



# SOCIAL INVESTMENT TAX RELIEF

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## A GUIDE TO SITR AND PROPERTY DEVELOPMENT

May 2017

For more information and resources on SITR, please visit [www.bigsocietycapital.com/sitr](http://www.bigsocietycapital.com/sitr).

This note has been prepared to help provide some further clarity around which property transactions can and can't qualify for SITR, as we understand many have asked questions about this. The note has been prepared for information purposes only and does not constitute legal advice.



In 2015 Big Society Capital published [a note on SITR and Property](#).

This note has been prepared to help provide some further clarity around the issues faced by social enterprises looking to raise SITR funding for:

- *buying or refurbishing property, or*
- *trades that involve generating revenues from the use of land and/or buildings*

The note has been prepared for information purposes only and does not constitute legal advice.

This note was originally prepared in 2015. But in the Chancellor's autumn statement of 2016 the Government announced a number of changes to the rules relating to SITR, one of which is likely to impact on social enterprises that generate revenues from letting or licensing their premises or facilities. At the time of writing, those changes (the "**2017 Rule Changes**") have been put on hold pending the outcome of the General Election on 8 June. But it is likely that the 2017 Rule Changes will be enacted later in the year and back-dated to 6 April 2017. So we have updated this note to reflect one particular aspect of the 2017 Rule Changes.

## INTRODUCTION

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Social Investment Tax Relief (or "**SITR**") is available for individuals who invest, by way of debt or equity, into social enterprises.<sup>1</sup>

However the relief is only available where the money raised is used to support a so-called "qualifying trade".

A qualifying trade means any trade other than an activity which is excluded.

The list of excluded trades is set out in the legislation governing SITR.<sup>2</sup> But "property development" is on that list of excluded activities.<sup>3</sup> And if the 2017 Rule Changes are enacted, "leasing (including letting ships on charter or other assets on hire)" will also be an excluded activity.

Many social enterprises hold or own some kind of interest in real estate. And some may look to raise funds in order to buy or refurbish property that they hold. Some will look to raise revenues by exploiting the use of their property or facilities. All of which gives rise to the concern that those enterprises may not be eligible to raise funding under SITR.

We've seen a number of social enterprises raise the concern that they may not be eligible for SITR. So in this note we look in a little more detail at:

- what "property development" means,
- the issues faced by social enterprise who let or licence their property or facilities (particularly in the light of the 2017 Rule Changes), and
- when and how a social enterprise with an interest in property might still be eligible for SITR.

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<sup>1</sup> See Part 5B of the Income Tax Act 2007

<sup>2</sup> See section 257MQ of the Income Tax Act 2007

<sup>3</sup> See the definition of "property development" in section 257MR of the Income Tax Act 2007



# PROPERTY DEVELOPMENT

## What is property development?

It means the development of land where the social enterprise:

- has (now or at any time in the past) an interest in land, **and**
- has the sole or main object of realising a gain from the disposal of an interest in that land when it is developed.

So we have to look at the intention of the social enterprise at the time the land is first bought. Why did the enterprise buy it? What does it intend to do with the land? Does its trade typically involve buying or selling land or property?

## What is NOT property development?

Buying and selling a piece of land, but doing absolutely nothing to it in the meantime, is not property development. Because there's no "development" activity. It might be an investment activity. Or it might be a trade (depending on the circumstances). But it's unlikely to be regarded as property development.

## Property Letting

Being a landlord is not "property development". In fact, a letting business not a "trade" at all. The rules on this are complex, but the starting point is that letting property in return for rent is not a "trade". It is taxed as a property investment business, and subject to its own set of tax rules. But is not, technically, a "trade". Even if it were a trade, under the 2017 Rule Changes it's likely that the activity of letting or licensing out a property would be caught by the new exclusion for leasing. So even though it is not "property development", it is not an activity which can qualify for SITR investment.

And just to make things a bit more complicated, it is possible that an enterprise might buy a property for redevelopment, and then let it out once developed. In that case it's carrying on two separate activities for tax purposes. First, it's a property developer. And secondly, it's a letting business. But neither activity qualifies for SITR investment.

## Examples:

By now, you may be thinking this stuff is quite complex. Well it can be. So in the rest of this note we:

- have set out a few situations where enterprises may:
  - hold an interest in property, and/or
  - generate revenues from that property, and
- explained whether or not that may amount to:
  - "property development", or
  - some other "excluded activity" for the purposes of SITR.

*A social enterprise buys the freehold, or pays the premium on a lease, of a building out of which the enterprise will trade.*

The intention of the social enterprise is to acquire premises out of which it trades. It is not doing this with the "sole or main object" of developing the property and selling it on for a profit. So this is not property development.

*A social enterprise buys a piece of land with the intention of building a property on that land, and where the enterprise will – once the property is built - trade out of that property for the foreseeable future.*

The intention of the social enterprise is to acquire premises out of which it trades. It is not doing this with the “sole or main object” of developing the property and selling it on for a profit. So this is not property development.

*A social enterprise owns a property out of which it trades. It needs to expand so it refurbishes and extends that property to make it fit for purpose.*

The intention of the social enterprise is ensure that the premises out of which it already trades are fit for purpose. It is not doing this with the “sole or main object” of developing the property and selling it on for a profit. So this is not property development.

*A social enterprise owns a property out of which it has operated for a number of years. It needs to expand its operations, so it sells that property in order to fund the expansion, and moves to bigger premises. It uses the profits from the sale of the original property to fund the purchase of the new property.*

Whether or not the sale of the existing property amounts to “property development” will depend on the intention of the parties at the time the original property was acquired. But if the enterprise has traded out of that property for a material length of time, it is unlikely that HMRC would argue that this is property development – HMRC would have to demonstrate that when the property was acquired the sole or main object was to develop it and sell it on for a profit.

The acquisition of the new property is not “property development”. The intention of the social enterprise is to acquire premises out of which it will trade. It is not doing this with the “sole or main object” of developing the property and selling it on for a profit. So this is not property development.

*A social enterprise owns a property out of which it trades. It needs to expand its operations, so it sells that property in order to fund the expansion, and moves to bigger premises. It uses the profits from the sale to fund the purchase of the new property. However the new premises are bigger than is needed. The enterprise believes it will expand into the whole of the new premises over time, so agrees a short term lease of some of the floor space in the new building, and uses the rest of the building for its own trade.*

The acquisition of the new property is not “property development”. The intention of the social enterprise is to acquire premises out of which it will trade. It is not doing this with the “sole or main object” of developing the property and selling it on for a profit once developed. So this is not property development.

The fact that in the short term the social enterprise lets out a portion of its new premises should not alter that. However, by letting out a proportion of its new building, the enterprise is now operating two businesses – its existing trade, and the business of a landlord. This raises two questions.

First, is the letting business a “trade” at all? As we’ve already mentioned, letting property in return for rent is not a “trade”. It’s not “property development”, but it is not an activity which can qualify for SITR investment.

There is an exception to this where an enterprise lets out surplus accommodation on a temporary basis. To qualify for this exemption, an enterprise must meet the following conditions:



- the accommodation is temporarily surplus to requirements, meaning:
  - if it has either been used in the trade, or acquired within the last three years,
  - the enterprise intends to use it in the trade at a later date, and
  - the letting is for a term not longer than three years.
- the building or land is not held as “trading stock” (i.e. part of the assets of an enterprise which are bought or sold for profit);
- the rental receipts are in respect of part of a building of which another part is used to carry on the trade; and
- the rental receipts are relatively small.

Secondly, if the letting business is a “trade” (i.e. the enterprise qualifies for this exemption), is it a qualifying trade for the purposes of SITR? Answer to which is probably now no. The 2017 Rule Changes will add the leasing of assets to the list of excluded activities for SITR.

*A social enterprise buys a property as an investment – it does not occupy the property, but leases it out. After a year or two, it sells the property (with the tenant in place) and makes a profit. It uses that profit as working capital in its trading activities.*

This is not a qualifying trade for SITR purposes. It is either property development or an investment activity. And the letting of the premises is also not a “trade” or, if it a trade, is likely to be an excluded activity because of the 2017 Rule Changes (see above). The fact that the profits from the property are applied in achieving the enterprise’s social objectives is irrelevant.

*A social enterprise trades by buying run-down houses, and employs homeless people in refurbishing the properties. The employees earn money to help them afford sustainable accommodation, and learn job skills. Once each house is fully refurbished, the enterprise sells the house for a profit. That profit is then ploughed back into the enterprise or used to fund the purchase of the next property to be refurbished.*

The intention is clear – i.e. to renovate the property and then sell it on for a profit. The fact that by doing so the enterprise achieves its social impact objectives is irrelevant. This is property development.

*A social enterprise trades by buying run-down houses, and employs homeless people in refurbishing the properties. Once each property is refurbished it is let (on a commercial basis) to the homeless people that the enterprise supports. The rental income is used as working capital in the enterprise or to help fund the purchase of the next property to be refurbished.*

Whether or not this might amount to “property development” will depend on the intention of the parties at the time each property was acquired. If the intention is to build up a “bank” of properties to be let as some form of social housing for the long term, it may well not be regarded as property development. However, the activity of letting may not be a “trade” or, if it a trade, is likely to be an excluded activity because of the 2017 Rule Changes (see above), so the enterprise may well not qualify for SITR.

*A social enterprise trades by refurbishing or redeveloping run-down houses, and employs homeless people in refurbishing the properties. However the social enterprise does not own the properties, which are bought and sold by a local property company which is a supporter of the social enterprise.*



This is not “property development” because the social enterprise has no interest in the properties being developed. It is a building contractor – which in these circumstances is a qualifying trade for SITR. However if the local property company that owns the properties, and contacts with the social enterprise, is also a shareholder in the social enterprise there may be an issue.

*A social enterprise has been given a dilapidated house and outbuildings that used to be the home of a famous author. It intends to raise funding to restore the house and outbuildings and open it to the public as a visitor attraction. It will generate revenues by charging an entrance fee, as well as running a restaurant, coffee shop and bookstore in the outbuildings. It will also rent out the space for corporate events in the evenings.*

The intention of the social enterprise is to restore premises out of which it will then trade. It is not doing this with the “sole or main object” of developing the property and selling it on for a profit. So this is not property development.

Running a restaurant, coffee shop and bookshop would be qualifying trades (but see the next example below for a potential trap).

Renting out the space for corporate hospitality may be “letting”, and therefore an excluded activity under the 2017 Rule Changes. However, if the social enterprise provides all the food, drink and entertainment, that aspect of its trade may be regarded as a service (rather than simple letting of space). Even if that were not the may well be qualifying.

*Let’s say that the same social enterprise decides that it does not want to run the restaurant and coffee shop. It lacks the expertise and does not wish to take the risk of making a loss, which might undermine the social impact objectives of the enterprise. So it invites catering companies to bid to operate concessions within the outbuildings. Under the concession agreement, the social enterprise allows the caterer to occupy the outbuildings during opening hours and to operate the restaurant and coffee shop in return for a fee calculated as a % of turnover.*

The concession agreement has changed the nature of the trade carried on by the social enterprise. As far as the SITR rules go, the caterer, and not the social enterprise, is operating the trade of running of a restaurant and coffee shop. The social enterprise’s “trade” is that of allowing the caterer to use the premises, for which it charges a fee. Which HMRC would regard as a form of lease or license. And as we have explained above, the activity of letting may not be a “trade” or, if it a trade, is likely to be an excluded activity because of the 2017 Rule Changes (see above). As the revenues generated by the restaurant and coffee shop are likely to be the majority of all trading revenues, the enterprise may well not qualify for SITR.

A more detailed note on this issue (and related points) is available on this website by clicking [here](#).

*A social enterprise intends to operate a sports centre in an inner-city area. It is given a dilapidated sports centre by the local authority that can no longer afford to run it. The social enterprise will raise money to refurbish the building and surrounding football and hockey pitches and tennis courts. It will then operate the sports centre and generate revenues by running fitness classes, operating a gym and letting individuals and teams book (by the hour) the use of the football and hockey pitches and tennis courts. It will also run a café.*

The intention of the social enterprise is to acquire premises out of which it trades. It is not doing this with the “sole or main object” of developing the property and selling it on for a profit. So this is not property development.



Whether or not its trade will be a qualifying trade will depend on the relative importance of each of its activities. Running fitness classes, operating a gym and maintaining a café are likely to be qualifying activities. However under the 2017 Rule Changes simply letting out the football and hockey pitches and tennis courts by the hour may be regarded as an excluded activity.

So we would have to look at the relative importance of each activity and assess whether or not the non-qualifying trading activities were material in the context of the overall trade.

But social enterprises that generate revenues from letting out the use of land or buildings by the hour, such as sports halls and village or community halls will need to assess whether or not their trades are now treated by HMRC as “letting assets on hire” which would be an excluded activity under the 2017 Rule Changes.

### The small print (or stuff our lawyers tell us to say)

This note is intended only as a guide. It is a very brief overview of what can be a complex area of the law. People have written whole books on this area, and we’ve restricted ourselves to a few pages. And the tax treatment of property transactions is very specific to the facts in each case, making it difficult to generalise.

So this note is not advice and if it’s wrong we will not have any liability to you. We’re just trying to be helpful.

Also, remember that the 2017 Rule Changes have not yet been enacted. We’ve assumed that they will be. But please bear in mind that the draft legislation might change, or the proposed changes may take effect from a different date, or they may not be enacted at all.

If you are an enterprise looking to raise SITR-eligible funding, or an investor looking to make an SITR-qualifying investment, you must take independent advice from a suitably qualified professional adviser **before** you act.

These notes are not a comprehensive review of the law relating to SITR. They are for information purposes only to give the reader a better understanding of this area and have been produced by Big Society Capital in its capacity as champion for the social investment market.

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