

EXPLANATORY MEMORANDUM TO
THE COMMUNITY INVESTMENT TAX RELIEF (ACCREDITATION OF
COMMUNITY DEVELOPMENT FINANCE INSTITUTIONS) (AMENDMENT)
REGULATIONS 2008

2008 No. 383

1. This explanatory memorandum has been prepared by HM Revenue and Customs and is laid before the House of Commons by Command of Her Majesty.

2. **Description**

The Community Investment Tax Relief (“CITR”) scheme encourages investment in disadvantaged communities by giving tax relief to investors who invest, either by loan or equity, in accredited Community Development Finance Institutions (“CDFIs”). Accreditation is conditional – to retain accreditation a CDFI must, over time, in turn invest minimum proportions of the funds raised under the scheme in businesses or social enterprises within, or serving, disadvantaged communities.

This Order amends the existing conditions of accreditation.

3. **Matters of special interest to the Select Committee on Statutory Instruments**

None.

4. **Legislative Background**

The CITR scheme was originally enacted by Schedules 16 and 17 of the Finance Act 2002. The scheme incentivises individuals and companies to invest in CDFIs by giving the investors a tax relief based on the value of their investment. The criteria under which accreditation is granted, and the conditions that attach to that accreditation, are set out in the Community Investment Tax Relief (Accreditation of Community Development Finance Institutions) Regulations 2003 (S.I. 2003/96).

Since the commencement of the scheme, Schedule 16 of the Finance Act 2002 has been rewritten under the Tax Law Rewrite project. Provisions that relate to the granting of CITR to, or withdrawal of it from, individuals and provisions relating to aspects of CDFIs or their activities are now included within Part 7 of the Income Tax Act 2007. This has left within Schedule 16 of the Finance Act 2007 only those provisions that relate to the granting of CITR to, or withdrawal of CITR from, companies.

This Order amends, for the first time, various aspects of S.I. 2003/96.

5. **Territorial Extent and Application**

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Ms Angela Eagle has made the following statement regarding Human Rights:

In my view the provisions of the Community Investment Tax Relief (Accreditation of Community Development Finance Institutions) (Amendment) Regulations 2008 are compatible with the Convention rights.

7. Policy background

Onward investment

The conditions under which CDFIs are accredited for the purposes of the CITR scheme include a requirement that the CDFI must, over time, invest minimum proportions of money raised under the scheme in qualifying enterprises located in, or serving, disadvantaged communities. Regulation 15 of S.I. 2003/96 requires that any CDFI that fails to meet those conditions must have its accreditation withdrawn. Existing and new investors in the CDFI would not then be eligible for tax relief on their investments.

This non-discretionary loss of accreditation makes the operation of the existing rules inflexible and potentially inequitable. An established CDFI with an otherwise good record of onward investment may fail to meet the condition simply because it falls below the required minimum level of onward investment for a very brief period. And a CDFI may be forced into a position of failure by circumstances outside its control, and despite its best efforts to avoid the failure.

The Order addresses these problems by amending S.I. 2003/96 with the effect that

- the current requirement that at all times after the third anniversary of its accreditation a CDFI must maintain an onward investment level of at least 75% is changed to one based on average investment over the course of the year, and,
- a CDFI that fails to meet its onward investment requirement can nevertheless retain its accreditation if it can satisfy the Secretary of State that the failure is due to factors outside its control, that it took reasonable steps to avoid the failure, and that it took steps to rectify the failure as soon as possible.

Article 6 of the Order introduces the new onward investment condition by substituting a new Regulation 8 into S.I. 2003/96. The new regulation does not alter the onward investment conditions relating to the first three years following a CDFI's initial accreditation. But for fourth and subsequent years the onward investment requirement is relaxed from one that requires a minimum 75% onward investment level to be maintained at all times to a new requirement that this level must achieve an average 75% over the course of the year.

There is a choice of two methods for calculating this average: one looks at daily onward investment levels, the other at levels on four roughly equally-spaced dates within the year. If the CDFI achieves an average of at least 75% using either of these methods it is deemed to have met the condition. The option of using just four dates is intended to reduce the administrative burden on CDFIs that are operating comfortably above the required level.

Articles 7 and 8 of the Order introduce the possibility that a CDFI that fails to meet the required onward investment levels can nevertheless retain its accreditation. Article 7

amends Regulation 15 of S.I. 2003/96 to provide that in considering withdrawal of accreditation regard must be had to new Regulations 15A to 15E, introduced by Article 8.

New Regulation 15A applies where a CDFI recognises a failure of its onward investment requirement after the end of the relevant year. It provides that the CDFI can apply to the Secretary of State, explaining the circumstances of the failure, and requesting that its accreditation should not be withdrawn notwithstanding the failure.

New Regulation 15B applies where a CDFI anticipates a failure of its onward investment requirement during a year. The CDFI can apply to the Secretary of State, in advance of the failure, explaining the circumstances and the measures it proposes to take in relation to the anticipated failure, and requesting that (should the failure later occur) its accreditation should not be withdrawn.

New Regulation 15C provides that if, having received an application under Regulation 15A the Secretary of State is satisfied that the failure was due to factors outside the control of the CDFI and persons connected with it and that the CDFI acted reasonably to try to avoid, and mitigate the extent of, the failure then the CDFI's accreditation should not be withdrawn.

New Regulation 15D applies where the Secretary of State has received an application under Regulation 15B. If the Secretary of State is satisfied that the anticipated failure is due to factors outside the control of the CDFI and persons connected with it, and that the measures proposed by the CDFI are a reasonable attempt to avoid or mitigate the extent of the failure, then the Secretary of State will notify the CDFI that should the failure later occur its accreditation will not be withdrawn. Where the Secretary of State cannot give such assurance the CDFI may make a further application, specifying further proposed measures.

New Regulation 15E contains provisions supplementary to Regulations 15A to 15D.

Changes to legislation and departments

The Order also takes the opportunity to update S.I. 2003/96 in respect of three recent changes to primary legislation, departmental names and organisation:

- references to primary legislation within S.I. 2003/96 are amended to reflect the changes brought about by the enactment of Income Tax Act 2007,
- references to the Department of Trade and Industry, its Small Business Service and officers within that entity are updated to reflect the creation and organisation of the Department for Business, Enterprise and Regulatory Reform (BERR), and
- the definition of small or medium-sized enterprises (SME) used for the purposes of the scheme is imported directly into S.I. 2003/96 in response to changes introduced by Finance Act 2007.

The updating in relation to the Income Tax Act 2007 and the creation of BERR are effected by Articles 3, 4 and 5 of the Order.

The importation of the SME definition into S.I. 2003/96 is needed following the introduction of Section 50 of the Finance Act 2007. Prior to this the CITR scheme employed the definition of SME included within Commission Recommendation 2003/361/EC by linking to it through the legislation dealing with Research and Development (R&D) tax relief in Schedule 20 to the Finance Act 2000 (which used the same European SME definition). But Section 50 of the Finance Act 2007 qualified the way in which the European SME definition is to be interpreted for the purposes for R&D tax relief, and made it difficult to see how the definition should be interpreted for the

purposes of the CITR scheme. Article 9 of the Order imports the European definition directly into Regulation 10 of S.I. 2003/96, removing any uncertainty over the SME definition to be used for the scheme.

Equity investments in profit-distributing enterprises

The final amendment made by the Order is also one of clarification. The State aid approval for the scheme (N 711/2001) makes it clear that equity investment in profit-distributing enterprises are not to be relevant investments under the scheme (i.e. they do not count towards a CDFI meeting its minimum onward investment level). This requirement is understood by the CDFI sector (which does not therefore engage in such investment under the scheme).

But because equity investment in profit-distributing enterprises is not specifically included within its list of ‘investments that are not relevant investments’ it is possible to read S.I. 2003/96 in such a way as to suggest that such investments are relevant investments. Article 10 of the Order inserts a new entry into Schedule 1 to S.I. 2003/96, putting beyond doubt that an equity investment in a profit-distributing enterprise is not a relevant investment.

8. Impact

A Regulatory Impact Assessment has not been prepared for this instrument as it has no impact on business, charities or voluntary bodies.

9. Contact

Richard Kent at HM Revenue & Customs (tel: 020 7147 2635 or e-mail: Richard.Kent@hmrc.gsi.gov.uk) can answer any queries regarding the instrument.