

# FINANCE ACT 2014

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## EXPLANATORY NOTES

### INTRODUCTION

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

#### Details of Schedule 11

#### Part 1

#### *Chapter 7*

137. Chapter 7, sections 257Q to 257RC describes the circumstances in which relief will be withdrawn or reduced.
138. New section 257Q provides for SI relief to be reduced or withdrawn if the investor receives value from the enterprise during the longer applicable period. See also section 257QG which extends the effect of this provision. Whether the relief will fall to be reduced or withdrawn completely depends on the amount of the value received in relation to the amount of relief given, as determined by the formula in subsection (2).
139. Subsection (3) lists provisions which supplement section 257Q.
140. Subsection (6) provides that for the purpose of the value received provisions, a spouse or civil partner who has acquired any part of an investment in the course of a transaction to which section 257T applies is to be treated as the investor.
141. New section 257QA provides that where the amount of the value received is 'insignificant' it is ignored. An amount is insignificant for this purpose if it does not exceed £1000, or if it exceeds £1000 it is insignificant in relation to the amount subscribed by the individual for the shares in question. 'Insignificant' is not defined for this purpose.
142. To ensure that this relaxation is not used for tax avoidance purposes, subsection (3) provides that the amount of any value is not to be regarded as insignificant if it is received under arrangements which exist at any time in the 12 months ending on the date of the investment. Subsection (6) extends this to include receipts by an associate of the investor, or provision of value by any person connected with the social enterprise. "Arrangements" is as defined in section 257TE.
143. Subsections (4) and (5) provide that where there is more than one receipt which, on its own, would be regarded as insignificant, the rule must be applied to the total amount received within the longer applicable period.
144. New section 257QB modifies the calculation given at subsections 257Q(1) and (2) for cases where there has been more than one issue of investment attracting SI relief.
145. New section 257QC modifies the calculation given at subsections 257Q(1) and (2) for cases where part of the investment is treated as though made in the tax year preceding that in which it was made (see section 257JA(4)).

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146. New section 257QD modifies the calculation given at subsections 257Q(1) and (2) for cases where the investor has not been able to obtain the maximum amount of SI relief available in respect of the investment. This would be the case where the maximum amount of relief available exceeded the investor's liability to income tax for the tax year in question.
147. New section 257QE explains when value is considered to have been received by an investor, for the purposes of sections 257Q and 257QB.
148. Subsections (2) to (6) list a wide range of types of payments, benefits and transactions which will give rise to a withdrawal or reduction of SI relief by virtue of the value received provisions. These will include any repayment or part repayment of the investment in respect of which SI relief has been obtained.
149. Subsection (7) provides that if SI relief is withdrawn because the investor has disposed of the investment within the relevant applicable period, the disposal proceeds are not treated as a receipt of value for the purposes of this section.
150. Subsection (8) provides that if the investor is a director of the enterprise, a payment of reasonable remuneration or the provision of a benefit for services provided in the capacity of director or employee, is not to be treated as value received for the purposes of this section.
151. New section 257QF contains a table setting out how the amount of any value received is to be calculated, depending on the nature of the value received.
152. New section 257QG supplements those sections dealing with receipt of value. It provides that those sections apply equally in cases where the value has been provided indirectly as well as directly to the individual; or where the value has been provided to the individual's associate; or where the value has been provided by a person connected with the social enterprise at any time during the longer applicable period.
153. New section 257QH provides that an individual can avoid the consequences of receiving value by returning the whole of the value to the person that gave it. The value may be returned in a number of ways, depending on the circumstances in which value was received. These may include a cash payment, the reversal of the waiver or discharge of a liability, or the transfer in reverse of an asset at under or over value corresponding to that in the original transaction giving rise to the receipt of value.
154. Subsection (5) lists a number of types of cash payment which are not to be treated as providing replacement value for the purpose of section 257QH. These consist broadly of payments at normal arm's length rates for goods or services received, for assets transferred, or representing interest on money lent.
155. New section 257QI supplements section 257QH.
156. Subsection (1) provides that replacement value cannot be used to offset the receipt of value to the extent that it has already previously been used to do so.
157. Subsection (2) deals with the time within which the replacement value must be given in order for the individual to be able to avoid the consequences of receiving value. The replacement value must be given without unreasonable delay. If the amount of the value received was the subject of appeal proceedings it must be given within 60 days after the final determination of the appeal. A payment made before the value was received may be taken into account as replacement value, provided it was not made before the beginning of the longer applicable period referred to in section 257KC.
158. New section 257QJ acts to ensure that tax relief is not available to the extent that an amount equivalent to any part of an individual's investment is used by the enterprise or by one of its subsidiaries to repay, redeem or repurchase any of that entity's share capital. The restriction applies in respect of any such repayment, redemption or repurchase within the longer applicable period referred to in section 257KC. The

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aim is to prevent tax advantaged funds from being used to provide an exit for earlier shareholders, rather than being used for the activities of the enterprise.

159. New section 257QK provides that a repayment of share capital falling within section 257QJ is ignored if both it and the market value of the share capital repaid are insignificant compared with the market value of the remaining issued share capital of the company. Note that, unlike section 257QA, this provision does not provide for a specified amount to be treated as insignificant.
160. To ensure that this relaxation is not subject to abuse, subsection (3) provides that the amount of any value shall not be regarded as insignificant if it is received under arrangements which exist at any time in the 12 months ending on the date of the share issue.
161. New sections 257QL to 257QO supplement section 257QJ by explaining how the tax reduction is to be calculated where there is more than one issue of shares; where more than one individual is involved; where a single issue of shares has been treated partly as made in the previous tax year by virtue of a claim under section 257JA(4); or where the maximum amount of relief was not obtained for the share issue.
162. New section 257QP provides an exception from section 257QJ, to take account of the fact that it is not uncommon for a company to be established via the issue of redeemable shares, which are then redeemed when the company is acquired by its intended permanent owners. No reduction is to be made where share capital has been issued of a nominal value equal to the authorised minimum required by the Companies Act 2006 for a public company to do business, the Registrar of Companies having issued the company with a certificate under that Section, and any of it is redeemed within 12 months of the date of its issue.
163. New section 257QQ acts to ensure that the legislation serves to encourage genuinely new investment in social enterprises by denying relief to anyone who directly or indirectly owned the trade before it came to be owned by the company.
164. The restriction has effect if at any time within the longer applicable period mentioned in section 257KC, either the individual or any group of persons to which he or she belongs either: has more than a half share interest in the trade or part of the trade as carried on by the social enterprise or its qualifying subsidiary, or controls the social enterprise. In the first case, the provision will apply if the individual or group also had such an interest in the trade, or a part of the trade, at some previous time in the same period when it was carried on by some person other than the social enterprise. In the second case, the restriction will apply if the individual or group, at some previous time in the same period, controlled another company which was then carrying on the trade or part of the trade. The persons to whom a trade belongs, or the extent of their interests in it, are to be determined in accordance with section 941 CTA 2010.
165. New section 257QR similarly acts to ensure that relief goes only in respect of genuine new investment, by denying relief to anyone who alone or together with others, controlled a company which then carried on the trade and that company has come to be owned by the social enterprise in which the individual has now invested. For this purpose, section 257TF provides that ‘control’ has the meaning given in section 450 CTA 2010.
166. New section 257QS provides for relief obtained by an investor to be withdrawn if it is subsequently found by HMRC not to be due. Where the reason for this is because the social enterprise does not meet, or has ceased to meet, any of the conditions specified in Chapter 4 of Part 5B, HMRC must give notice to the social enterprise before relief can be withdrawn. The purpose of this procedure is to allow the party to any appeal proceedings to be the social enterprise itself in cases where most of the relevant evidence lies within its own power, and to simplify the withdrawal process in

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cases where there is a large number of investors. See new section 257SA for further information about appeals, and new section 257SB for information about time limits.

167. New section 257R explains that if the investment is wholly or partly disposed of during the shorter applicable period other than to a spouse or civil partner – see section 257T, then relief is to be reduced or withdrawn.
168. Subsection (2) and (3) treat the disposal differently depending on whether it has been made by way of an arms' length bargain or not. Where the disposal is other than at arms' length, the relief is withdrawn entirely. Where it is an arms' length bargain, relief is reduced (including withdrawn completely) by the application of the formula at subsection (4).
169. New section 257RA supplements section 257R by explaining how the reduction or withdrawal of relief is to be calculated in cases where the investor did not receive the maximum amount of relief for the investment.
170. New section 257RB provides that if the investor grants a call option over any part of the investment, that part is treated as though it had been disposed of with the result that the provisions of section 257R will apply. A call option is defined by the legislation as an option granted by the investor which, if exercised, would bind the investor to sell the whole or part of the investment.
171. New section 257RC has a similar effect where at any time in the longer applicable period referred to in section 257KC, a person grants a put option to the investor. A put option is defined as an option granted to the investor by any person which, if exercised, would bind the grantor to purchase any of the investment.