

FINANCE ACT 2014

EXPLANATORY NOTES

INTRODUCTION

Section 57 and Schedules 11 & 12: Tax Relief for Social Investment

Details of Schedule 11

Part 1

Chapter 3

37. Chapter 3, sections 257L to 257LH, sets out eligibility conditions relating to the investor and the investment.
38. New section 257L describes the types of investment which may qualify for relief. Investments may be in shares, or in debt instruments including simple loans. The section ensures that either type of investment must be the lowest-ranking of its type in the event of a winding up and therefore exposed to the greatest degree of risk for investors. In the case of qualifying debt investments, these must as far as possible rank equally in a winding up with those shares which rank lowest. Investments in shares may not carry any right to an amount of dividend which is fixed absolutely; or whose rate is fixed either by reference to the amount invested or by reference to some other factor which is not contingent upon the enterprise's financial success. Irrespective of the nature of the investment, any right of return must not be greater than a reasonable commercial rate. No definition is provided for "reasonable commercial rate".
39. New section 257LA ensures that income tax relief will only be available where the amount in respect of which relief may be claimed has been paid over in cash to the enterprise when the investment is considered to have been made. This means, for instance, that where an investor has undertaken to provide the enterprise with an amount but the enterprise has not drawn down some or all of the amount committed, then relief will be due only on the drawn down amount.
40. New section 257LB(1) ensures that the investor has no right to have the investment redeemed, repaid or repurchased during the shorter applicable period.
41. New section 257LB(2) to (4) ensures that the investment is not made with the benefit of any arrangement which might guarantee an exit from the investment.
42. New subsection 257LB(5) disapplies the requirements in section 257LB(2) to (4) in relation to accredited social impact contractors. This recognises the fact that an accredited social impact contract is likely to be time-limited and will therefore usually include an exit arrangement for investors.
43. New section 257LC(1) prevents the investment from qualifying if at any time in the shorter applicable period, there exist arrangements aimed at protecting the investor's capital, or otherwise protecting the investor from the risks attached to making the investment. This would include, for example, schemes which insure investors against making a loss, and schemes to maintain the value of the investment artificially.

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44. Subsection (2) provides an exception for ordinary commercial matters such as insurance by the enterprise against normal trading risks.
45. New section 257LD denies relief if in the longer applicable period, the investor, or any associate, receives a loan from any person which would not have been made, or would not have been made on the same terms, were it not for the making of the relevant investment. This includes cases where credit is given or a debt due from the investor or associate is assigned. This section mirrors the equivalent Enterprise Investment Scheme provision at section 164 ITA. HMRC has published an interpretation of that provision in Statement of Practice SP6/98 and it is anticipated that that interpretation is likely to apply equally here, providing that the Statement of Practice is still in existence.
46. New section 257LE prevents the investment from qualifying if it is made as part of a scheme or arrangement whose purpose is tax avoidance.
47. New section 257LF prevents individuals from qualifying for relief if they are, or their associates are, employees, partners, remunerated directors or trustees of the enterprise, or of other bodies which have certain relationships with the enterprise. Those restrictions apply throughout the longer applicable period described in section 257KC, and therefore exclude individuals who have had (or whose associates have had) one of the relationships mentioned with the enterprise before the date the investment is made, even if that relationship has ended by the time the investment is made. The term “associate” is defined in new section 257TC as including spouse, civil partner, ancestor or lineal descendant, business partner and certain trustee relationships.
48. Subsection (3) provides definitions of some terms used in section 257LF. The definition of “related person” includes a person connected with the social enterprise or a linked company. In this context, “connected” is as defined by section 993 ITA, as provided by section 1021 ITA. This subsection also defines “subsidiary” as a 51% subsidiary, which is further explained in section 989 ITA.
49. Subsection (4) explains what is meant by a “remunerated director” in this context. A director is “remunerated” if during the longer applicable period he or a partnership of which he is a member receives, or is entitled to receive, a payment from a “related person” as defined in subsection (3). “Director”, for the purpose of Part 5B, takes its meaning from section 452 Corporation Tax Act 2010, modified so that references to companies in that section are to be read as including charities which are trusts. See new section 257TE.
50. Subsection (5) provides that certain types of payment are not taken into account in determining whether the director is “remunerated”. These are mostly payments of various types which do not constitute payments for services rendered as a director. However, reasonable payments which are for services rendered as a director may also be ignored, if one of two further conditions is met.
51. The first of these conditions is at subsection (6). This is that the investment was made at a time when the investor met the requirements of section 257LF, 257LG and 257LH, and also had never been involved in carrying on the whole or any part of the trade, business or profession carried on by the social enterprise or a subsidiary.
52. The second of the conditions is at subsection (7). This is that if the first condition is not met, the investment is made before the third anniversary of the last investment made by the director at a time when the investment met the first condition.
53. Subsection (8) provides that in cases where a director is also an employee of an enterprise, for the purposes of new section 257LF the employee relationship is to be disregarded.
54. New section 257LG prevents individuals from qualifying for relief if they, or their associates, have a certain level of interest in the capital of the enterprise or of a 51% subsidiary of the enterprise. This restriction applies throughout the longer applicable

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period, and it applies in respect of an interest in a company which is a 51% subsidiary at any time in that period, even if it is not such a subsidiary at the time of investment.

55. Subsection (3) prevents an individual from qualifying if that individual or an associate controls the enterprise or a 51% subsidiary. “Control” for this purpose is defined at new section 257TD and takes the meaning in section 450 and 451 of the Corporation Tax Act 2010, expanded so that references to company in those sections are to be read as including references to charitable trusts. Trustees who alone, or together with another person connected with them, have the power to exercise certain trustee functions, are regarded as controlling an enterprise in this context.
56. Subsection (4) prevents an individual from qualifying for relief if at any time in the longer applicable period, that individual or an associate has directly or indirectly more than 30% of any of the following:
- The issued share capital of an enterprise or its 51% subsidiary (as defined in section 989 ITA).
 - The loan capital of the social enterprise or its 51% subsidiary.
 - The voting power of an enterprise or its 51% subsidiary.
57. Subsection (5) disapplies subsection (3) and (4) in respect of any shareholdings at a time when the enterprise has issued only subscriber shares, and has not yet started its business or any preparations for its business. This prevents an individual from being disqualified merely by virtue of having taken shares in a company for the purpose of registering that company with Companies’ House but where it is intended that there will be other investors in due course.
58. Subsection (6) defines “loan capital” for the purpose of subsection (4) as including any debt incurred by the relevant enterprise for any money borrowed or capital asset acquired by it; for any right to receive income created in favour of it; or for consideration the value of which to the enterprise was (at the time the debt was incurred) substantially less than the amount of the debt (including any premium on the debt). But loan capital is treated as excluding debts arising on a normal bank overdraft.
59. New section 257LH imposes a requirement that there must be no “reciprocal” arrangement allowing individuals to circumvent the restrictions in sections 257LF and LG by investing in each other’s social enterprises. This provision would apply, for example, where A, B and C are each directors of community interest companies A Ltd, B Ltd and C Ltd respectively, and A invests in B Ltd, B in C Ltd and C in A Ltd.