



Response from AAT to HM Treasury/BIS consultation on social investment tax relief

September 2013

AAT 140 Aldersgate Street London EC1A 4HY

Introduction

AAT is pleased to respond to this consultation and welcomes the Government's intention to introduce social investment tax relief. With members working for and on behalf of both social enterprise organisations, AAT recognises the need to open up new sources of investment and acknowledges that this relief has the potential to support that objective. It will however be important to recognise the unique features of the sector and to ensure that this are recognised in the detail of regulation.

Our members also work on behalf of the potential investors and for them it will be important that the scheme is easy to understand and simple for them and their advisers to administer.

It is those key areas that we address in the answers to the specific questions raised in the consultation.

We look forward to continue working with Government on the detailed proposals as they emerge following the consultation.

Adam Harper
Director of Professional Development
adam.harper@aat.org.uk
020 7397 3075

Response to Questions

Question 1: Do you agree with the proposed criteria for assessing options for the social enterprise tax relief? Please provide comments as appropriate.

AAT broadly agrees with the criteria for evaluation set out in box 2A. There are two additional comments that we would make.

One is that, in the context of simplicity, the focus of the criterion is on administration. As one of the key targets is that individuals should invest, it is also important that the investment products and potential incentives are simple to understand so that the market is not restricted to professional investors.

Secondly in relation to compliance with state aid rules, while we recognise the need to comply with EC regulation, there is the potential for this to be overly restrictive of the amount of investment and Government should not be shy of maximising any flexibility and seeking appropriate exemption or amendment to regulations.

Question 2: 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.

AAT considers that this definition of social enterprise to be eligible for tax relief is logical and can understand the rationale behind it. One area to be addressed however would be to

ensure that the non-charitable trading subsidiaries of charities, many of which will undertake social enterprise activity, are not excluded from eligibility.

Question 3: 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.

In our view, no.

Question 4: 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?

On balance AAT would consider that the advantages of eligibility would outweigh any disadvantages for charities.

While there is clearly a risk that donations may be displaced into investments, it is our view that the investment products are likely to be designed and set up in competition to other incentivised investments and will look different and appeal to a different market than that looking to make donations via gift aid.

If this initiative is to be successful, it will require engagement of investors who see this as a viable alternative and/or addition to a portfolio and not simply those whose initial motivation is charitable donation.

Question 5: 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?

AAT does not identify any other specific avoidance risks other than that identified of dual relief.

Question 6: 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?

Question 7: 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.

While AAT understands the attraction and benefit of mirroring the features of EIS, in this case we are concerned that a limit based on the number of employees may not be appropriate for the social enterprise sector. This is because there are a number of social enterprises that aim to provide social benefit through the provision of employment opportunities for disadvantaged individuals. If these individuals were included in a calculation of employee numbers this would in many cases take the organisation over the 250 threshold and exclude them from the opportunity of raising finance through this scheme.

In looking at an alternative AAT would consider that the appropriate measure should be one that best identifies an organisation's access to and ability to raise capital. For social enterprises turnover may not be a good measure of this. This is because social enterprises may often have a high turnover but only hold a small amount of assets. This will severely

limit their ability to raise capital. In this context using the gross asset ceiling in EIS of £15 million would seem to be most appropriate.

Question 8: 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.

AAT would argue that the primary issue in relation to targeting and restriction of activities should be the social benefit involved which is best identified through the definition of social enterprises and the fact that they are regulated to provide such benefits. Thus the main guide is likely to be the Charity Commission's definition of public benefit.

Examples might include the operation of social care Housing and the provision of financial services to people experiencing financial exclusion.

These activities are excluded from the existing commercial schemes but are precisely the sort of activities that social enterprises are set up to deliver.

The social enterprise delivery and financial model for such services may mean that they will not have the easy access to financing that might be presumed. Therefore AAT would argue that they should not be excluded from the scheme solely on that presumption.

Question 9: 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?

Question 10: 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?

AAT broadly agrees with the general principles laid down and the summary criteria set out in box 4A. Specific issues will be dealt with in answers to the following questions

Question 11: 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?

AAT agrees that the primary target for this relief must be to generate unsecured funding which is where the main gap currently exists and therefore this rule is appropriate.

In this context AAT believes that simple unsecured loan funding should be available under this tax relief scheme. The return on this would normally be a simple set return not linked to performance. Any rule saying that returns must be linked to performance would exclude this opportunity and we would argue is therefore inappropriate.

Question 12: 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?

While understanding the Government's concern to avoid any manipulation on returns, it is not clear from the proposals what would constitute a commercial rate of return. Any consideration of this must look at the whole package including the benefits obtained from any tax relief. There also needs to be facility to calculate social benefit as part of the overall return.

It may be that it is appropriate to set a maximum return but we do not see the advantages of setting a minimum.

Question 13: Would it be appropriate to allow redeemable shares, or an equivalent for debt-like investments, after the minimum period for investment had been reached?

Yes it would be appropriate to allow redemption or an equivalent for debt like investments after the minimum period.

Question 14: 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.

AAT does not consider that there would be any obvious unintended consequences from the proposed criteria.

Question 15: 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?

AAT understands the Government's desire to move quickly on this and therefore not to fall foul of existing European Commission rules. However we do believe that a ceiling of €200,000 per investee organisation will limit the impact of this scheme.

We would therefore urge the government to look again at this issue. We would not claim to be experts in this field but are aware that a number of organisations have a different interpretation and believe the Government has greater scope than is allowed for in the proposal set down in the consultation..

Question 16: Is a cap of £1 million of investments per investor per year the right amount?

This is appropriate as equivalent to maximum EIS qualifying investment.

Question 17: 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?

AAT supports this proposal

Question 18: 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?

Question 19: 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?

Question 20: 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?

Question 21: Should the performance related interest cap be raised or removed, and what impact would that have on the protection of community assets?

AAT has no specific comment on these issues

Question 22: 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?

AAT has some concern that there may be circumstances where an individual who is a trustee of a charity or have a similar non-beneficial connection would be precluded from benefiting from the relief.

We are not clear that this is an appropriate exclusion, as unlike an investor in a company they will not obtain the dual potential benefit of sharing in any gain from the activity that the investment has supported as well as the tax relief on that investment. We consider that this merits further consideration as such individuals might well be a source for new investment.

Question 23: Would the proposed five year time period for minimum investment be appropriate? If not, what would be a more appropriate investment period and why?

AAT believes that there is a risk that having a longer time period for minimum investment than EIS (three years) might prove a disincentive to investors.

Question 24: 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?

AAT believes that it's important that the rules are equivalent to EIS. These will therefore be well understood by potential investors and their advisers.

Question 25: 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?

Again AAT believes that making investment arrangements as close as possible to existing schemes is most likely to be understood by investors and their agents and therefore encourage take-up. We therefore agree that it would be inappropriate to set a different set of rules for indirect investment in social enterprises.

Question 26: What are the advantages and disadvantages of continuing to operate both CITR and a new tax relief for investment in social enterprise?

AAT understands and supports the Government's ambition to simplify the tax regime and therefore to consider rationalising these two reliefs. However it is important that in doing so the incentive for companies to invest in community interest activities is not lost.

Question 27: 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.

With the exception of our comments in question 22 above in relation to investments by associated individuals, AAT supports the proposed anti-abuse measures and has no additional suggestions.

Questions 28-35

AAT has no comment on these questions. Our primary interest and expertise is in the technical taxation and administration elements of the proposals. There are others better qualified to answer these wider questions about the current scale and potential of the market for social enterprise and investment.

AAT
September 2013