GET SITR

Social Investment Tax Relief

ACQUIRING ANOTHER SOCIAL ENTERPRISE – CAN YOU BENEFIT FROM SITR?

For more information and resources on Social Investment Tax Relief, please visit: www.getsitr.org.uk

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GET SITR provides free support and resources to better understand and use Social Investment Tax Relief. It is a joint initiative led by Big Society Capital in partnership with the CIC Association, CIC Regulator, Community Shares Company, Community Shares Unit and Power to Change.

1. INTRODUCTION

Introduced in 2014, and expanded in 2017, Social Investment Tax Relief ("SITR") allows individuals to help social enterprises[1] grow by offering a tax relief on investments.

Under SITR an individual can subscribe for shares in, or lend money to, a social enterprise and claim 30% income tax relief on the amount invested.

Who should read this note?

You should read this if you are an **organisation** who is looking to raise investment using SITR where the investment is relevant to the takeover of another social enterprise.

But before we begin... the legal small print

This note is for information purposes only to give the reader a better understanding of the how SITR tax relief may be available to fund the activities of a new subsidiary in the particular circumstances described in this note (and any commentary is specific to these facts only). This note is not a comprehensive review of the law relating to SITR. Any investor's tax position will depend on their own personal circumstances.

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This note is based on our understanding of law and HMRC practice as at the date it is published. All information is current as of the date of publication, subject to change without notice, and may become outdated over time.

[1] By 'social enterprise' we mean all eligible organisations for SITR, namely charities, community interest companies, community benefit societies and accredited social impact contractors

2. CONTEXT

On some occasions, a social enterprise may wish to assume or take over the activities of another social enterprise.

And in those circumstances, the parties may want to use funding raised through SITR to help finance the newly-acquired subsidiary social enterprise.

In this note we explore the extent to which that may be achievable (in the specific set of facts described below).

3. THE ISSUE

Consider the scenario where a community interest company ("CIC") is no longer viable as a stand-alone operation or would be more likely to achieve its mission if part of a larger group.

So CIC's Board approaches another social enterprise ("SE") and asks if SE would be willing to acquire CIC, on the basis that SE will invest, say, £100,000 in CIC to provide growth capital (allowing CIC to achieve its impact mission).

SE is happy to do this but wants to raise the £100,000 under SITR.

But we know that the rules relating to SITR state that if SE raises SITR funding, it cannot:

- make "investments" (because that is not a trading activity), or
- use the SITR funding to acquire shares in another company or enterprise.

So, it looks like we have a problem.

4. THE (POTENTIAL) SOLUTION

We came across this situation very recently where we were asked to provide help under our Get SITR campaign. But when we looked at the rules in a bit more detail (and there is a lot of detail!), we thought it could work if:

- SE raised £100,000 from investors looking to claim SITR
- SE then immediately used that £100,000 to subscribe for 100,000 shares in the CIC
- This left SE holding the vast majority of the shares in CIC – meaning that CIC was almost 100% owned by SE
- CIC then used that £100,000 as working capital in its trade in order to grow.

So we decided to ask HMRC if they thought this worked.

5. DID IT WORK?

HMRC agreed that this could work i.e. SITR tax relief could be available on that £100,000 investment into SE – even though the SITR funding was being used in conjunction with the acquisition of another company (i.e. CIC), and even though the SITR money was being used to invest in shares in CIC.

In the Appendix to this note we have set out the technical detail of the query we raised with HMRC, and their response.

Please remember that this worked in the scenario we have outlined because of a number of critical features:

- both CIC and SE are social enterprises meeting all other criteria for SITR funding, and both carry on "qualifying trades"
- the SITR funding raised by SE was not used to buy any shares in CIC
- the transaction resulted in CIC becoming at least 90% owned by SE
- the monies invested into CIC were then used as working capital to support the growth of CIC's "qualifying trade"

6. SO WHAT DOES THIS MEAN FOR YOU?

It means that in certain circumstances, SITR funding **can** help support the merger of two social enterprises – where the SITR funding is needed to provide growth capital.

But remember:

- HMRC's response on this issue was very specific to the facts outlined – if you are looking at another transaction that differs to any material extent, it may not work
- If you are considering a transaction of this nature you are strongly recommended to:
    - get some expert help, and
    - seek an advance assurance from HMRC that SITR will be available.

Appendix

In this Appendix we have set out the contents of the detailed note sent to HMRC, and a summary of HMRC's response.

Please note that HMRC's response is general guidance only and is specific to the facts set out below. We hope it is helpful, but is not advice, and is not a guarantee that SITR will be available to your organisation. If you are considering a transaction of this nature you are strongly recommended to:

- get some expert help, and
- seek an advance assurance from HMRC that SITR will be available

1. BACKGROUND

TradeCo CIC is community interest company limited by shares, that has been undertaking a "qualifying trade" (within the meaning of section 257MP Income Tax Act 2007) for a number of years. It needs more capital to make a step-change in its operations. The current owners, which are not themselves able to provide that funding, would like to see it stay in community hands.

The current owners hold 100 shares each of £1 in TradeCo.

A new Community Benefit Society ("BenCom") has been established to take over the activities of TradeCo for the benefit of the community.

2. PROPOSAL

BenCom intends to issue £100,000 of withdrawable shares and hopes to do this in a fashion that would allow the subscribers for those shares to claim relief under SITR.

On the same day that BenCom's withdrawable shares are issued, BenCom will use these funds to subscribe for 100,000 new £1 Shares in TradeCo. TradeCo will, after this purchase, be a 90% social subsidiary of BenCom (its issued share capital will comprise 100,200 shares of which all but 200 will be held by BenCom). Over the ensuing period (28 months at the latest), TradeCo will spend these funds carrying-on its qualifying trade.

SITR DEFINITIONS

The 'funded purpose' is, in the first instance preparing to carry on a qualifying trade, which is intended to be carried on by a TradeCo, a 90% social subsidiary (c.f. Section 257ML(1)(b) of Income Tax Act 2007), and in the second instance is the carrying out of that qualifying trade by TradeCo.

3. QUESTION

Does this meet the test in Section 257MM (3) of the Income Tax Act 2007?

That section says:

> *(3) Employing money on the acquisition of shares or stock in a body does not of itself amount to employing the money for the funded purpose.*

Our belief is the clause contains an important wording choice: "does not of itself" rather than "does not", which implies that there is something else that could make it "amount to employing the money for the funded purpose". Since the money has been employed on subscription for shares of TradeCo – meaning that Tradeco has, in turn, received the £100,000 funding - logically the only entity that can employ it at that point is TradeCo itself - and TradeCo does indeed intend to employ these funds for the carrying-on of a qualifying trade.

The notes to the legislation:
http://www.legislation.gov.uk/ukpga/2014/26/notes/division/1/56

> *Subsection (3) provides that employing money on the acquisition of shares or stock in a company does not of itself amount to employing the money for the purposes of the funded purpose.* ***This restriction should not prevent the money being used to acquire shares in a subsidiary company, providing that after the share issue the subsidiary is a qualifying 90% social subsidiary (see section 257MV) and that subsidiary then goes on to use the money for a funded purpose carried on by it*** *(which will exclude the acquisition of shares or stock in another company). This section is disapplied in the case of an accredited social impact contractor.*

In addition, wording identical to s.257MM(3) of the Income Tax Act 2007 appears in the code for the Seed Enterprise Investment Scheme (see s.257CC(2) ITA). In that context HMRC manuals (VCM33040) state the following:

> ***Spending money to acquire shares in another company***
>
> *The legislation specifies that spending money on the acquisition of shares or stock in a company does not of itself amount to spending the money for the purposes of a 'qualifying business activity'.* ***This does not prevent the money being used to acquire shares in a subsidiary company, providing that after the share issue the subsidiary is a qualifying 90 percent subsidiary (see VCM34040) and that subsidiary then goes on to use the money for a qualifying business activity carried on by it*** *(which will exclude the acquisition of shares or stock in another company).*

Both statements may support this interpretation.

4. HMRC RESPONSE

We submitted this question and interpretation to HMRC to gain their perspective. This is shared below.

> *"The essence of the matter is that the funds raised by the investment in BenCom are used to subscribe for shares newly issued by the target subsidiary, TradeCo, so that the money raised is available for TradeCo to employ for the 'funded purpose'. As such it is distinct from a situation where the new parent acquires shares in a way that does not transfer the funds to the subsidiary, for instance by purchasing shares from outgoing investors. In that latter situation the share acquisition would "not of itself amount to employing the money for the funded purpose [i.e. a qualifying trade carried on by the subsidiary]"*