TAXREP 07/14

(ICAEW REP 19/14)

ICAEW TAX REPRESENTATION

DRAFT LEGISLATION FINANCE BILL 2014

Comments submitted on 4 February 2014 by ICAEW Tax Faculty in response to HM Revenue & Customs draft legislation *Social investment tax relief* published on 10 December 2013

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the draft legislation *Social investment tax relief* published by HM Revenue & Customs (HMRC) on 10 December 2013.

2. We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

3. Information about the Tax Faculty and ICAEW is given below. We have also set out, in Appendix 1, the Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system.

WHO WE ARE

4. ICAEW is a world leading professional membership organisation that promotes, develops and supports over 142,000 chartered accountants worldwide. We provide qualifications and professional development, share our knowledge, insight and technical expertise, and protect the quality and integrity of the accountancy and finance profession.

5. As leaders in accountancy, finance and business our members have the knowledge, skills and commitment to maintain the highest professional standards and integrity. Together we contribute to the success of individuals, organisations, communities and economies around the world.

6. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including TAXline, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

MAJOR POINTS

7. We are pleased to note that changes have been made to reflect the responses to the consultation document on Social Investment Tax Relief (SITR).

8. We welcome the reduction in the period the investment has to be held from five years to three years.

9. In the main the legislation mirrors the Enterprise Investment Scheme (EIS) legislation with all the complexity therein and all its flaws. We are concerned there may be a problem in terms of costs for any social enterprise to ensure compliance with the legislation compared to the potential benefit given the restrictions on the size of the eligible investment they can receive.

10. A clearance procedure would be helpful even if like the EIS clearance it is non-statutory.

11. Clause 257LF in the draft legislation restricts certain individuals from qualifying for the tax relief and mirrors the EIS restrictions with the addition of trustees of the social enterprise. We are concerned that the people who are most involved with the charity are specifically excluded from the relief. In addition we do not understand why a trustee is prevented from qualifying for relief when a non-remunerated director can qualify. The summary of responses at para 2.43 states that this is 'in line with the general principle that it is a role undertaken voluntarily for the benefit of the charity and for no financial benefit of the trustee'. The duties of a trustee of a charity are onerous and there are provisions in regard to conflict of interest. The position of a trustee does not seem very different to that of a non-remunerated director and in many ways it is arguably better regulated so why should a trustee not be thought able to distinguish between his duties as a trustee and his position as an investor?

STATE AID

12. Restricting the level of relief to €200,000 means that clearance is not required for state aid but the intention is to introduce a larger scheme and so notification will be required. We welcome the intention to expand the relief.

13. Since the Summer 2013 consultation on SITR closed the European Commission has released three important documents with relevance to the design of this relief:
- a revised regulation exempting *de minimis* amounts of aid, which entered into force on 1 January 2014 (Commission Regulation No. 1407/2013 adopted on 18 December 2013);
- a consultation on a draft revision of the current General Block Exemption Regulation (GBER) which the Commission intends to finalise and adopt by July 2014 (C(2013)9256 issued on 18 December 2013); and
- new guidelines on aid to promote risk finance investments which will replace the current guidelines adopted in 2006 and will enter into force on 1 July 2014 (C(2014)34/2 issued on 15 January 2014).

14. The new measures are intended to operate until 31 December 2020.

15. The revised *de minimis* regulation maintains the existing cap on exempt aid at €200,000 per undertaking over a 3 year period, but enterprises in financial difficulty are no longer excluded from this relief. Whereas the current GBER does not cover tax incentives for private investors, the revised version will bring them within its scope. In addition, the new risk finance guidelines will enable a wider range of enterprises to be eligible to benefit under a notified scheme.

16. We understand that the draft clauses published on 10 December 2013 are intended to be compatible with these documents. See Appendix 2 for our comments.

COMMENTS ON THE DRAFT LEGISLATION

17. Clause 257JA(4)(b)
It should be possible for part **or all** of the invested amount to be treated as if it had been invested in the preceding tax year. This is the intention and it seems the highlighted words have been omitted.

18. Clause 257JC
A reference to a company includes a reference to a charity that is a trust only for "this Part". Should this reference apply also for Part 2 of Schedule 1 and Schedule 2 ?
Presumably it is intended that a reference to a company includes a reference to a charitable unincorporated association by virtue of s992 ITA.

19. Clause 257KB(2)(b)
The requirement to issue a "debenture" could be confusing as the word has a legal meaning (a document evidencing a debt) that differs from its popular meaning (a bond or similar security). We understand that it is intended that it should be possible for a wide variety of debt instruments to be eligible for SITR and we suggest therefore that the legislation only needs to provide for the issue of a "debt instrument".

20. Clause 257KB(2)(b)(ii)
This should be amended to cater for the situation where an investor agrees to provide debt finance but the funds are drawn down in instalments by the social enterprise. Relief should be given by reference to the date when the funds are transferred to the social enterprise.

21. Clause 257L(2)(e) & (4)(b)
It is unclear how a rate negotiated by parties dealing at arm's length could ever be a rate greater than a reasonable commercial rate.

22. Clause 257L(4)(c)
Presumably this condition only has to be satisfied if the debt has not been repaid in full prior to the commencement of the winding up.

23. Clause 257LB(1)
Would a loan for an unspecified term that is repayable on demand be regarded as an arrangement for a loan to be repaid in the 3 year shorter applicable period?

24. Clause 257LE
In practice it may well be difficult to say that an investor is making the investment for "commercial" reasons when his/her motivation may well be wholly or partly for philanthropic reasons or at best a "mixed motive" investment. This clause seems to be superfluous given that there is a general anti abuse rule.

25. Clause 257LF
We understand that the proposal to exclude individuals with an existing relationship with the social enterprise from being eligible investors is based on the similar restriction under the EIS regime. However, we are concerned that excluding the very people who are most likely to be enthusiastic about investing in a social enterprise will unduly limit the size of the investor pool.

26. Moreover the definition in 257KC(3)(b) of the "longer applicable period" as starting up to one year before the investment date restricts the ability of enterprises and individuals with an existing relationship within the social enterprise to end that particular relationship in order to become an eligible investor.

27. Clauses 257LF(2)(c), 257LF(3), 257ME(2), 257MU
Although 257JC defines "company" to include a charitable trust, a 51% subsidiary is defined by s989 ITA and s1154 CTA 2010 in terms that can only readily be applied to a body corporate.

28. Clause 257M
It was suggested at the SITR Working Group meeting at the Treasury on 15 January 2014 that it might be possible to remove the financial health requirement on the basis that the revised EC *de minimis* regulation adopted on 18 December 2013 no longer included such a requirement.

29. Clause 257MA(1)
The formula cannot be correct as drafted since it would preclude a social enterprise from raising more than EUR 200,000. We understand that HMRC is working on a revised formula.

30. Clauses 257MG, 257MI, 257MV
A 90% subsidiary is defined by s989 ITA and s1154 CTA 2010 in terms that an only readily be applied to a body corporate.

31. Clause 257MJ(2)(a)
The three forms of social enterprise listed in 257J(2) are all required by law to be established for public or community benefit purposes and any trading activity should be a means of furthering those purposes rather than an end in itself. Accordingly the trading requirement should be rephrased as an activities test rather than a purposes test.

32. Clause 257 MJ(3)(b)
The current wording suggests that, where a social enterprise negotiates to acquire an existing or future company but the negotiations prove to be abortive, the target will be treated as a qualifying subsidiary during the negotiation period up to the point when the intention to acquire it is abandoned. We do not believe that this is intended.

33. Clause 257MJ(7)
The definition of "non-qualifying activities" includes any non-trading activities carried on by non-charitable members of a social enterprise group. Given that CICs and Bencoms are required by law to have activities that further public or community benefit purposes and are more than incidental activities, these activities will not necessarily be carried on in the course of a trade and it seems illogical to treat them as non-qualifying solely on this ground. Under the current definition many non-profit organisations involved in the provision of social housing would not be able to meet the trading requirement as their activities commonly involve the carrying on of a property business rather than a trade.

34. Clause 257MP(1)(b)
No guidance is given as to what level of excluded activities will be regarded as a "substantial" part of a trade. In other contexts HMRC has suggested that 20% could be regarded as substantial. Given the diversity of enterprises and activities that could be eligible to benefit from SITR, we favour leaving "substantial" undefined in order to allow for a degree of flexibility in the application of the test.

35. Clause 257MR
The current definition of "property development" would cover the development by a non-profit registered social landlord (RSL) of housing for sale on a shared equity basis. If the Government intends that this activity should not be excluded from benefiting from qualifying social investments we consider that a specific carve out for these RSLs will be required.

36. Clause 257MS
As drafted this provision would enable a social enterprise that is currently receiving a feed-in tariff (FIT) subsidy to be eligible to benefit from SITR once it has ceased to receive the FIT subsidy even if it continues to receive any other subsidies for the generation or export of electricity. We presume that the aggregate amount of these other subsidies would nevertheless have to be taken into account in determining whether the enterprise has received notifiable state aid.

37. Clause 257MU & 257MV
We assume that it is intended that ownership of a 51% or a 90% subsidiary can be traced indirectly as well as directly in line with s1155 CTA 2010.

38. Clause 257NA(2)
The effect of this provision is to require a claim to carry back part of the investment to the previous tax year to be filed by the **fourth** anniversary of the normal filing date for the tax year in which the investment is made. It is important that HMRC's guidance makes this clear.

39. Clause 257PE(6)
In contrast to the other provisions in this section which treat the investor as receiving value from the social enterprise where funds are effectively transferred from the enterprise to the investor, this provision applies the same treatment where the investor sells all or part of his/her investment to an individual who cannot qualify for SITR because of a failure to meet the requirements in 257LF or 257LG. This provision effectively prevents the investor from selling out to a number of other individuals who would potentially form a significant part of what may often be a limited market for social investments in the enterprise concerned. It is not clear what policy is served by clawing back the original investor's SITR in these circumstances.

40. Clause 257PL(2)
It should be possible for the investor to donate his/her investment to charity without losing SITR.

41. Clause 257T(3)(b)
It is quite common in practice for a person to have the power to appoint or remove a trustee of a charitable trust, but the power would not of itself give that person effective control of the charity.

42. Part 2, para 10
This provision seems to be unnecessary as s416 ITA requires an individual to make a payment of money to a charity in order to be able to claim Gift Aid relief and it has never been accepted that a waiver by an individual of an entitlement to a sum meets this test.

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APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.

4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.

5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see icaew.com/en/technical/tax/tax-faculty/~/media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx)

APPENDIX 2

Interaction with General Block Exemption Regulation

Revised *de minimis* regulation
Article 2(2)
This measure defines an undertaking to include all enterprises that are considered to be under common control under specific tests that have been modelled on the concept of "linked enterprises" that is used in the definition of small and medium-sized enterprises (SMEs) for many other EU law purposes. Social enterprises are unlikely to be familiar with this concept and will need HMRC guidance on the application of these tests.

Draft revised GBER
Article 1(4)(c)
Whereas aid to undertakings in difficulty can now qualify for exemption under the revised *de minimis* regulation, this provision excludes all such aid (except for the limited purpose of making good the damage caused by natural disasters) from relief under the GBER on the basis that it is assessed under separate guidelines issued in 2004. It seems sensible for the UK to retain the similar exclusion in draft clause 257M with a view to gaining swift approval by the Commission of a SITR scheme that includes notifiable elements.

Articles 4(1)(g) & 20(9)
We note that the cap on risk finance aid per eligible undertaking of €15 million is in line with draft clause 257MC. However, it may also be necessary to take into account any other state aid for the aided activity or undertaking in determining whether the notification threshold and the maximum aid intensity is respected (Article 8(1)).

Article 20(1)
As the exemption of notification of risk finance aid is limited to aid in favour of SMEs, it is important that the definition of a SME in Annex II is respected. At present this includes a cap on the number of full-time equivalent employees at 250 persons. This is inconsistent with draft clause 257MH which imposes a cap of 499 persons, although there is scope for the Commission to approve a higher limit under the new risk finance guidelines.
It is also necessary for an enterprise to determine whether it is excluded from qualifying as a SME by reason of a connection with a "partner enterprise" or a "linked enterprise". It is important that HMRC provides guidance on these issues.

Risk finance guidelines
Paragraph 28 As the Commission will not approve under these guidelines any measures that involve a breach of EU law, it is important that the benefits are not reserved for activities carried on in the UK or UK resident investors and enterprises.

Paragraph 47 The new guidelines enable the approval of aid for larger enterprises that exceed the SME thresholds, provided that evidence of market failure is provided to the Commission.

Paragraphs 48, 87 & 120-126 The new guidelines would also enable the existing SITR proposals to be extended in the future to corporate investors (including financial intermediaries) in social enterprises that are SMEs should the UK Government wish to do so.

Paragraph 150 A key condition for the approval of aid involving tax incentives is that the tax relief should not be available to investors who are not independent from the company invested in. Independence is not defined, and it would be helpful to discuss the boundaries of this condition with the Commission. Presumably the restrictions in draft clause 257LF on eligible investors have been drafted with this condition in mind. In the context of social enterprises, however, it would be

unfortunate if the restriction barred investment by the very individuals who are most likely to be interested in making an eligible investment.