Community
Shares

Community Shares Unit: Guidance Note

Changes to investment tax relief rules: How the Finance Act 2015 affects societies issuing community shares

December 2015

This note summarises the rule changes to investment tax relief schemes introduced in the Finance Act 2015, which received Royal Assent on 18 November 2015. It has been subsequently updated following the release of a policy paper on 9 December 2015, on *Income Tax: exclusion of energy generation from venture capital schemes*.

What is investment tax relief and how does it relate to community shares?

People who buy community shares are often eligible for income tax relief on their investment. There are three main tax relief schemes, which can be utilised:

- Enterprise Investment Scheme (EIS)
- Seed Enterprise Investment Scheme (SEIS)
- Social Investment Tax Relief (SITR)

Most societies will find out from HMRC in advance if their share offer will qualify for tax relief, and will mention it in their share offer document. This means prospective investors may be able to claim relief from income tax when they purchase shares. For EIS and SITR the tax relief rate is 30%. This means that for every £100 someone invests, they get £30 deducted from their income tax bill. For SEIS the tax relief is 50%, so for every £100 they invest they get £50 off.

EIS is the largest of the schemes. SEIS is only for new enterprises less than two years old. SITR is only for certain types of social enterprise.

The Government has introduced new legislation, the Finance Act 2015, which contains rule changes to EIS and SEIS that will impact on societies issuing community shares. Although most of these rule changes were contained in the first draft of the Bill, a further amendment to the rules was introduced at the third reading of the Bill, which has had a major and significant impact on community energy societies.

Rule changes affecting community energy societies

Any investment in a community energy society (or community interest company), in receipt of subsidies for the generation of energy, must have been made before 30 November 2015 to be eligible for EIS or SEIS tax relief.

All investments made on or after 30 November 2015, regardless of whether the society has received advance assurance from HMRC that their share offer was eligible for tax relief, will not be able to claim EIS or SEIS tax relief if they are involved in the subsidised generation of energy

On 6 April 2016, all remaining energy generating activities will be excluded from the EIS and SEIS tax relief schemes.

With regards to SITR, at present only subsidised generation or export of electricity is excluded from SITR , i.e. in receipt of a FIT subsidy. Therefore, all non-subsidised energy (electricity, power, heat, gas or fuel etc.) generating activities or those that are subsidised but where that subsidy is not a FIT (e.g. a RHI or ROC) could still qualify. However, HMRC has confirmed that "action will be taken on enlargement of SITR, expected within six to twelve months, to exclude all remaining energy activities."

The longer term impact on community energy societies, coming on top of proposals to reduce the subsidies available for the generation of electricity, are hard to quantify at this stage, but are likely to be substantial. The Community Shares Unit will work with the Department of Energy and Climate Change to

understand the impact of these changes, and to identify how the community energy sector can be respond to the new challenges it faces.

Which other rules have been changed?

The Finance Act introduces significant changes to the rules governing EIS and SEIS, designed to ensure that these schemes maintained their EU State Aid approval. The Community Shares Unit (CSU) has identified two key changes, which may have an adverse impact on societies issuing community shares:

- For EIS, enterprises now need to be less than seven years old to be eligible (except where investment is more than 50% of annual turnover averaged over last five years)
- A new rule was introduced preventing the investment being used to acquire existing businesses or business assets

The CSU believes that that is could have significant impact on the eligibility of community share offers in areas such as shops, pubs, football clubs and other activities involving community asset transfers. This is on the basis that many of these share offers are raising investment to purchase existing businesses or business assets. Acquiring a business means buying shares in a company, or purchasing its trade, goodwill or some other form of intangible asset.

The Finance Act explains what a business asset is (see paragraph 11 of Schedule 5, and paragraph 5 (new section 280D) and paragraph 10 of Schedule 6, to the Finance Act and the accompanying explanatory notes). The CSU is working with HMRC to develop a clearer interpretation of these new rules, and this guidance, and the Community Share Handbook, will be revised in due course when this has been achieved. In the meantime, the following guidance on what constitutes a business asset is provisional only, and societies should seek advance assurance from HMRC if they are in any doubt about eligibility.

An important distinction needs to be made between a business asset and an asset used by a business. So, in this context it would be allowable for a society to purchase premises for a shop, even if those premises had previously been used as a shop, as long as there was no payment for the trade, goodwill or intangible assets associated with its previous use as a shop. The same would be true for a society that purchased a football stadium; as long as it did not purchase any rights attached to the football club that previously operated from that ground or stadium.

These new rules do not apply to SITR, so it is anticipated that societies affected by these rules may choose to migrate to SITR, especially if and when this scheme is enlarged.

What does it mean for societies planning to launch share offers?

Societies currently planning share offers and hoping to offer EIS and SEIS tax relief are encouraged to review the detail within the Finance Act as to whether these rule changes may affect the offer of tax relief to prospective investors.

Importantly, societies should contact the Small Company Enterprise Centre (SCEC) at HMRC. The SCEC is responsible for deciding whether an enterprise and its share issue qualify for the Scheme. It does this by checking that the enterprise's accounts, governing document, business plan and other documentation relating to the share issue, comply with the requirements of the Scheme.

The SCEC operates an advance assurance scheme, whereby an enterprise can submit their plans and documents in advance, using the appropriate form EIS(AA) or SEIS1, and the SCEC will advise on whether

or not the proposed share offer is likely to qualify for either tax relief. However, the mere fact that a society has obtained advance assurance, does not protect an offer from subsequent changes to the rules. So any society that obtained advance assurance prior to when the rule changes came it effect, but which has not yet issued shares, should check that its scheme is still eligible.

Advance assurance is not mandatory; an enterprise and its investors can still qualify for the scheme after the shares have been issued, but potential investors are likely to take comfort from advance assurance when deciding whether to invest.

What about SITR?

Social Investment Tax Relief (SITR) was launched in April 2014 with the aim of encouraging investment in social enterprises by unconnected individuals. SITR currently functions under the State Aid de minimus principles, but the government has applied for State Aid clearance, which will result in an expansion of the scheme as noted below.

SITR is not affected by the rule changes announced in the Finance Act 2015 and functions under a different State Aid regime. **If a society's share offer is no longer eligible for EIS or SEIS due to the new rule changes, it may be eligible for SITR.**

Like SEIS, the maximum amount a social enterprise can offer tax relief on is restricted to the State Aid de minimus limit. But unlike SEIS, where the maximum amount that can be offered is fixed at £150,000, SITR uses a formula to calculate the maximum amount, based on the value of the tax reliefs, less any state aid already received by the social enterprise during a rolling three year qualifying period. At current tax relief rates, this works out as €344,827, equivalent to around £250,000.

However, the government has applied for State Aid clearance, and when this is achieved the investment limit per organisation will increase to £5m per annum, subject to a maximum limit of £15m. Formal application to the EU for State Aid clearance of SITR was made in January 2015, requesting clearance to enlarge the scheme as set out in the Autumn Statement 2014. Discussions relating to State Aid applications are confidential so there have been no updates during the process as to when this approval will be received.

Get in touch

The Community Shares Unit can respond to any queries relating how these rule changes impacts on a society's intentions to raise capital through an offer of non-transferable, withdrawable share capital (community share offer). Get in touch with us here.

About the Community Shares Unit

The Community Shares Unit is supported by the Department of Communities and Local Government (DCLG) and Department for Energy and Climate Change (DECC) and is delivered in partnership by Co-operatives UK and Locality. Modelled on the highly successful Asset Transfer Unit within Locality, the unit works with partners to develop standards of good practice, encourage policy reforms and raise awareness to support the growth of community shares.

www.communityshares.org.uk