

Briefing document

Social investment tax relief

Introduction

Social Investment Tax Relief (SITR) is a form of tax relief which is available to individuals who make qualifying investments into certain specific types of social enterprises between 6 April 2014 and 5 April 2021 (inclusive). It is modelled on the Enterprise Investment Scheme (EIS), which is intended to help smaller, higher-risk unquoted trading companies to raise capital by offering tax reliefs to potential investors. There are however a number of differences between the two reliefs. This note provides a high-level overview of SITR.

SITR will end in 2021 unless the government legislates otherwise.

Tax reliefs

The tax reliefs which are available on qualifying investments into social enterprises are as follows:

- **Income tax reducer:** The investor is eligible to claim an income tax reduction of up to 30% of the amount invested (maximum income tax reduction of £300,000 per annum).
- **Capital Gains Tax (CGT) exemption:** Any gain on disposal of the social enterprise may be exempt from CGT, provided at least some income tax relief was given when the investment was made and the investment is sold after having been held for at least three years.
- **CGT hold-over:** It is possible to defer gains made on disposal of other assets, up to the amount invested in the qualifying social enterprise. The deferred capital gain will come back into charge, and so CGT will be payable, on disposal of the social enterprise or if the relevant conditions cease to be met.

SITR is available on qualifying investments of up to £1million per annum. Relief can be carried back to the previous tax year.

The investment must be held for at least three years and various conditions must be met throughout the three year period following investment into the social enterprise (or the date trading commenced if this is later). If the relevant conditions are not met throughout this period, income tax relief may be clawed back, the CGT exemption may be lost and deferred gains will come back into charge. Deferred capital gains which come back into charge will be subject to CGT at the prevailing CGT rate at that time.

UK residents and non-UK residents

Income tax relief is available to both UK and non-UK residents. The CGT exemption on disposal is available if income tax relief has been claimed and not withdrawn, though is typically only relevant to UK resident individuals, as non-UK resident individuals are not normally subject to CGT on disposal of shares or loans.

Hold-over relief can only be claimed by individuals who are UK resident both when the gain to be held-over is realised and when the investment is made.

Claiming relief

In order for SITR to be available, it must be claimed no later than the fifth anniversary of the tax return filing deadline for the tax year in which the investment is made. For example, for investments made in 2020/21, the tax return filing deadline is 31 January 2022 and so a SITR claim must be made by 31 January 2027.

If relief is to be carried back and claimed in respect of the tax year before the investment is made, the deadline for making the claim is four years and ten months from the tax year in which the investment is made.

Losses

It may be possible to claim a capital loss, which could be offset against capital gains, if a loss arises on disposal of shares or, in certain cases, on loans. Capital losses are generally calculated by deducting the cost of an asset from the proceeds received, though the capital loss on disposal of a social enterprise may be reduced if income tax relief has been claimed.

In certain circumstances, where various conditions are met and (broadly) EIS relief would have been available on the investment, it may be possible to offset the loss on disposal of shares (but not loans) against income. It should however be noted that tax relief may not be available on all losses realised on disposal of social enterprises, particularly where investments have been made by way of loan.

Qualifying investments

It is possible to claim SITR on subscriptions for shares in and on making certain unsecured loans to social enterprises. Relief is available on investments into the following:

- Community Interest Companies. These are limited companies which were created for the use of people who want to conduct a business or other activity for the benefit of the community and not purely for private profit. They are subject to lighter regulation than charities, but, other than SITR, do not benefit from any particular tax reliefs;
- Community Benefit Societies. These are a specific type of Industrial and Provident Society which operate for the benefit of the community and are regulated by the Financial Conduct Authority. The rules of the society must not allow profits or assets to be distributed to members. Depending on the purpose of the society, it may be eligible to register as a charity, and so benefit from certain exemptions from tax;
- Accredited social impact contractors. These are companies which have entered into arrangements with the government by which they receive compensation in exchange for achieving certain socially desirable outcomes (such arrangements are called 'social impact bonds');
- Charities. Charities must be registered with an appropriate body. For charities based in England and Wales, the charity must be registered with the Charity Commission;
- Any other body prescribed by an order made by the Treasury.

Broadly, in order to be eligible for SITR the social enterprise must be trading on a commercial basis with a view to realisation of profit. Charities do not need to be trading per se, but must carry on a qualifying trade for which the funds raised through SITR will be used. Specific rules apply to accredited social impact contractors.

A number of trades are not eligible for SITR, including property development, certain financial activities and, since 6 April 2017, operating or managing residential care or nursing homes.

Key conditions

Various conditions must be met by both the investor and by the social enterprise in order for SITR to be available. The key conditions are summarised below. A number of other conditions must also be met and appropriate advice should be taken before making an investment with the intention of qualifying for SITR.

The investor and the investment

- The investor and his or her associates must not be employees or paid directors. Directors are able to be reimbursed for reasonable business expenses and there are rules allowing reasonable remuneration from the social enterprise in certain cases, which are akin to the EIS rules for business angels. Associates include spouses, civil partners, parents and children.
- The investor must not own more than 30% of (i) ordinary share capital, (ii) loan capital or (iii) voting rights. Interests held by associates are taken into account when determining whether or not the 30% test is breached. 'Associates' include spouses, civil partners, ancestors (such as parents) and lineal descendants (such as children).
- The investor must not have a guaranteed level of return, nor can arrangements be in place to realise the investment at the date the investment is made. The investor is able to receive a commercial rate of interest on loans made to the social enterprise, but, in general, if the investor receives value from the social enterprise, such as on disposal of shares or if the loan to the social enterprise is repaid, income tax relief will be wholly or partially withdrawn (depending on the amounts involved).
- Any shares must rank beneath debts of the company on a winding up, other than debts on which SITR has been claimed, and must not rank above any other class of shares.

- Loans must be unsecured, must not rank above any secured debts of the social enterprise and must rank equally with the lowest ranking class of shares.
- The investor must not have claimed income tax relief under EIS, Seed EIS or community investment tax relief on the same investment. The investor must also not have claimed EIS capital gains deferral relief or Seed EIS re-investment relief on the same investment.

The social enterprise

- Broadly, social enterprises are able to raise up to £1.5million over their lifetime through SITR. SITR is targeted at social enterprises that are less than seven years old, though older enterprises may be able to raise funds in limited circumstances, subject to meeting certain conditions.
- The social enterprise must not have more than £15million gross assets immediately before the investment or more than £16million gross assets immediately after the investment.
- The social enterprise must not be a quoted company and there must be no arrangements in place for it to become a quoted company. AIM listed shares are considered to be unquoted for these purposes.
- All of the money raised on which SITR is claimed must be used for qualifying purposes within 28 months of the date of investment, or 24 months in the case of an accredited social impact contractor.

Commercial issues

Whilst the proposed tax reliefs are attractive, they are only one of a number of aspects of which a potential investor should be aware. Investments into qualifying social enterprises are likely to carry significant investment risk and so appropriate investment advice is essential.

It may be difficult to sell an interest in a social enterprise, particularly as SITR is only available on subscription for new shares and new loans directly to the enterprise. This means there may be relatively few purchasers of shares or loans in qualifying social enterprises.

Investments into social enterprises should therefore be considered as part of your wider investment and/or philanthropic strategies.

Indirect investments

SITR is only available on investments which are made by individuals directly into social enterprises. In the 2015 Budget the government announced that they will introduce Social Venture Capital Trusts (VCTs), modelled on the existing scheme for commercial trading companies and subject to EU state aid approval. The intention was for income tax relief to be available at a rate of 30% of the amount invested.

It was announced that legislation would be introduced in a 'future Finance Bill', but no further details have been published since the Budget 2015 announcement.

Find out more...

This note reflects the law in force as at 9 April 2020. Please be aware that this note does not cover all aspects of this subject. To find out more about any aspect of the above, please discuss with your usual Deloitte contact. If you do not have a usual contact, please contact Michelle Robinson (michellerobinson@deloitte.co.uk). For further information visit our website at www.deloitte.co.uk.

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