualifying for SITR. The reinvestment in a qualifying investment must occur no more than three years after the disposal or one year before. On disposal of the SITR investment, the deferred CGT becomes payable.

Where income tax relief has been received and the investment is held for at least three years, any gain resulting from the social investment is free from CGT.

5 What is a qualifying investment?

A social enterprise is a commercial business operating in a way that helps people or communities. To qualify for SITR, the social enterprise must be one or more of the following:

- a Community Interest Company ("CIC") – a limited company, with special additional features, created for the use of people who want to conduct a business or other activity for community benefit, and not purely for private advantage;
- a Community Benefit Society ("BenCom") - an incorporated society with an asset lock, a legal device preventing the distribution of residual assets to members. The purpose of an asset lock is to ensure that the community benefit of any public funding is maintained, preventing, for instance, distributions to shareholders;
- a charity, which can be a charitable company limited by guarantee, or a trust;
- an accredited social impact provider.

6 What other features are necessary?

The social enterprise must have a defined social purpose for the whole of the qualifying period of the investment. Unless it is a charity, the primary purpose of the social enterprise must be to carry on a qualifying trade on a commercial basis with the aim of making a profit. Furthermore, the social enterprise must:

- be unquoted at the time of the investment;
- have fewer than 500 full-time equivalent employees at the time of investment (250 from 6/4/17);
- have no more than £15m of gross assets immediately before the investment and no more than £16m immediately after the investment; and
- have employed the monies raised from that investment for the purposes of the chosen trade within 28 months of the date of the investment.

Social enterprises will need to apply to HM Revenue & Customs to confirm that they meet the requirements of the scheme and investors will be able to claim tax relief once this confirmation has been given.

Certain trades are excluded from the scheme, irrespective of whether they are providing a social benefit. These include dealing in certain types of assets and commodities, property development, certain financial activities, agricultural activities and road freight transport.

7 Risks

The issue of risk may be a little different for a social enterprise than for other companies. Factors that affect the risk profile of the enterprise, such as its stage of development, the experience and capability of its management team, its market position and size, and its financial position still need to be considered. However, the enterprise's social mission is also relevant; it may reduce the risk by bringing clarity of purpose and the support of its community or, conversely, it may make the business less flexible and therefore increase the risk profile.

8 Eligible investors

"Social enterprises, charities and voluntary bodies have the knowledge, human touch and personal commitment to succeed where governments often fail. But they need finance too. They can get it from socially minded investors."

David Cameron

Whilst there are no restrictions on who can invest in an enterprise, SITR is limited to certain individuals.

Investors cannot get relief if they (or their associates) hold more than 30% of the enterprise, are employees, partners, remunerated directors or trustees of the enterprise. In addition, if you agree to invest in someone else's social enterprise and they agree to invest in yours so that you can avoid the 30% rule, neither investment would qualify for tax relief.

9 How much can be raised and how much can be invested?

Under EU rules, SITR is a form of State subsidised aid and qualifying enterprises are restricted in the amount they receive. There is a formula which determines the cap and, at the current rates for CGT and SITR, this makes the limit €344,827 per social enterprise over any three year period. This equates to about £300,000 - the exact sterling equivalent is the spot exchange rate on the date of investment.

From 6/4/17 social enterprises aged up to 7 years old can raise up to £1.5m.

If a social enterprise needs more capital than can be raised within the SITR limits, additional money can be raised from further investments, but these will not qualify for SITR.

Individual investors can invest in more than one social enterprise but the investment limit in any single tax year is £1m. This is independent of any investments under EIS and the Seed Enterprise Investment Scheme ("SEIS"), which are subject to their own annual investment limits.

10 What are SITR Funds?

Investment through an SITR investment fund allows money pooled from a number of investors to be subscribed for SITR shares and debentures in a range of qualifying investments selected by a Fund Manager.

The Fund Manager invests on the investor's behalf (via a discretionary investment management agreement with each investor), enabling them to claim various tax reliefs.

As such whilst an SITR 'fund' is not a fund in the traditional sense, rather a number of investments into individual social enterprises, they provide a way for investors to participate in the scheme whilst enjoying the diversification benefits of a 'fund' managed by experienced professionals.

Funds help social enterprises overcome the restriction on a single investor holding 30% or more of the investment, especially where an SITR loan is the investee's first debt.

Whilst EIS funds can be unapproved or approved - approval being related to the spread and number of investments ensuring that the fund satisfies certain administrative criteria laid down by HMRC - SITR funds,

like SEIS funds, do not make the distinction and are all unapproved.

An experienced partner

Thompson Taraz provides a range of fund management and specialist consultancy services to both investors and social enterprises, including advising on eligibility and tax reliefs, safe custody and the holding of client money, as well as registrar activities and investor communications.

For more information on SITR or any of our fund management services, please contact:
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