MOORE Kingston Smith

SOCIAL INVESTMENT TAX RELIEF

What is the objective of the SITR scheme?

The Social Investment Tax Relief is designed to support social enterprises seeking external finance by offering a range of tax reliefs to individual investors who invest in new shares, or new qualifying debt investments in those social enterprises. SITR applies for investments made on or after 6 April 2014. It will no longer be available for investments made after 5 April 2021.

How does a company qualify as a SITR company?

The investment must be in a social enterprise, which means any community interest company, community benefit society or a charity. A charity can have the legal form of either a company or a trust. It must meet a number of tests:

- It must be unquoted;
- The gross assets of the social enterprise must not exceed £15 million before the investment and £16 million after its investment;
- The number of full-time employees of the social enterprise must not exceed 250, though this excludes volunteers;
- For companies that receive their initial investment within seven years of their first commercial sale, the total amount of potential investment in any one social enterprise, over the enterprise's lifetime, cannot exceed £1.5 million.
- For older companies, the total amount of potential tax relief available on investments in any one social enterprise cannot exceed €200,000 in the period of three years ending with the day the SITR investment is made, reduced by any other de-minimus EU state aid. Effectively, this means it is a three year rolling limit;
- The social enterprise cannot be controlled by another company;
- The social enterprise and any 90% subsidiary cannot be a member of a partnership;
- The social enterprise cannot control another company that is not a 51% subsidiary;
- If not a parent company, the social enterprise must either be a charity or exist wholly for the purpose of carrying on a qualifying trade (see below);
- If a parent company of a group then the group's business must meet the requirement of the scheme.
- The social enterprise, or its 90% subsidiary, must either be carrying on a qualifying trade or be preparing to carry on such a trade with the trade commencing within two years of the SITR investment.

What type of investment can you invest in?

Investments must be on newly issued shares, new qualifying debt instruments or new social impact bonds. The investment must have been paid in full, and in cash, at the time the investment is made.

Any investments on which SITR is to be claimed should not be issued during the social registration process, but only at a later date when it can receive payment for them. If the investment is in shares, those shares must be ordinary shares, which do not carry any right to a fixed return. The shares must also not carry any right to the social enterprise's assets on a winding up which rank above the debts, or other shares in the social enterprise.

To be a qualifying debt investment, 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 rank equally with shares that do not rank above any other shares so far as the law allows.

If the investor owns any debentures or shares in the social enterprise or any of its subsidiaries immediately prior to the investment, those shares or debentures must be 'risk finance investments' or 'permitted subscriber shares'.

Can the Social Enterprise carry on any trade?

No, though most trades qualify. A trade does not qualify if it consists wholly or substantially of "excluded activities". Substantial is considered 20% or more of the whole.

Excluded activities include:

- Dealing in land, in commodities or futures, in shares, securities or other financial instruments
- Banking, insurance, money-lending, debtfactoring hire purchase financing or other financial activities (with the exception of lending money to another social enterprise);
- Property development

- Activity in the fishing and agricultural sector covered by Council Regulation (EC) No.104/2000 on 17 December 1999 on the common organisation of the markets in fishery and agriculture products
- The primary production of products listed in Annex 1 to the Treaty on the Functioning of the European Union (agricultural etc. products)
- Generating heat or other energy
- Producing gas or fuel
- Road freight transport for hire or reward
- Asset lending and on-lending
- Receiving royalties or licence fees
- Investments in nursing homes and residential care homes (though the Government has advised these will be allowed in future via an accreditation scheme)
- Providing services to another person where the person's trade consists, to a substantial extent, of excluded activities and the person controlling that trade also controls the company carrying on that trade.

Is there a requirement as to how the money is invested in the Social Enterprise?

Within 28 months of the investment, all the monies raised must have been employed by the qualifying trade carried on by the social enterprise or its 90% subsidiary. Repayment of loans or acquisition of shares will not fulfil this requirement.

HMRC may give a social enterprise a notice to provide it with certain information in order to comply with EU State aid regulations. The information requested may be about the social enterprise's investors, activities and/or its social investment tax relief claim.

Can anyone invest under SITR?

- As an individual investor you will qualify provided:
- Investors are independent from the enterprise. Specifically, during the period of one year before the investment to three years after the investment, you and your associates do not own more than 30% of the social enterprise's:

  o Ordinary share capital

  o Loan rights

  o Voting rights
- Associates include relatives, business partners, trustees of any settlement of which you are a settlor or beneficiary. Relatives are defined as spouses, civil partners, grandparents, parents, children and grandchildren, but do not include brothers and sisters.
- During the period of one year before the investment to three years after you are not employed by a partner of, a trustee or a paid director of the social enterprise.

How does the income tax relief work?

The tax relief consists of income tax relief as well as capital gains tax deferral relief, provided that the relevant conditions are met by both the social enterprise invested in and the investor.

A qualifying investor will be entitled to obtain income tax relief at a rate of 30% on the SITR up to the annual investment limit.

The annual investment limit is currently £1,000,000 resulting in a maximum income tax saving of £300,000 (£1,000,000 at 30%). There is no minimum investment limit. The income tax reducer can only reduce the income tax liability of the year to nil. However, where an investment is made under SITR in one year it can, by election, be treated as though it was an investment made in the immediately preceding tax year, subject to the overall limit for that year. However, it is not possible to carry it back to a year earlier than the introduction of SITR on 6 April 2014.

The advantages of carrying back a payment to a previous year is that it speeds up the tax relief and gives a cash flow advantage.

The income tax relief can be clawed back by HM Revenue & Customs if the social enterprise fails the qualifying conditions within the first three years from the date the investment was acquired.

Relief is not available in respect of money raised under SITR to pay off existing loans.

Anti avoidance measures also exclude any investment for which arrangements are put in place with the main purpose of delivering a benefit to an individual or party connected to the social enterprise.

How does the capital gains tax deferral relief work?

The payment of tax on a capital gain can be deferred where the gain is reinvested in shares or debt instruments, which also qualify for SITR Income Tax Relief. It is not necessary for the investor to have made a claim for SITR Income Tax Relief. The gain can arise from any kind of asset, but must arise in the period 6 April 2014 to 5 April 2023. The SITR instrument must be made in the period one year before to three years after the gain arose.

There is no minimum period that the investment must be held but the deferred gain comes back into charge whenever the investment is disposed of or the social enterprise ceases to qualify for SITR.

Will there be a capital gain when I subsequently sell my SITR investment?

If SITR income tax relief has been received (and has not been withdrawn) on the cost of the investment, and the investment is disposed of after it has been held for at least three years, any gain on the investment will be free of Capital Gains Tax (CGT).

How can Moore Kingston Smith assist me?

We at Moore Kingston Smith can provide you with a comprehensive service with the right advice at the right time in order to make sure that an investment is properly structured to attract SITR.

We can review your organisation and the nature of its trade, and apply for advance SITR assurance that the social enterprise is a qualifying entity conducting a qualifying trade.

We can assist with compliance with any information request from HMRC for the purpose of EU state aid regulations.

Note that SITR is subject to withdrawal if either the social enterprise or the investor ceases to meet the eligibility requirements. We can help the company and investors to make sure that these eligibility requirements do not cease to apply.

The above provides a brief summary of SITR relief and should not be relied upon without taking further advice. Please get in touch with our team if you would like to discuss aspects of SITR in greater depth, or other related topics.