



TAXREP 42/13

(ICAEW REP 118/13)

ICAEW TAX REPRESENTATION

CONSULTATION ON SOCIAL INVESTMENT TAX RELIEF

Comments submitted on 6 September 2013 by ICAEW Tax Faculty in response to HM Treasury and Department for Business Innovation and Skills consultation document *Consultation on Social Investment Tax Relief* published on 6 June 2013

Contents

	Paragraph
Introduction	1-3
Who we are	4-6
Key point summary	7-11
Responses to consultation questions	12-45
Ten Tenets for a Better Tax System	Appendix 1

INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation document [*Consultation on Social Investment Tax Relief*](#) published by HM Treasury (HMT) and Department for Business Innovation and Skills (BIS) on 6 June 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 professional membership organisation, supporting over 140,000 chartered accountants around the world. Through our technical knowledge, skills and expertise, we provide insight and leadership to the global accountancy and finance profession.
5. Our members provide financial knowledge and guidance based on the highest professional, technical and ethical standards. We develop and support individuals, organisations and communities to help them achieve long-term, sustainable economic value.
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.

KEY POINT SUMMARY

7. We welcome the introduction of a tax relief to encourage social investment. However, the rules for the new relief should be based as far as possible on existing rules for Enterprise Investment Scheme (EIS) and Venture Capital Trust (VCT) investments. That said the existing rules are overly complex and the opportunity should be taken to simplify the rules. We are concerned about the proliferation of rules and reliefs and the more they can be unified the better as this will assist the efforts of claimants to comply.
8. We are concerned that if the tax relief for social investment is greater than for charitable donations that this will have a detrimental impact on charities; the charities may receive less as donations and more as a repayable investment and this switch in the nature of the funding could potentially cost the government more.
9. Similarly the existing definitions for Community Interest Company (CIC) or Community Benefit Society (Bencoms) should be piggy backed for the new relief.
10. Unsecured loans paying a commercial rate of interest should be eligible for the relief.
11. The size of the eligible investment into social sector organisations should be increased from the proposed €200,000.
12. Earlier this year a consultation was issued on [*Community Amateur Sports Clubs*](#) (CASC) (our response was published as [*TAXREP 37/13*](#)) and we can see that there will be potential for confusion between the two types of relief. Also, as there is no provision for a CASC to

deregister it may be that some entities are denied the opportunity to benefit from this social investment relief.

RESPONSES TO CONSULTATION QUESTIONS

Q1: Do you agree with the proposed criteria for assessing options for the social enterprise tax relief? Please provide comments as appropriate.

13. On the whole we agree with the criteria, they are laudable but not necessarily achievable. The key criteria of “simple and straightforward to administer” is not always compatible with “not open to abuse”.

Q2: Would adopting a definition of social enterprise comprising Community Interest Companies, Community Benefit Societies and charities that are registered with the charity (or other principal) regulator and also recognised as charities for tax purposes exclude organisations that might reasonably be included, or include organisations that in your view should be excluded? If so, please say why.

14. We agree that wherever possible existing definitions should be used otherwise there would be an unnecessary level of complexity and there would always be a need to allow exceptions to the rule if some organisations were excluded should different definitions be adopted. By using the existing definitions any organisation that believes it should be able to access the new social investment funds could register itself as CIC or Bencoms changing its structure if necessary to fall within the definition. It may be appropriate to include CASC within the definition of a social enterprise.

Q3: Is there an alternative definition of social enterprise that would more accurately reflect the types of organisation that should benefit from the relief, and would be workable in legislation? If so, please provide one.

15. As noted above we believe it would be better to use existing definitions.

Q4: Are there any particular advantages or disadvantages to making charities eligible for the relief? In particular, is there a risk that donations to charities will be displaced into investments and what would be the consequences of this?

16. It would be detrimental to charities if social investment replaced donations, donations do not have to be repaid and can be used in total for their charitable purposes but an investment would in theory ultimately have to be repaid and so cannot be used in quite the same way. If the tax relief for social investment was greater than for a charitable donation that could influence donors to the detriment of the charity. An alternative approach if charities wanted to access the social investment they could, for example, register their trading arm as a CIC or Bencoms rather than charities per se being included within the definition of eligible investee organisation.

Q5: If charities are eligible for the relief, it will be necessary for specific anti-avoidance rules to ensure investments do not receive relief as both investments and donations, including the need to account for donations and investments separately. Do you foresee any practical problems with this? Are there any other specific avoidance risks that would arise from allowing charities to be investee organisations?

17. See our response to Q4.

Q6: Would a size requirement of up to 250 employees be appropriate for the social investment tax relief, or should a lower limit be introduced initially?

18. In our view a size restriction based on employees is not appropriate but if one is to be included 250 is suitable. Many of these organisations will have volunteers rather than employees which is why we do not consider this to be an appropriate measure.

Q7: What are the benefits and disadvantages of using gross assets or turnover to measure size, and what would the appropriate limits be? Please provide reasons and evidence.

19. A gross asset test is probably the most appropriate measure and a limit of £15 million to mirror the VCT and EIS schemes would be suitable.

20. With reference to Q6 and Q7 the limits proposed are relatively high and if the intention is to target small social enterprises initially then all of these limits should be reduced.

Q8: Would it be appropriate to exclude particular activities from the social investment tax relief, in order to keep the tax relief well-targeted, or would the existing regulation of the qualifying organisations be sufficient? If the Government does introduce exclusions, should specific organisations be entitled to the social investment tax relief that are not currently able to access the venture capital reliefs, for example organisations delivering social care, or arts based organisations? Should any additional exclusions apply? Please give reasons.

21. As noted above the more the new relief borrows from existing legislation the better. If the activities of the organisation qualify it as a CIC or Bencoms that should be sufficient restriction.

Q9: Do you agree with these general principles governing the scope of the investment instrument as a means to ensure that the tax relief for social investments is well-targeted and focussed on appropriately high risk investments?

22. We agree with the general principles and agree that multiple tax reliefs should not be available on the same investment.

Q10: What would be the most appropriate way to ensure that tax relief is not provided for less risky debt investments? Do the summary criteria set out in Box 4.A achieve this aim?

The criteria in Box 4.A will help to achieve the aim of only giving tax relief to the more risky debt investments.

Q11: Would a rule requiring investments not to be secured against assets or subject to guarantee ensure that the tax reliefs are well-targeted? Would this create any substantive difficulties for investors?

23. It would help to ensure that the tax reliefs are well-targeted.

Q12: Is it reasonable to require an investment return at a commercial rate, given the nature of the social investment market? If so, what would be the most appropriate way to ensure that any dividends or interest payments that form a return on the investment are paid at a broadly commercial rate? How can the Government best limit opportunities for manipulation on returns?

24. It should be up to the social investee to set the return to be paid on the investments but subject to a maximum in order to qualify for tax relief; there should not be a minimum return. However, the lack of security and preferential rights mean that the commercial rate of return should be quite high and the original rates in paragraph 4.15 of a maximum dividend of Bank of England rate + 5% and performance related interest limited to Bank of England Base Rate + 4% are too low. This interest rate represents the best rate obtainable for an unsecured loan and we believe that in the context of a social investment the rate should be much higher than this.

Q13: Would it be appropriate to allow redeemable shares, or an equivalent for debt-like investments, after the minimum period for investment had been reached?

25. Yes conversion to redeemable shares at the end of the qualifying period should be allowed. There needs to be some kind of exit plan in order to attract investors.

Q14: Would the criteria overall result in any damaging, distortive or unintended consequences in the field of private investment into social enterprise? Please give examples where investments would be supported, or where difficulties might arise.

26. No comment.

Q15: Would a tax relief allowing investments of a maximum of €200,000 per investee organisation over three years be successful in generating additional social investment? If so, what types and sizes of social enterprise would be likely to benefit?

27. We understand that having a higher level may require State aid approval from the European Commission but such a low level is unlikely to attract sufficient investment. To avoid delays the relief could be introduced with this cap but the Government should actively seek approval for a higher limit.

Q16: Is a cap of £1 million of investments per investor per year the right amount?

28. A cap of £1 million should not be restrictive to the majority of potential investors.

Q17: Should the EIS conditions on how and when the money raised by the investment must be used also apply to the social investment tax relief?

29. Yes.

Q18: Is the double cap, (aggregate cap at 35 per cent and dividend cap – maximum 20 per cent) on distribution by CIC limited by shares too burdensome and does it therefore discourage investment or setting up such a CIC? How and why?

30. No comment.

Q19: If there were to be a change to the caps, should one or both of the caps be removed or increased? Please give reasons and explain how this should be done. Would this change allow adequate protection of community assets?

31. No comment.

Q20: What would be the effect of changing or removing the peg to the initial paid up value of shares? Would this affect the statutory asset lock and the protection of community assets? If so, please say why. How should the value of shares be determined – by the market, by inflation, by a specified percentage?

32. No comment.

Q21: Should the performance related interest cap be raised or removed, and what impact would that have on the protection of community assets?

33. The performance related cap should be removed. Further the cap of 10% is too low to reflect the risk taken by the investor.

Q22: Would the proposed definitions of connected parties create any specific problems for investments into social enterprises? How might the Government best ensure that all types of investment instrument were captured through rules on financial connections to a company, without being overly restrictive in the case of emergency financing?

34. The connected party rules are reasonable and specific problems are not envisaged.

Q23: Would the proposed five year time period for minimum investment be appropriate? If not, what would be a more appropriate investment period and why?

35. A three year time limit as for EIS would be more appropriate, our view is that the nature of the investment is more akin to EIS than VCT so the shorter investment period is more fitting.

Q24: The Government welcomes views on the appropriate balance to be struck on offering any tax reliefs in addition to initial income tax and reinvestment reliefs. If in addition the Government were to offer a tax relief on disposal of qualifying social investments, would a tax relief on gains, or a new rule to encourage serial investments into social enterprises be preferable?

- 36.** The tax reliefs offered should mirror those for EIS investments so in addition to the initial reliefs any gains on disposal should be exempt, inheritance tax relief should be available after two years and loss relief against capital or income in the event that the investment is not repaid.

Q25: Do you agree that the Government should not introduce a new set of rules specifically to support indirect investment into social enterprises via a separate legal entity such as an LLP? What are the potential effects of using the nominee approach outlined above? Are there likely to be fund managers who are able to offer nominee investments?

- 37.** No comment.

Q26: What are the advantages and disadvantages of continuing to operate both CITR and a new tax relief for investment in social enterprise?

- 38.** It is possible that the two schemes attract two different types of investor and until the impact of the new social investment relief is known the Community Investment Tax Relief should be retained.

Q27: Would any of these anti-abuse measures be likely to have unintended adverse consequences? Please also list any further anti-abuse measures that might be needed.

- 39.** The anti-abuse measures should not have adverse consequences and together with the General Anti-Abuse Rules already enacted these should be sufficient to protect revenues.

Q28: Please provide information on the current size and composition of the social enterprise environment. For example, information on the total number and size of companies of potential eligible Community Interest Companies (CICs), Community Benefit Societies (bencoms) and Charities, levels of employment, amount currently received by private investors (excluding companies), estimates of turnover, and breakdown by type of capital (quasi-equity/equity/debt).

- 40.** No comment.

Q29: How has the UK Social Enterprise market performed in recent years and what are the wider economic trends? Please provide detailed information or examples, including:

- changes in overall levels of private investment by type of capital, other funding sources, turnover and employment within the UK Social Enterprise market;
- changes in overall levels of demand and evidence of funding gaps within the UK Social Enterprise market. Is this a problem specific to any particular sector, type of company?
- case studies of different social enterprises receiving private investment with an indication of their level of risk, the size of average investment and expected return.

- 41.** No comment

Q30: What are the three or four main factors that have driven the changes in the UK social enterprise market?

- 42.** No comment.

Q31: What are the barriers that currently put investors off investing in the social enterprise market?

- 43.** No comment.

Q32: What is the loss to the economy from underinvestment in the UK social enterprise market?

44. No comment.

Q33: What are the three or four main features of the tax relief that you deem important to incentivise investment in the UK social enterprise market? Please provide figures on how this will impact on the level of investment.

45. No comment.

Q34: What level of new private investment you think will be generated by the introduction of the tax relief and why?

46. No comment.

Q35: What type of investor is likely to drive an increase in social investment, and are they targeted by the policy as currently outlined? If not, what would be needed to bring them into the policy?

47. No comment.

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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)