

**Power to Change response to consultation paper on Social Investment Tax Relief**

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**About us**

Power to Change is an independent charitable trust set up in January 2015 to grow and support community business across England. Over ten years, with a £150 million endowment from the Community Lottery Fund, Power to Change is supporting community businesses to create better places across England. We want to support people to take action to address local challenges, enabling them to control vital assets and services that might otherwise disappear, or start new businesses themselves in response to local needs. At the heart of our vision is the devolution of power to local communities. We believe that putting business in community hands makes places better.

In this response, we have focused on questions one to eight, ten and 14. We would be very happy to discuss further any of the points raised here.

## **Summary of recommendations**

In this submission we have sought to respond with evidence-based answers wherever possible. In this submission we make the following policy recommendations:

### **Question 5**

Set a clear policy objective for SITR to enable more social investment on the part of engaged stakeholder/beneficiary communities.

### **Question 6**

Create a Social Entrepreneurs' Relief by removing the 'no employee investors requirement' from SITR.

### **Question 8**

Increase the lifetime limit to that set for EIS.

### **Question 14**

Remove the rules under Section 257MJ of the Income Tax Act 2007 which make investments supporting activities that HMRC would not consider to be a 'trade' ineligible for SITR.

Make the community ownership and leasing of assets eligible for SITR.

Remove renewable energy generation and export from the excluded activities list for SITR.

Remove production of primary agricultural products from the excluded activities list for SITR.

Make property development by an asset locked community benefit society eligible for SITR.

Create a 50 percent tax relief for seed social investments equivalent to SEIS ('Seed SITR').

Remove the seven-year age limit for businesses offering SITR to investors.

Develop a scheme whereby social investors can 'gift' the value of their SITR to the business they are investing in.

**Question 1: If you are a social enterprise, are you interested in or planning to scale up? How do you intend to achieve this and how much do you hope to raise in investment?**

- 1.1 Although we are not ourselves a social enterprise, we would draw your attention to a recent report into the community business market published by our Research Institute.<sup>1</sup> This found that 76 per cent of community businesses reported attracting investment to expand and around 70 per cent securing new contracts and diversifying into new markets.

**Question 2: Other than individual investors, what sources of finance do trading social enterprises seek and acquire?**

- 2.1 Evidence suggests that, for community businesses, members drawn from communities of place and interest are the most significant source of finance. They finance their community businesses through member share capital (most notably Community Shares), by buying bonds, making loans to the business, paying subscriptions and making donations. Most of these transactions should be considered by government as finance from ‘individual investors’, albeit investors that are ‘inside’ the social enterprise. Other than this, the most significant sources of finance for community businesses are grants and debt from institutions, with approaches like factoring, supplier credit and member donations also playing a role.<sup>2</sup>
- 2.2 Research from Bailey et al. offers an overview of how the community business model in England is financed: in the early years, businesses depend heavily on a variety of subsidies and public sector grants and loans.<sup>3</sup> Local authorities often provide relatively short leases on below-market rents on land and buildings. As the businesses prove their viability, leases are extended and additional assets transferred. In addition, businesses also make good use of other public sector funding sources: European Regional Development Fund, Local Enterprise Partnerships and third sector sources such as the Heritage Lottery Fund and Power to Change.
- 2.3 Where necessary, commercial loans are negotiated but only on the basis of well-constructed business plans and backed by property (or other assets) offered as collateral. Trading projects often also enable other services to be provided. Bailey et al. describe “a complex but balanced business model.”<sup>4</sup> Trading opportunities tend to be exploited where they fit with the core objectives and where they generate a

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<sup>1</sup> [Community business in England: Learning from the Power to Change Research Institute 2016-17 \(2018\)](#)

<sup>2</sup> Ibid

<sup>3</sup> [An assessment of community-based social enterprises in three European countries \(2018\)](#)

<sup>4</sup> Ibid

surplus which enables the non-trading activities to be undertaken or expanded.

- 2.4 We would draw your attention to the small but strategically promising role that institutional investment and financing is starting to play. Power to Change is one such funder, making match-investments in co-operatives and community businesses through our Community Shares Booster Programme, which is delivered by the Community Shares Unit, a partnership between Co-operatives UK and Locality. Community Development Finance Institutions, such as Key Fund and Co-operative and Community Finance can also play a role in this space.

#### **The Community Shares Booster Programme**

The Community Shares Booster Programme, a £3 million programme funded by Power to Change and delivered by the Community Shares Unit, aims to support societies that can demonstrate high levels of community impact, innovation and engagement. The programme offers up to £100,000 match funding in societies that can demonstrate higher than average levels of community impact, innovation and engagement.

This investment is in the form of equity held on equal terms with other community shareholders, many of whom should be eligible to use the relief on their investments. So far, the programme has invested over £1.2 million alongside over 5,000 individual investors in communities, leveraging a further £2.7 million.

### **Question 3: How difficult or easy is SITR to access for social enterprises?**

- 3.1 For the majority of social enterprises, accessing SITR is very difficult because they would need to issue debt or equity securities to investors, which is neither necessary nor appropriate for most of them. Moreover, a significant minority of community businesses operate business models that do not support the servicing of bonds or dividends, for example by relying heavily on grants and other non-trading income. While government research in 2017 found that 39 per cent of social enterprises with growth expectation planned to approach external finance providers, the same research also found that the main sources of finance sought by social enterprises were bank overdrafts, credit cards and loans.<sup>5</sup>
- 3.2 Raising capital from investors can be complex, costly, time-consuming and daunting. If not done appropriately it also carries a risk that the social purpose and impact of the enterprise could be undermined. There are legal and technical barriers to some community businesses making a 'public' offer of securities.

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<sup>5</sup> [DCMS and BEIS 'Social Enterprise: Market Trends 2017' \(2017\)](#)

- 3.3 Within the social economy, and even more so within the population of SITR-eligible organisations, the pool of likely businesses for whom it is necessary and appropriate to issue debt or equity securities to investors is limited to the following:
- community benefit societies using a model for ownership and control of revenue generating assets and enterprise, making use of Community Shares and potentially community debt instruments
  - Public Service Mutuals, either community interest companies or community benefit societies, issuing debt instruments
  - Other comparatively large community interest companies, charities or community benefit societies
- 3.4 This is backed up by the evidence to date on actual SITR use compiled by Big Society Capital.<sup>6</sup>

**Question 4: What are the factors that lead to a successful trading social enterprise?**

- 4.1 To some extent, the factors are little different from businesses in general. Success depends on:
- An effective, efficient value creation model - using inputs efficiently to produce commercial value and social impacts, in a way that is 'competitive' in the relevant markets
  - Having the right capital and investment in that capital – including physical, human and social capital
  - Maximising the value added in relationships with, and participation of, workers, customers, the community at large
  - Having effective systems for decision making, trouble shooting, organisational learning and renewal
- 4.2 To deliver on a social mission through the operation of a successful business model, social enterprises and community businesses tend to approach these factors differently from 'for-profit-only' businesses, in varied ways. And where the social enterprise is also a co-operative, distinct approaches to social value creation, capital, investment, stakeholder relationships and governance are essential components.

**Question 5: Do you think social enterprises need private investment and for what purposes?**

- 5.1 The Power to Change Research Institute has identified challenges relating to finance (access, cost and suitability) as a barrier to success.<sup>7</sup> In addition, we believe

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<sup>6</sup> <https://www.bigsocietycapital.com/get-sitr/social-investment-tax-relief-deals-database>

<sup>7</sup> [Community business in England: Learning from the Power to Change Research Institute 2016-17 \(2017\)](#)

community businesses, like most businesses, would benefit from greater investment in productivity enhancements.

- 5.2 That said, the potential for the types of private investment that could draw SITR should not be overstated. A significant number of community businesses do not operate in capital intensive industries and can meet their capital needs through the contributions of members, bank lending and through retained earnings. However, over time some community businesses do develop capital needs that their retained earnings and borrowing cannot meet and at this point they may well require private investment.
- 5.3 Furthermore, there are community businesses that have bigger capital requirements early on. For example, those seeking to make extensive use of land and premises must fill a significant finance gap at the beginning. For some community businesses, the community benefit society model can itself be a vehicle for raising finance by crowdfunding it from a larger pool of members. This is even the case when a lot of capital is needed from the beginning. The key finance model here is Community Shares, which has developed into a £100 million market since 2009 and has led to broad community ownership of land, property and renewable energy.

#### **Question 6: Is tax the most appropriate government lever for supporting funding for social enterprises?**

- 6.1 This depends on specifics such as the where a business is in the life cycle, what activities it undertakes and what the related capital needs are. A tax relief such as SITR is a very appropriate lever for incentivising the allocation of investment towards social enterprises that:
- have a business model that is likely to generate a revenue over the long term
  - need to raise capital from investors and use a structure that is suited to doing so, such as a community benefit society using Community Shares
  - offer investment prospects that are less attractive in narrow commercial terms than those offered by non-social enterprises undertaking similar activities

#### Community Investment ISAs

- 6.2 We also see significant new opportunities for people to opt for some of their savings to be invested in community businesses with tax benefits. This follows very welcome action in 2016 to make bonds issued by co-operative and community benefit societies eligible for the Innovative Finance ISA. To unlock this opportunity government could help to convene community businesses, crowdfunding websites and socially-purposed financial institutions such as credit unions, to explore the potential of developing 'Community Investment ISAs'.

#### Enterprise-focused tax incentives

- 6.3 We also ask government to consider the potential for using the tax lever not to incentivise the behaviours of external investors, which is only really useful for some particular subsets of social enterprise, but to incentivise the behaviours of social enterprises themselves.

- 6.4 A new tax incentive could encourage some of the profits created by social enterprises to be pooled in independent, mission- and asset-locked funds, to be put to work at greater scale for greater impact, to fund enterprise development services and to provide more accessible finance for social enterprises. Government could offer a corporation tax relief on profits paid into such institutions.
- 6.5 Crucially, the targeting and eligibility criteria for such a relief would regulate the institutions receiving the profits, rather than the enterprise, so this could be used to incentivise the behaviour of any business that chose to use its profits in this way, regardless of legal form or corporate purpose. Eligible receivers would need to be mission- and asset-locked social enterprises in their own right, committed to using funds to support things like co-operative development, with an appropriate degree of operational independence from the businesses that provide these funds.

#### Non-tax support for start-ups

- 6.6 Evidence provided elsewhere in this response suggests that government should also make sure its interventions in start-up and growth finance, such as the New Enterprise Allowance and Start-Up Loans respond to the particular needs of social enterprises. While there are no specific barriers to using these funding sources to help establish community businesses, both the financing and the accompanying enterprise advice have been designed with 'for-profit-only' lone entrepreneurship in mind. For example, Start-up Loans are made to individuals not corporations and business partners must apply for and be approved for loans separately.

#### **Question 7: What criteria would be best measure of success for SITR?**

- 7.1 Success should be measured by the extent to which SITR addresses the market failure it was created in response to. As stated in the consultation document, SITR was created because insufficient investment is allocated to social enterprises, because in narrow commercial terms these businesses very often must offer less attractive investment prospects than non-social enterprises, due to the primacy of their social purpose and their organisational and legal structures.
- 7.2 So, SITR should be judged as successful by the extent to which it incentivises investment that generates a social as well as a financial return, where the capital might otherwise have been allocated to ventures that are a more attractive prospect in narrow commercial terms, or not invested at all. On this last point, we believe one measure of success should be the extent to which SITR enables a 'democratisation' of social investment among people who might otherwise not invest at all.
- 7.3 Key indicators of success might include:
- Increase in the volume and scale of social investments supported by SITR
  - Qualitative and quantitative evidence of increased social returns on investment supported by SITR
  - Increased participation in social investment by people from outside the traditional demographics of wealth, status and background supported by SITR

- Increased volume and value of assets and enterprises in community ownership, delivering community benefits supported by SITR
- 7.4 We urge government to be realistic and patient when setting aspirations for indicators such as these. As stated, the population of SITR-eligible enterprises that might realistically issue debt and equity instruments to investors is small and growing only steadily. And this is further limited by the current restrictions within SITR on ‘trade’ and excluded activity (see our response to **Question 14**).

**Question 8: Is the SITR limit of £1.5 million appropriate?**

The lifetime limit of £1.5 million is inappropriate and undermines the ability of SITR to meet its policy objectives. The disparity with the value of reliefs available for non-social investments via SEIS, EIS and VCT further intensifies the market failure SITR was intended to address, by disincentivising the allocation of capital to investments that generate social return but are less attractive in narrow commercial terms.

**Recommendation: Increase the lifetime limit to that set for EIS**

**Question 10: Would you invest in social enterprise without tax relief?**

- 10.1 We would like to draw government’s attention to data that sheds some light on the impact of tax reliefs on the behaviours of community businesses and their investors.

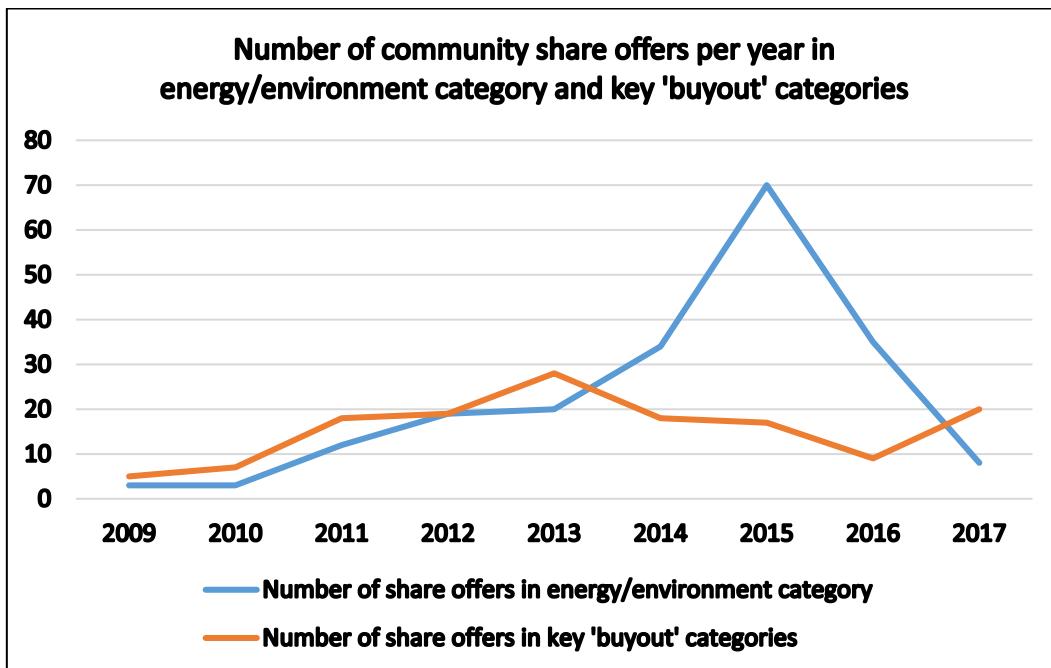
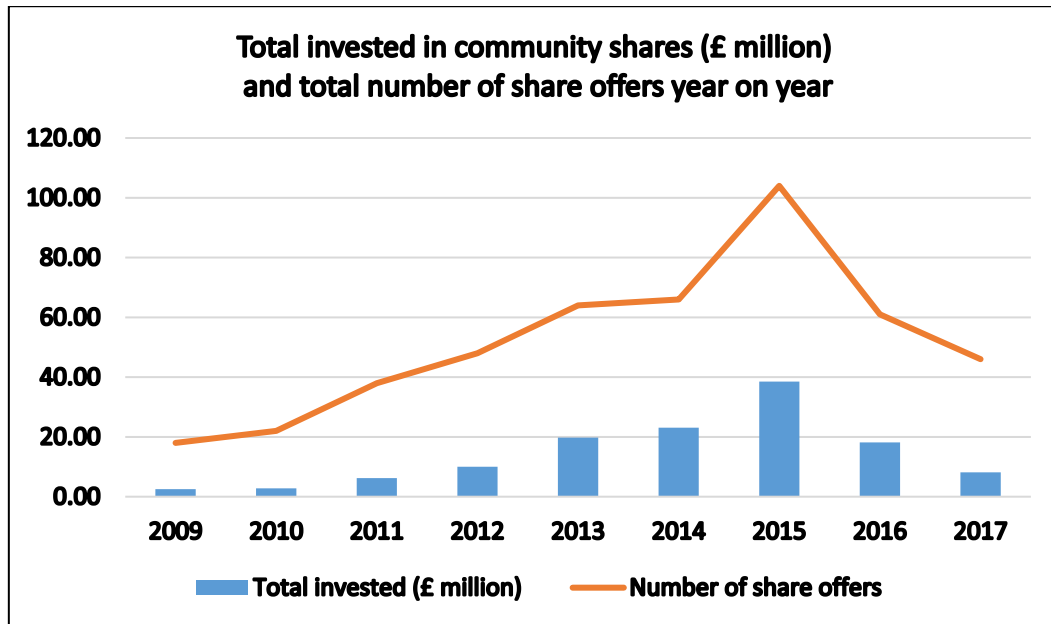
Community Shares Unit data

- 10.2 With Locality and a small team of experts, Co-operatives UK runs the Community Shares Unit, which among other things collates data on community share offers. Trends in recent years are useful indicators of how recent changes in tax relief eligibility have impacted on activity.
- 10.3 The two biggest changes in tax relief support for Community Shares in recent years have been:
- a loss of EIS for energy generation from October 2015 (and exclusion from expanded SITR)
  - a loss of EIS for ‘buyouts’ of businesses and assets from November 2015 (and similar exclusions in the expanded SITR)
- 10.4 These withdrawals had a marked impact on community shares activity. Total annual investment in community shares declined from a £38.5 million peak in 2015 to just £8.1 million in 2017. In line with this, the total number of share offers each year declined from a 2015 peak of 102 to just 54 in 2017.<sup>8</sup>

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<sup>8</sup> [Community Shares Unit ‘Community Shares Unit: Open Data Explorer’ \(2018\)](#)





- 10.5 The number of community share offers in categories key to the 'community buyout' of businesses and business assets (community retail and pubs and brewing) peaked in 2013. The biggest drop (47 per cent) occurred in 2016, following the withdrawal of EIS for the 'community buyout' of businesses and business assets in November 2015, though the downward trend clearly began before this tax change and has since begun to pick up.
- 10.6 The total number of community share offers in the energy and environment category dropped from a peak of 70 in 2015 to 8 in 2017. Taken alongside evidence we gathered in 2014 on the role of EIS in community energy investment (see below) we believe there has been a link between the loss of EIS and the dramatic fall in community energy share offers. However, this trend must also be understood within the context of a potentially much more significant non-tax development: the effective

end of predictable, viable electricity generation income for community energy schemes, as a result of the dramatic Feed-in Tariff wind-down from February 2016 onwards. In 2018 a survey by Community Energy England established that the Feed-In Tariff wind-down had been the leading cause of stalled community energy projects in 2016-17.<sup>9</sup>

10.7 But evidences leads us to think that the loss of EIS will have contributed to the drop off in renewable energy-related community share activity. We believe the loss of EIS may well have *reduced investment* in this part of the community business landscape even in a scenario where the Feed-In Tariff had continued. This evidence comes in the form of community energy investor survey data we gathered in 2014.

Community energy investor survey data

10.8 In 2014 Co-operatives UK sought to understand how the ability to claim EIS had influenced people’s decisions to invest in community energy schemes. The results suggested that, all other things being equal, the lack of tax reliefs on investment returns significantly reduced levels of social investment in this sector.

10.9 Co-operatives UK surveyed the sector and 1,056 individual investor-members of at least 57 independent community energy societies completed an online questionnaire. Of these, 883 had benefited from EIS relief. Asked what they would have done if EIS had not been available 37 per cent of respondents (who had benefited from EIS) told us they would have invested less. When asked what lower amount they might have invested, responses averaged out at a 45 per cent reduction. A further 38 per cent of investors told us that without EIS they would not have invested at all.

10.10 The table below shows the average investment amounts and the total investment represented by each of the three respondent groups mentioned in paragraph. The data suggested that in real monetary terms the absence of EIS would have **resulted in a 59 per cent loss** in community investment.

	Investors		Average investment	
<b>Not invested at all</b>	338	38%	£4,303	34%
<b>Invested less</b>	327	37%	£6,101	48%
<b>Invested the same amount</b>	218	25%	£2,385	19%

10.11 In the same survey Co-operatives UK asked what impact a future without any investment tax relief might have on future decisions to invest. The responses were as follows:

- 22 per cent said it would make no difference
- 40 per cent said they would invest less
- 38 per cent said they would be less likely to invest at all

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<sup>9</sup> [Community Energy England 'State of the Sector Report 2018' \(2018\)](#)

10.12 The results of the survey also showed that EIS had the least impact on the smallest investments. Of those who said they would have invested the same amount even without EIS, 61 per cent invested under £2,000. Of those who invested under £500, 52 per cent indicated that EIS had no impact. However, the results show the role of EIS on decision making growing rapidly as the investments increase in size. So by contrast 74 per cent of those who invested between £1,000 and £1,499 said that without EIS they would either have invested less or not invested at all.

### Conclusion

10.13 The data suggests that tax reliefs can contribute to making it more likely that people make social investments, and more likely that they will invest in greater amounts. We believe the most significant impact of tax reliefs on investors is how they encourage them to invest more in a social enterprise than they might do otherwise. As the consultation document rightly says, social investments often offer the prospect of comparatively low financial returns for the level of risk involved. The social return on investment can often make up for this, especially in the context of community investment, where lots of investors have a close communal stake in the social impact that will be generated. But a tax relief can further make up for lower returns and thus incentivise an even greater allocation of capital to social investments.

10.14 Further, for newer community businesses where the investors will be asked to be more patient than when investing in a latter stage growth and consolidation businesses, a 'Seed' SITR scheme – similar to the Seed Enterprise Investment Scheme – where the relief offered would be 50 per cent is something that could contribute to making it more likely that people make social investments, and more likely that they will invest in greater amounts.

### **Question 14: As an investor, enterprise or interested party, do you have a view as to why the take up of SITR has been less than expected?**

14.1 As we said in response to **Question 3**, the number of SITR-eligible social enterprises (community benefit society, community interest company, charity) in the UK that are likely or able to raise money from investors by issuing debt or equity instruments is quite small. To reiterate, the majority of social enterprises, including co-operatives and community businesses, are very small or micro-businesses.<sup>10 11</sup> Furthermore a significant minority operate business models that do not support the servicing of bonds or dividends, for example by relying heavily on grants and other non-trading income.<sup>12</sup>

14.2 Raising capital from investors can be complex, costly, time consuming and daunting. If not done appropriately it also carries a risk that the social purpose and impact of the enterprise could be undermined.

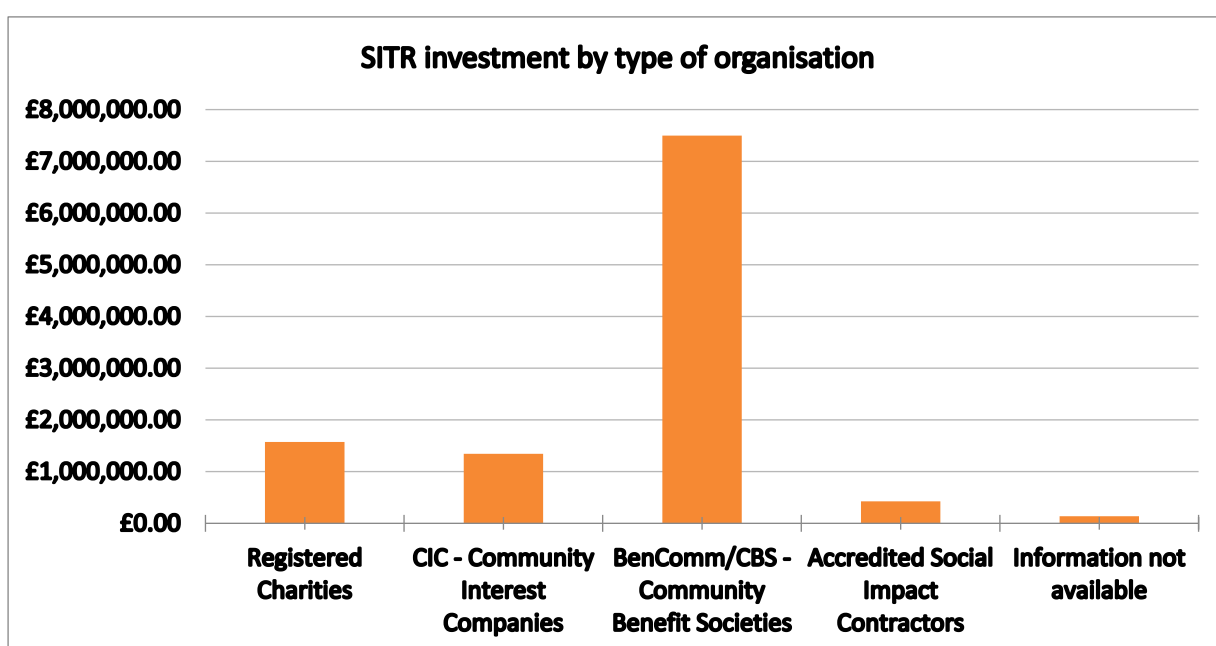
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<sup>10</sup> SEUK [reported in 2017](#) that 86% of social enterprises had a turnover under £1 million

<sup>11</sup> [Co-operatives UK 'Co-operative Economy Open Data'](#)

<sup>12</sup> SEUK [reported in 2017](#) that a quarter of social enterprises earn more than 75% of their income from trading

- 14.3 Within the social economy, and even more so within the population of SITR-eligible organisations, the pool of businesses for whom it is necessary and appropriate to issue debt or equity securities to investors is largely limited to community benefit societies using a model for revenue generating assets and enterprise, using Community Shares and community bonds. This is why, according to Big Society Capital's SITR open data, community benefit societies account for by far the largest portion of SITR use to date, both terms of volume and value.<sup>13</sup>
- 14.4 Community benefit societies and community shares account for *all* of the £4.8 million of equity raised through SITR. And while we really must stress the unmatched success of community shares in raising full risk equity finance for social enterprises, community benefit societies also account for 45 per cent of debt raised through SITR and on average have raised debt investment through SITR in larger amounts.<sup>14</sup>



*Data from Big Society Capital*

- 14.5 This limitation in the pool of social enterprises likely to use SITR is compounded by the current restrictions within SITR on 'non-trade activity' and other excluded activities. A significant number of community benefit societies using Community Shares undertake activities that are excluded under SITR rules, for example because they develop property, own land and assets that they lease out, or generate and export renewable energy.
- 14.6 These restrictions stop SITR from supporting investment in a substantial subset of social enterprises that have in recent years made a success of issuing equity and debt to investors. We firmly believe these restrictions undermine the ability of SITR to

<sup>13</sup> <https://www.bigsocietycapital.com/get-sitr/social-investment-tax-relief-deals-database>

<sup>14</sup> Ibid

meet its core policy objective of incentivising more investment that generates a social return but is less attractive in narrow commercial terms.

- 14.7 Before going on to explain these points in more detail, we believe it is important to set out the key features of Community Shares and the unique share capital and special corporate form that underpins them. And we also believe it is important to specify some distinct developmental challenges experienced by community businesses. Together these factors make these social investments even less attractive in narrow commercial terms, further intensifying the market failure that SITR was created to respond to.

### **Features of Community Shares**

Community Shares use a form of equity unique to co-operative and community benefit societies, called withdrawable share capital. Both the corporate form and the share capital in particular have features that are particularly well-suited to patient, mission-aligned investment in community business, but which can also therefore be less attractive in narrow commercial terms.

Withdrawable share capital provides a form of equity for the business under FRS102 accounting standards, yet unlike company equity it can be withdrawn by the shareholder at par value, under conditions controlled by the society, providing a simple non-market exit. Community benefit societies almost always impose a fixed term of a number of years during which withdrawal is prohibited and then limit the total combined amount investors can withdraw each year for longer still.

These shares also do not carry a right to a dividend, but instead shareholders can receive a steady (though not guaranteed or fixed) rate of interest to provide a long-term return on investment, that is enough to obtain and retain the capital of patient, mission-aligned members, but no more than this.

Because of the limitation of withdrawal at par value (or below par, should the business experience difficulties) and the community benefit society asset lock, Community Shares do not give shareholders a right to the underlying assets of the society. Thus Community Shares, unlike company shares, do not include any possibility for capital appreciation - for investors to make capital gains from sale of their shares - or sale of the business or its assets. This distinction is especially important when considering how a Community Shares investment offer in property development, for example, might compare with non-social enterprise investment in property development. It is easy to see how the market failure SITR was created in response to would apply.

Lastly, in a community benefit society, shareholders have one vote no matter how many shares they have. Control of the society is democratic rather than being determined by individuals' financial interest in the business.

All this makes community shares perfectly suited to investment in community businesses. But the limited return on investment, which is indeed significantly limited when the absence of any capital gain is taken into account, the fact that withdrawal is not permitted for many years, and the lack of investment-linked control, all makes for a comparatively unattractive investment opportunity in narrow commercial terms.

- 14.8 Community businesses raising investment to develop or acquire assets or enterprise come up against particular challenges including: tough and uncertain negotiations

with the owners of assets and businesses; competition against larger, better-resourced and better-connected private sector actors looking to acquire sites and assets for private gain; uncertainty about a community's investment appetite and capacity; steep learning curves for community volunteers; and scepticism among key stakeholders (private, public, civil society) unfamiliar with community businesses.

- 14.9 Communities cannot escape these difficulties or mitigate uncertainties, risks and losses by running multiple projects in varied locations, as other private sector actors seeking investment can. Most of these community businesses raising investment represent a start up from scratch, with all the uncertainty that inevitably comes from any new venture.
- 14.10 Furthermore, the majority of community investors start off unfamiliar with investment and business ownership. For them, such activity is part of a journey of self-efficacy and learning and is not perceivably low risk. Perceived risk for community investors must be placed within the context of people pooling often scarce resources for a social purpose, for low returns with no prospect of capital gain. As the evidence we discussed in our response to **Question 10** suggests, a tax relief tends to help encourage their participation.

#### Non-trade activity

- 14.11 Section 257MJ of the Income Tax Act 2007 rules that investments supporting activities that HMRC would not consider to be a 'trade' are ineligible for SITR. We believe the importing of the concept of a 'trade' from EIS is problematic and undermines the ability of SITR to meet its core policy objectives.
- 14.12 We understand and support the rationale behind requiring EIS-eligible investments to be in businesses that carry on a 'trade', as this helps to target EIS in ways that support the underlying policy objectives: incentivising investment in new, risky, innovative, growth-oriented businesses. But we ask government to consider whether this rationale makes sense for SITR, given that SITR has different policy objectives: to incentivise more capital to be allocated to investments that generate a social return but are less attractive in narrow commercial terms.
- 14.13 When it comes to addressing this market failure, it is to a large extent irrelevant whether the investment will fund a risky trade or not. We offer government the example below to illustrate what we accept is a challenging argument to make.

#### **Investments in land ownership and leasing**

Consider two potential investments:

- **Investment A:** a 'for-profit-only' venture is raising investment to acquire land in a gentrifying neighbourhood, which it expects to lease to mid-market commercial property developers. Investors are offered the prospect of both strong yields year on year and a significant capital gain when the uplift in asset value is captured on exit.
- **Investment B:** a community benefit society is offering community shares and bonds to fund the acquisition of land in the same neighbourhood, which it will keep in community ownership for community benefit in perpetuity, for the sole use of

affordable, community-led housing developments for poorer residents. Investors are offered a modest yield year on year, limited liquidity and no possibility of capital gain from any uplift in asset value.

Neither investment is in a 'trade' as HMRC would see it. The market failure SITR is meant to address will result in more capital being allocated to Investment A than Investment B. The significant social return on Investment B will encourage some people to invest but people of are less likely to invest, or are likely to invest less, in Investment B.

In the current land and property market, the venture behind Investment A is likely to go ahead. But an under-allocated of capital to Investment B does more than reduce its social return, it makes it much less likely that the venture will go ahead at all.

If Investment B could benefit from SITR, then more capital would be allocated to it and the social return on this investment would more likely be realised.

**Recommendation 1: Remove the rules under Section 257MJ of the Income Tax Act 2007 that make investments supporting activities that HMRC would not consider to be a 'trade' ineligible for SITR.**

14.14 Further, there are a number of 'exclusions' in the SITR rules that limit its utility for supporting high-impact social investments, notably: leasing activities; property development; agriculture; generating energy like electricity or heat; exporting electricity.

14.15 It is notable these excluded activities mirror those for EIS and, as we understand it, the rationale for the exclusions has been imported from EIS as well: investments in these activities are not risky enough to warrant a tax relief because of prevailing market conditions and/or the existence of other public support. As with non-trading activity, we question whether this rationale makes sense for SITR, given that SITR has different policy objectives: to incentivise more capital to be allocated to investments that generate a social return but are less attractive in narrow commercial terms.

Leasing activity

14.16 Leasing forms a substantial subset of the community ownership sector. It is very common for assets, such as a village shop listed as an Asset of Community Value under the Localism Act, to be acquired through a 'community buyout' using Community Shares and ultimately controlled by the community for long-term community benefit, but then leased to a third party to run the business day to day. Often, ownership and leasing is critical the realising of community benefit, for example when commercial property is brought into community ownership and control as a way for local people to shape the evolution of their high street. To take one final example, a land trust used Community Shares to fund the acquisition of agricultural land which is then leased to small, low impact farm businesses as a means of enabling the development of a viable low impact agricultural base. In all these cases leasing is a significant part of the value creation model through which community benefit can be realised on a commercial basis.

- 14.17 Given the limited returns on investment, the absence of any possibility of capital gain and the lack of investment-linked control, the market failure that SITR was created in response to would certainly apply in leasing-based business models.
- 14.18 Arrangements in which an asset locked community benefit society owns and ultimately controls land, property or facilities for community benefit, which it then rents to third parties, in whole or in part, should be made eligible for SITR.

**Recommendation 2: Remove leasing activities from the excluded activities list for SITR.**

*Generating energy and exporting electricity*

- 14.19 Community energy is one of social investment's biggest success stories in terms of the scale of investment, number of enterprises, broadening of investor demography and social impact. It was initially the case that community-owned renewables energy would be an activity included within the scope of the relief. This was subsequently removed.
- 14.20 As well as the environmental benefit from renewable energy generation, community energy schemes have given ordinary people and their local communities a stake and a say in the renewable energy transition. Surpluses have then been reinvested in other interventions such as energy efficiency improvements, education initiatives or low carbon transport. Beyond environmental impact, many community energy schemes use surpluses to reduce fuel poverty. And all represent a revenue-generating model that produces funds that are controlled democratically by communities and committed for communal benefit.<sup>15</sup>
- 14.21 The rationale for excluding energy generation and export from EIS, SEIS and SITR has been that other government interventions have created a renewables sector that offers low risk investment opportunities with predictable returns. But since 2015 government has dramatically reduced incentives and subsidies for onshore renewable generation, while also making the planning environment much more hostile. This means that smaller scale, community-led renewable energy schemes are comparatively risky and challenging undertakings.
- 14.22 More importantly, regardless of whether there is government support for small-scale renewable energy generation, community energy schemes using community shares must offer investment opportunities that are less attractive in narrow commercial terms than other renewable energy investment offers (see our points on community shares and community business discussed above). Thus the market failure that leads more capital to be allocated to non-social investments applies regardless.

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<sup>15</sup> [https://communityenergyengland.org/files/document/51/1499247266\\_CommunityEnergy-StateoftheSectorReport.pdf](https://communityenergyengland.org/files/document/51/1499247266_CommunityEnergy-StateoftheSectorReport.pdf)



**Recommendation 3: Remove renewable energy generation and export from the excluded activities list for SITR.**

14.23 We understand that government grew concerned that the ‘community energy carve out’ (that allowed community energy schemes to continue benefiting from EIS from 2012 to 2015) came to be misused for contrived tax planning purposes, rather than to support genuine community investment in renewable energy deployment.

14.24 We believe this could be guarded against by restricting SITR eligibility to social enterprises and community businesses with the following characteristics:

- a community benefit society raising money through a Community Share and/or bond issue
- where there are two classes of membership and shareholding contained in the society’s rules, approved by the FCA:
  - community members who live within a defined geographic area with full voting rights and control over ongoing community activities
  - generalist social investors with limited voting rights

**Agricultural activity**

14.25 Investments in agricultural social enterprises are ineligible for EIS because of the existence of direct support for farm businesses through the Common Agricultural Policy (CAP). This is understandable as it helps ensure EIS meets its policy objective. We ask government to consider whether the exclusion helps SITR to archive its rather different policy objective.

14.26 There is an ecologically sustainable, vibrant, innovative, and potentially very significant agricultural social enterprise sector in the UK, most notably in ‘community agriculture’.<sup>16</sup> More investment could scale up and mainstream many of the solutions that are urgently needed to produce the food we need without inflicting further damage on our natural environment.<sup>17</sup>

14.27 At the very least, we ask that SITR be made available for community businesses operating on sub 5 hectare sites, because these are not eligible for direct support under the CAP. But we also ask government to consider that, given the choice between an investment in ‘for-profit-only’ horticultural business receiving direct support under the CAP and a horticultural social enterprise receiving the same direct support under the CAP, the market failure SITR was created to respond to will lead more capital to be allocated to the former.

**Recommendation 4: Remove production of primary agricultural products from the excluded activities list for SITR**

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<sup>16</sup> Soil Association [‘The impact of community supported agriculture’ \(2011\)](#)

<sup>17</sup> <https://trilliuminvest.com/wp-content/uploads/2017/05/Investing-in-Sustainable-Food-and-Agriculture.pdf>

### Property development activity

- 14.28 The rationale for excluding investments in property development from EIS / SEIS does not make sense when trying to ensure SITR meets its policy objective.
- 14.29 Clearly, property development is excluded from the conventional tax reliefs due to the scope to make significant capital gain on the appreciation in value of property, once developed.
- 14.30 Investments in community businesses such as community-led housing and social landlords can deliver very significant social returns on investment by reintroducing some urgently needed affordability and long term stability into land and property markets. But because these enterprises are not developing property to be appreciable asset to generate capital gain, investments will always be less attractive in narrow commercial terms than investments in non-social enterprise property developments.
- 14.31 For example, there are community benefit societies that operate both as land trusts and affordable homes developers, seeking to raise substantial amounts through Community Shares.<sup>18</sup> While they are successful in their own contexts, the extent to which socially-purposed property development can become more mainstream is limited by market failure that continues to drive more investments into speculative, higher yield developments.

### **Recommendation 5: Remove property development from the excluded activities list for SIT 'Gifting SITR'**

- 14.32 Evidence from the Community Shares market also tells us that there often large numbers of community investors making small investments (of £100 for example), who are PAYE and so very unfamiliar with filing forms with HMRC, who do not claim SITR (or EIS) even when they can.
- 14.33 The impact of SITR is often too small in each individual case to motivate the investor to make a claim. But the combined benefit of these otherwise forgone reliefs for the community business could be considerable. We suggest government could develop what could be described as a 'Gift Aid' scheme for SITR, wherein investors who are not motivated to claim SITR 'gift' its value to the social enterprise instead.

### **Recommendation 6: Develop a scheme whereby social investors can 'gift' the value of their SITR to the business they are investing in.**

#### Seed SITR

We believe the lack of a 50 per cent Seed SITR deters some use of SITR. Once SEIS has been used, many social enterprises will find it more straightforward to

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<sup>18</sup> For example, [Leeds Community Homes](#) has raised £360,000 to build 16 affordable, eco-efficient homes

advance to EIS if possible.

The inability of a social enterprise to offer a 50 per cent relief for the earliest stage and highest risk investments, further intensifies the market failure SITR was intended to address, by encouraging more of that capital to be allocated to non-social SEIS-backed investment opportunities instead.

**Recommendation 7: Create a 50 percent tax relief for seed social investments equivalent to SEIS ('Seed SITR)**

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