DIY SOCIAL INVESTMENT

A SOCIAL ENTREPRENEUR'S GUIDE TO CREATING YOUR OWN SOCIAL INVESTMENT THROUGH SOCIAL INVESTMENT TAX RELIEF (SITR)

FOR SOCIAL ENTERPRISES AND CHARITIES

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GET SITR
A tax break for charities and social enterprises

FLIP FINANCE

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FOREWORD

This guide is written primarily for social entrepreneurs seeking to raise finance for their project, though it will hopefully also be a useful resource for support agencies and social investment professionals.

It aims to empower entrepreneurs to consider an alternative method of finance that could enable you to achieve your ambitions without impinging on your social mission. The model we have used is innovative - in the sense that very few people have used it - but it is one that you could you use too.

The motivation to publish a guide comes from one of my social enterprise's, Freedom Bakery, social missions: to disclose our business model and our experiences of seeking finance for the benefit of other entrepreneurs, social enterprises and charities.

I hope this guide shows you, as entrepreneurs, that 'DIY social investment' could be an option for your organisation, whilst also providing policymakers and funders with valuable insights into how to support this new but potentially significant part of the social investment landscape.

Matt Fountain
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FREEDOM BAKERY

Glasgow, 01 April 2016

IMPORTANT

The following document is from a social enterprise and charity perspective and is for guidance only. It cannot be accepted as professional tax, legal or investment advice. Any organisation looking to create their own investment proposition - Social Investment Tax Relief (SITR) or otherwise - should consider taking independent advice and should not rely solely on the contents of this guide.

The full rules related to SITR and financial promotions are more complex than illustrated here. Therefore, the contents of this guide should not be treated as comprehensive.

Organisations and individuals need to be aware of and should consider taking professional advice on:

(i) Insolvency rules needing to be considered whenever an organisation takes on debt (breach of these rules can result in personal liability for directors);

(ii) Regulations around inviting members of the public to invest (again, breach of these rules can result in personal liability for directors).

Delivered Next Day Personally (DNDP) raised £50,000 investment through SITR

GLOSSARY
KEY TERMINOLOGY EXPLAINED

Asset: Something that an organisation owns - often a building or equipment.

Debt Finance: An amount of money borrowed, typically to provide working capital, by an organisation from another organisation or individual.

Capital Holiday: A period of time where the principal of a loan does not need to be paid. With SITR, this period is a minimum of 3 years and 1 day.

Creditors: Institutions or individuals who lend money to an organisation.

'De Minimis' State Aid: In this context, we mean where an organisation has received funding directly or indirectly from the government.

Enterprise Investment Scheme (EIS): A tax relief scheme (launched in 1994) designed to encourage investments in small unquoted companies 'carrying on' a qualifying trade in the UK.

Equity: A stake in an enterprise owned by shareholders. Some social enterprises have shareholding structures (often special rules apply to protect the organisation's assets) but, currently, this is relatively uncommon across the social sector.

High Net Worth Individual (HNWI): A classification that denotes the wealth of a person. Although there is no precise definition of how rich somebody must be to fit into this category, Nesta and others define it as 'those with greater than £1,000,000 of investable wealth'.

Interest: A fee paid by a borrower (i.e. an organisation) to a lender (i.e. an investor) on top of repaying the money that has been lent.

Patient Capital: Money lent by an investor who is prepared to wait a relatively long time to get their money back. Also known as long term capital.

Principal: The money originally invested or loaned, on which base interest and returns are calculated.

Retail Investor: Typically, an investor who invests small amounts of their own money rather than investing on behalf of others.

Risk: The potential of losing an investment weighed against the potential of making a profit on the investment and / or achieving positive social change through that investment.

Self-generated Revenue: Revenue generated by an organisation either trading in the sale of a product or service, rather than receiving its income in the form of grants.

Social Investment Finance Intermediary (SIFI): An organisation that connects an enterprise with a social purpose with investment, either by raising and investment funds or by helping enterprises to find investment.

Social Investment Tax Relief (SITR): The government's tax relief scheme for social investment which encourages individuals to support social enterprises and charities by helping them access new sources of repayable finance. Individuals receive a 30% tax break when investing into an eligible organisation

Subordinated Debt: Debt which is ranked below more 'senior' debt. In the event that the borrower organisation is wound up, subordinated debt will be paid only after other senior creditors have received payment. Because the risk for the lender is greater, interest rates are usually higher than for secured loans.

Unsecured Loan: A loan that does not take security over an organisation's assets. Because the risk for the lender is greater, interest rates are usually higher than for secured loans.

Working Capital: Money an organisation needs to finance its day-to-day operations.

INTRODUCTION

This guide is split into three parts: a short introduction to social investment and Social Investment Tax Relief (SITR); a case study of how we used SITR to raise finance for Freedom Bakery; and a step-by-step guide for charities and social enterprises hoping to use SITR.

SITR can be a useful tool for social entrepreneurs looking for investment to develop their early stage venture. It gives social enterprises the chance to raise money directly from investors who will invest on the right terms for the business and may also offer to contribute any relevant expertise they have to your venture.

This guide focuses on raising finance via SITR loans rather than selling equity as most charities and social enterprises are unable to sell shares. Some of this procedural guidance is not currently covered by existing government guidance.

FC United of Manchester raised £270,000 investment through SITR

PART 1
SOME USEFUL CONTEXT

Why social investment?

Most social entrepreneurs begin their quest by piloting their idea with grant funding. As ideas become concepts and concepts get defined in a business plan, we look for next stage grant funding to allow us to properly establish ourselves and begin to trade. At this stage, your growing social enterprise may also need to consider taking on repayable finance to supplement its revenue-generating or grant-funded activities.

The need for additional finance is often due to one of two reasons: (i) the initial startup costs of a project are not fully covered by available grant funding or (ii) the project has a radical approach and may not be eligible for the grants that are available.

The 2008 recession led to fundamental changes in the overall funding situation for the social sector, and the sector responded by supporting the creation of a social investment market.

The aim of this market is that charities and social enterprises are able to access finance that they would be prohibited from accessing from the mainstream, for example, from banks. There are many social investment products available, but in this guidance we will focus on loans (also known as debt finance).

Many social enterprise and charity boards do not want to take debt because they are uneasy about taking on liabilities which they may not be able to repay. Traditionally, loans are difficult to get from mainstream banks. The social investment market includes specialist Social Investment Finance Intermediaries (SIFIs). These investors are supportive, knowledgeable and accessible and can make it easier for social enterprises and charities to obtain loan finance.

However, the finance provided by SIFIs can come up at high interest rates, so some entrepreneurs or boards may be deterred by the cost and affordability of their money. Social Investment Tax Relief (SITR) offers an alternative.

What is Social Investment Tax Relief (SITR)?

SITR is a relatively new tax break, which helps social enterprises and charities to raise finance from individual investors by offering those investors 30% income tax relief on loans or equity investment into social enterprises and charities.

SITR essentially mimics some already well-established tax schemes for private companies - such as Enterprise Investment Scheme (EIS) - that many new businesses utilise in order to raise investment. So, although the concept might seem foreign to social sector eyes, SITR is something which has been designed for the investing world to understand, particularly traditional investors, often known as high net worth individuals (HNWIs).

The major difference between SITR and other investment tax breaks is that it can be used for unsecured loans whereas schemes aimed at private businesses are usually focused on equity investments (**see Part 3 - The Rules**).

Benefits of an SITR loan

The key benefit for investors in making an SITR loan is that, through this scheme, the government is reducing the risk involved in investing in your social enterprise. The investor is guaranteed to get 30% of their investment ('the principle') off their income tax bill whatever happens.

So if, for example, an investor lends your social enterprise £10,000, they would then be able to reduce their income tax bill for the year by £3,000. In addition, investors can receive interest on their loan - though interest rates cannot exceed 'reasonable' commercial rates - so if your social enterprise successfully repays the investment, the investor has got a really good deal.

An additional benefit is that because SITR, unlike other tax breaks, applies to unsecured loans as well as equity investments, investors do not need to worry about their 'exit'. They can make an investment and have their money repaid without needing the company to reach a point where they can sell their shares to somebody else.

The benefits for social enterprises and charities are:

- **It can be easier to get investment:** because SITR reduces the risk of investing in social enterprises and charities, it is more likely that investors will be interested in investing.
- **Patient capital:** repayments of SITR loans cannot begin until 3 years and 1 day after the investment has been made, so organisations do not need to worry about repayments for the first years and may therefore need to borrow less to manage their cashflow.
- **Investment on the right terms:** raising investment directly through an SITR loan means social enterprises and charities have the ability to negotiate their own terms with investors, which means that loans could be cheaper than what is available from banks or SIFIs, and investors may even agree to interest-free loans.

FareShare SouthWest raised £70,000 investment through SITR

PART 2
FREEDOM'S INVESTMENT STORY

Freedom Bakery kitchen at HMP Low Moss - trainee bakers prepping orders

Starting up Freedom Bakery CIC

The Freedom Bakery is a startup social enterprise that established an artisan baking and catering facility at HMP Low Moss (near Glasgow) to train offenders and enhance their employability. We generate income by selling the products baked by offenders, both within the jail and to wholesale and retail customers in Glasgow.

In April 2015, following a 6-month feasibility study, we received 4-year contract from the Scottish Prison Service (SPS) to establish a kitchen and café at Low Moss and started looking for investment to get the bakery up and running.

The initial investment we needed, £65,000, was high for an early stage social enterprise. As the bakery was a new, untested concept, we were unlikely to secure more than a third of the money through grant funding and, as Freedom is a Community Interest Company (CIC) limited by guarantee, we could not sell shares.

We had to consider other options, so we looked into getting a loan from a Social Investment Finance Intermediary (SIFI) to be repaid over the 4 years of our contract with the SPS. We found three possible loan deals available to us from SIFIs in Scotland and the UK. The costs were higher than a loan from a mainstream provider because of the perceived risk in lending to a new social enterprise.

The details of these loan options were as follows:

	Loan Amount	Loan Interest per annum	Repayment Period	Interest Holiday	Capital Holiday	Total Repayment
Option 1	£45,000	7%	4 years	1 years	1 years	£50,021
Option 2	£40,000 (plus £20,000 grant)[1]	7%	4 years	0 years	0 years	£45,977
Option 3	£45,000	10%	4 years	0 years	0 years	£54,783

The obvious choice was to pursue Option 2 because, in addition to being the cheapest investment option, it would also provide the grant funding we were looking for. Unfortunately, Option 2 was offered by a fund that is intended for specific geographic locations. Low Moss prison (3 miles outside Glasgow) is located in an ineligible postcode. Even though Option 2 were willing to accept an application, Freedom's board were concerned about spending time on an application before being told that we did not meet the eligibility requirements. We therefore did not pursue an application for this option.

Both Option 1 and Option 3 required Freedom to borrow more than we wanted to: £45,000 instead of £40,000. Borrowing more than we needed would mean we had to generate more income to meet repayments. We were concerned that this would make the project financially unsustainable, so we decided we could not pursue either of these options.[2]

[1] For this particular loan/grant option the maximum loan that can be taken out is £40,000. A grant of 50% on the loan was offered as part of this option.

[2] Later, however, once we proved that 91% of our beneficiaries resided in the eligible postcodes of this fund, we did receive funding from this SIFI.

SITR as an option for Freedom

Fortunately, it turned out there was another option that we learnt about through the CIC Association. We could create a loan offer ourselves and directly approach individual investors to ask for the money and, after qualifying for SITR Advance Assurance (see below), we would be able to offer investors a reasonable overall return on investment (ROI).

We did our research on how SITR could work and how Freedom might market our investment opportunity, then put forward a proposal to potential investors (**see Appendix 1**).

Details of the loan are summarised here:

	Loan Amount	Loan Interest on principle	Repayment Period	Interest Holiday	Capital Holiday	Total Repayment
SITR	£40,000	7% (equivalent to 1.75% APR)	4 years	0 years	3 years and 1 day	£42,800

Creating an SITR loan enabled Freedom to seek finance that was far cheaper than the options offered by SIFIs. In addition to the lower interest costs, the fact that we did not have to start repaying the capital until the beginning of year 4 of the loan contract, meant Freedom could manage our cashflow more efficiently and borrow less.

We offered a deliberately low interest rate (7% on the principle, equivalent to 1.75% per annum over four years) because we were aware that the 30% tax relief would be the main financial draw to the investment, while the interest would be seen as an additional benefit. We could have offered a 0% interest rate and subsequently discovered that some of our investors would have still invested if this had been the offer.

We advertised the interest based on a percentage of the principal (i.e. as a proportion of the sum borrowed) rather than the standard per annum basis (where interest is calculated on the sum owed at the start of each new year). This was unintentional and based on my inexperience of loan finance. However, it actually makes the offer more transparent and easier to understand for both organisations and non-professional investors.

Attaining Advance Assurance

In a nutshell, Advance Assurance is a process through which you inform HMRC of the maximum amount of investment you plan to raise through SITR, what you intend to do with that capital, and how your deal meets the criteria of the tax relief scheme. Gaining Advance Assurance is not a statutory requirement of SITR i.e. it is optional. However, it is a vitally important step as it minimises the risk of your SITR loan offer not qualifying for tax relief when your investors make their investments.

There is plenty of online guidance on how to put together an application for Advanced Assurance with HMRC, but the information is fragmented and often hard to understand. I worked my way through the guidance but found it difficult so, after preparing as much of the application as I could, I approached a tax specialist who had given presentations on SITR and asked for their assistance.

Although this guide gives you the essential information you need to prepare your own SITR deal - enabling you to do a lot of the groundwork yourself - final checks by a lawyer and a tax specialist are highly recommended. In our case, the tax specialist suggested some changes to the legal wording of our application and submitted it on Freedom's behalf.

Freedom's rye and walnut breads being prepped prior to baking

In the end, Freedom applied for assurance to raise up to £50,000 through SITR. Our original intention was to raise £40,000, but by applying for Advanced Assurance to raise up to £50,000, we gave ourselves the option of raising an additional £10,000 without going through the application process again. There are no penalties for not raising the full amount stated on your Advance Assurance.

The application took a week to prepare and it was a further 4 weeks from submission until Advance Assurance was given by HMRC. During this period, I began seeking investors.

Finding our investors

None of the investment professionals were able to help us in an official capacity, because they did not work with SITR investments, and I was under the impression (wrongly, it turns out) that angel networks would see our investment opportunity as being too small. So although I pitched at a couple of angel network events, we didn't pursue this option rigorously.

What did happen was that the contacts in our networks distributed Freedom's proposal to their personal networks, and it was through this process that we quickly found the individuals who wanted to invest. It took 6 weeks to find the investors we needed to make up the SITR loan of £40,000 in this first round. We went on to raise another £8,500 in a second round, which was completed one month after the first. In total, we raised £48,500 of the £50,000 we could have raised based on our Advance Assurance.

Our secondary strategy (if we hadn't found the investors we needed through our own networks) would have been to approach a peer-to-peer (P2P) business loan intermediary, such as Funding Circle, and appeal to the 'crowd' directly. This would have made the loan more expensive due to the costs involved in using the platform (though still cheaper than SIFI-based investment) but it can be a good route for reaching potential investors. It is likely that this option will become easier during 2016 due to the matchfunding for investments via crowdfunding platforms provided by Big Society Capital.

Profile of Freedom's investors

Over two funding rounds we received investment from seven people in total, each investing between £2,000 and £11,000. None of the investors would be described as 'social investors' - in the sense of being part of organised social angel networks. Two of our investors were within our immediate network; the other five were unknown to us before we began raising the investment.

Two of our investors would be classified as high net worth individuals (HNWIs), and there are two that are not HNWIs but are experienced in making traditional investments. The other three would be classified as 'retail investors', and one of these investors took all their money out of a stagnant ISA investment and put it into Freedom via our SITR loan offer.

Geographically, two of the investors are based in Scotland, the other five are based in London and the South East. They all are aged between 40 – 60 years old, three of which are female and four are male.

Though we didn't systematically research the motivations of our investors, the majority said that their primary interest was in Freedom's social objectives. It also became apparent that the tax relief was of more importance than the 7% interest on the principle that we offered in addition to the 30% tax relief.

It's worth noting that the process of taking on SITR investment does not just bring capital, it also broadens networks and brings additional expertise to the mix. One investor with relevant industry experience has even joined Freedom's Advisory Board and another acts as an advisor, whose expertise we're able to draw on whenever needed.

The finished product 48 hours later - Freedom's baguettes

PART 3
HOW DOES SITR WORK?

The Rules

The rules around SITR are quite distinct and have been designed so that no one individual can have influence either upon governance, or on the finances of the social enterprise[3]. The following rules need to be adhered to and communicated when a social enterprise 'advertises' the investment to an individual (**see Appendix 1** as an example).

Rules for the investor

- Tax relief can only be claimed by individuals.
- Individuals[4] cannot[5] be an employee, trustee, partner or a paid director. If an individual makes an investment and then becomes a paid director, this will not prohibit the individual from receiving SITR relief as long as their wage is in line with the service they provide.
- Individuals must hold their investments for 3 years and 1 day, before any principal repayment can be made. There cannot be any prearranged exits that provide for an exit within that initial 3-year holding period. Interest can be paid back throughout the loan period (provided the rate of return is reasonable).
- Any loan must be unsecured and must be subordinated debt. What this means is that if the social enterprise were to fail and wind up, the loan comes at the bottom of the pile of debts that are paid back in the sale / appraisal of the social enterprise's assets to meet the repayment of its debts. It also means that if the social enterprise has shares, the SITR loan will be repaid alongside the lowest ranking class of shares.
- Individuals[6] cannot hold more than 30% of the total loan capital. For example, if a social enterprise has loan capital of £10,000, the maximum an individual could lend is £3,000[7]. By implication then, in an SITR loan a social enterprise will be looking for at least 4 individuals to make up a loan quota, if it has no other debt.
- If there are no other loan agreements in place - i.e. the SITR loan makes up the full loan capital of the organisation - individuals will need to be coordinated to transfer money on the same day (or within a 24 hour period). This is because if an individual were to transfer earlier than another, then technically they would hold 100% of the loan capital.

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[3] They may however take an advisory role.

[4] This rule covers investors and also "associates" of the investor (namely (i) spouse or civil partner, ancestors or lineal descendants, (ii) business partners and (iii) certain trusts).

[5] Save in very limited circumstances.

[6] This rule covers individuals and also "associates" of the investor partner, ancestors or lineal descendants, business partners and certain trusts).

[7] Also organisations have to be careful that none of the other loan capital is repaid early as this would take the SITR investor above 30%.

- All money pledged for the SITR loan needs to be transferred to the social enterprise before the loan agreement becomes effective. The loan contract date can be set later than the agreed date for investors to transfer their money.
- There is an individual limit of £1 million per tax year for SITR investments.
- The interest rate cannot be higher than a 'reasonable commercial' rate of return, i.e. what a bank might offer a small business. By implication social enterprises should always seek favourable terms.

Rules for social enterprises and charities

There are specific qualifications for defining a social enterprise and its activities in SITR.

- The social enterprise or charity needs to take one of the following legal structures:
  - **Social enterprises:** any form of Community Interest Company (CIC).
  - **Charities:** a Trust or a company with 'charitable status'.
  - **Community Benefit Societies:** must be a prescribed 'BenCom' (i.e. incorporate in its Rules an asset lock etc). These cannot include 'social landlords'.
- The organisation cannot have more than £15 million in gross assets immediately before the investment is made.
- The organisation needs to be unquoted (i.e. not trade on a recognised stock exchange) but this is unlikely to be a concern for readers here.
- The organisation cannot be controlled by another company.
- There must be fewer than 500 employees (full time equivalent).
- The organisation cannot be in a partnership.
- In a group structure all subsidiary companies need to be 51% owned by the parent organisation.

There are also specific trading requirements, which largely prohibit social enterprises and charities that will be trading in financial services (except in lending to other social enterprises and charities), insurance and aspects of property, i.e. dealing in land or property development[8]. Other excluded trading activities include fishery and aquaculture, production of agricultural products, generating electricity for export, road freight for hire or purchase.

There are specific rules around an organisation seeking SITR investment:

- Currently, a social enterprise, Trust or qualifying BenCom cannot raise more than around £270,000 in any rolling 3-year period. The government has announced that it intends to raise this to £5 million in any one year, but this has not yet been enacted due to awaiting approval from the EU Commission.

[8] Big Society Capital (BSC) have published more detail in SITR and Property Development - March 2015.

- Any 'De Minimis' State Aid counts towards that £270,000 cap. This means that if a social enterprise or charity is receiving grants that come from government sources, then this will be deducted from the amount the organisation can raise under SITR.
- All monies lent under an SITR loan must be used for qualifying trading activities, i.e. those set out in the SITR application, within 28 months of the loan being made to a social enterprise or charity.

01. Advance Assurance

Once entrepreneurs are satisfied that their social enterprise structure (or equivalent, as stated above) and proposed investment offer qualifies for SITR, they should seek to gain 'Advance Assurance' from HMRC. Although it is not compulsory, it gives investors certainty of tax relief, and smooths the process when the tax relief is actually claimed.

To obtain an Advance Assurance, organisations need to send all the required information for SITR accreditation to HMRC to assess whether your investors are eligible for SITR tax relief. It is relatively straightforward, and requires the following:

- A covering email to HMRC (**enterprise.centre@hmrc.gsi.gov.uk**)
- An Appendix setting out details of the investment as a covering document
- Attachments of the following documents:
  - (a) Certificate of Incorporation.
  - (b) Articles of Association (or other constitutional documents e.g. a Trust Deed).
  - (c) Memorandum of Association.
  - (d) Executive Summary advertising the investment (**see Appendix 1**).
  - (e) Loan Agreement (**see Appendix 2**).
  - (f) Any documents which may support your investment, e.g. a copy of a contract which shows sustained income.
  - (g) If using an agent, a signed letter of a director or trustee of the organisation directing the agent to act on their behalf. Your agent can provide you with the letter to sign, and return.

02. Compliance Statement

The next stage is to submit a Compliance Statement to HMRC, through which HMRC checks and agrees that the legal conditions of your SITR loan offer laid out in the Advance Assurance (if you have made an application) have been met. Similar checks that legal conditions have been met apply if Advance Assurance has not been sought. HMRC will also review the details of the individuals who have made pledges to invest in your enterprise through your SITR loan offer.

A social enterprise (or qualifying equivalent) must complete a Compliance Statement every time a new investment is received from new investors, or if existing investors make further investments to the social enterprise. To clarify, by 'each time' HMRC mean:

- Where multiple investors invest on the same date, in the same organisation, you must send HMRC a Compliance Statement recording all of the investments made on that date (regardless of whether the investment takes the form of shares, debt or a mixture of both).
- Where the investments are made on a number of different dates, in the same organisation, you must send HMRC a separate Compliance Statement for each day the investments were made, showing all the investments made on that date (regardless of whether the investment takes the form of shares, debt or a mixture of both).

The Compliance Statement form can be downloaded here:
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/375550/sitr.pdf

Guidance notes for the Compliance Statement form can be downloaded here:
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/375551/sitr-notes.pdf

Compliance Statements need to be submitted for each investment within the following time frame:

- **Earliest date:** The relevant trading activity funded through SITR must have begun and been sustained for 4 months.
- **Latest date:** No later than 2 years after the end of the tax year in which the investment was made or, if later, 2 years after the earliest date as referred to above.

You may additionally need to send the same supporting documentation as in the Advance Assurance Application (see above). However, so long as what was submitted to HMRC in the Advance Assurance application has not changed since, then it is not necessary to submit the same documentation again. Post the form to the following address:

Small Company Enterprise Centre (Admin Team)
Mid-size Business S0777
PO Box 3900
Glasgow
G70 6AA

03. Compliance Certificate

Once HMRC have accepted the Compliance Statement, they will send a letter to the social enterprise (or qualifying equivalent) allowing it to issue Compliance Certificates. A Compliance Certificate must be issued to all investors who were stated on the Compliance Statement form. Investors will need these certificates to actually claim the tax relief.

HMRC will issue their own copy of the Compliance Certificate along with a covering note recording each investor's name, the amount they have invested and the date the investment was made. This could take 4 - 6 weeks.

How investors claim tax relief

The Compliance Certificate allows individuals, who have invested in organiations via an SITR loan offer, to claim the tax relief on their investment. The government has published guidance notes for investors claiming tax relief:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/389931/investors-process.pdf

In the context of an SITR loan, investors will seek a rebate from their income tax liability for the tax year in which the loan was made. Investors can claim up to 5 years after the 31 January in the following tax year in which the investment was made (this is a longer period than most tax relief schemes, to take account of the fact that it is partially dependent on what a social enterprise does).

There is a 'carry-back' facility which allows all or part of the amount invested in one tax year to be treated as though the investment had been made in the preceding tax year. For example, investors making investments after 06 April 2016, can carry-back their relief for the tax year 2015/16.

Self Assessed investors can make a claim to SITR relief in one of two ways. In both cases it is best to do this online, as the service is better prepared for SITR claims, and it will save time. Investors can either:

- Make a claim on their Self Assessment tax return for the tax year in which they made your investment.
- Ask for their Self Assessment payment on the account bill to be reduced to reflect any relief that is due (if they opt for this approach, they will still have to show the claim on your SA tax return, when they get it).

If an investor pays tax through PAYE and does not complete a Self Assessment return, then these investors should write to HMRC (at the address shown on their latest notice of tax code), enclosing the relevant Compliance Certificate(s). HMRC will then process the claim and, once qualified, will issue a new tax code to an investor's employer.

Social Investment Tax Relief process summary

Pre Investment →

Post Investment →

STEP 1 - **ELIGIBILITY**

- No more than £15m in gross assets
- Up to 500 employees
- CIC, Charity (Trust or company with charitable status) or BenCom (without obviously ineligible trading activity)

STEP 2 - **INVESTOR RESEARCH**

Possible investment source

- SITR Investment Fund
- Crowd / Community Shares
- Retail investors (minimum 4 or no more than 30% of debt)

Investment size & terms

- Amount of debt (or equity)
- Term of Loan – duration & interest

STEP 3 - **PRE-ASSURANCE**

- Prepare Advance Assurance document
- 4 – 6 weeks for HMRC processing

STEP 4 - **INVESTMENT PREPARATION**

- Secure investor source
- Complete legal documentation (see examples in Appendices 1 & 2)
- Agree date for transfer of funds with investors
- Agree date for commencement of loan contract

STEP 5 - **INVESTMENT**

- Ensure that all money has been transferred in advance of start date of the loan contract to ensure no investor holds more than 30% of the debt

STEP 6 - **SITR COMPLIANCE**

Statement

- Sent to HMRC each time a new investment is made
- Earliest date: trading activity funded through SITR must have begun and been sustained for at least 4 months
- Latest date: no later than 2 years after the end of the tax year in which the investment was made

Certificate

- Must be issued to each investor

STEP 7 - **REPAYMENT OF DEBT**

- Minimum of 3 years and 1 day capital holiday.
- If applicable, interest to be paid throughout loan period, which is on average 5 years.

Entrepreneurs and social enterprises – the environment and the ethical question?

We are only just emerging out of one of the worst widespread financial crises the world has experienced. Unfortunately its effects will be felt by the social sector for some time.

This period of economic turmoil has set the context for many important debates and has encouraged social enterprises to generate ideas for how the sector deals with survival and recovery.

Does the current economic situation increase the need for social enterprises and charities to adopt more commercial approaches in order to become self-sufficient?

Is it fair that the social sector should be made to change following an economic crash that many see as being the fault of governments and big business?

These debates persist amongst academics and within the sector. While the economic situation makes the arguments particularly topical, they're ultimately just part of a seemingly endless discussion about what the role of social enterprise should be.

Cultural attitudes

The questions around investment into social enterprises and charities are not just to do with diminishing grant pots or higher competition as the sector (and social need) grows: they're often about cultural attitudes towards trading to become self-sufficient.

If we view the social sector as a spectrum of organisations with business models ranging from the entirely non-commercial (hospices or homeless shelters) to the commercial (community cafés or 'green' energy suppliers) then we can understand the diversity of organisations within the sector.

There is a big difference between an entrepreneur-led social organisation established as a social enterprise primarily for ease of governance, and a social enterprise set up by a charity as a commercial subsidiary to generate revenue to fund its charitable aims. Many social organisations blend social aims directly with revenue generation using models like supported employment.

Understanding this spectrum of commercial and non-commercial activities should assist entrepreneurs in deciding where SITR can be utilised appropriately, i.e. its most useful for social enterprises and charities who are ultimately aiming to become self-sufficient through trading income.

Competing in commercial markets

Any social enterprise that is selling a product or service to the public is competing within a commercial market. As a social enterprise, Freedom is part of the social sector but we do not identify ourselves primarily as part of the social sector. More importantly, we are a bakery competing with other bakeries to sell people bread and pastries.

To become a self-sustaining social enterprise we need to focus on marketing, branding, revenue targets and competitive strategies. However, implementing such strategies does not need to be to the detriment of achieving social outcomes.

I would argue that it is the entrepreneur's responsibility to secure social outcomes by achieving financial sustainability. If you are running a social enterprise competing in commercial markets and you are not financially sustainable then your business model is flawed and it needs to be revised.

SITR is a useful tool for social entrepreneurs looking for investment to develop their early stage venture into a self-sufficient business. It gives social enterprises the chance to raise money from investors who will invest on the right terms for the business and may also offer additional expertise. Hopefully SITR has been explained well enough here, and by other initiatives, that you will consider it as an option when seeking finance for your social enterprise.

Some thoughts on finding investors

Until relatively recently, social investment leaders have viewed individual 'investors' very much from a traditional perspective and have supported the creation of social angel networks - groups of high net worth individuals (HNWIs) keen to invest in businesses that do social good.

There are other ways to find investors. Many social enterprises (and other small businesses) are now seeking alternative finance, including through crowdfunding or peer-to-peer (P2P) lending.

'Understanding Alternative Finance', a report published by Nesta in November 2014, found that the market for P2P business lending (where businesses take on a loan from a 'crowd' of individuals) increased from £62 million in 2012 to £749 million in 2014; an average growth of 250%. SITR loan offers, which requires a minimum of four individual investors, are essentially a form of P2P lending.

The Nesta report delved in the characteristics of P2P lenders. It found that their average income was around £50,000 and that:

> The majority of P2P business lenders learned about this alternative finance model through online advertising (28%) and online intermediaries such as MoneySupermarket (25%). When budgeting for lending through P2P business lending platforms, it is clear that the money primarily comes from lenders' investment budget (54%) or their savings (45%).

Nesta...

These are not traditional investors but wealthy professionals seeking alternatives to poor, savings products; they are 'retail investors':

> In equity-based crowdfunding where the average growth is 410%, 62% of investors had no previous investment experience whatsoever.
>
> Nesta...

Retail investors often value the experience of 'meeting' a potential investee through a video pitch and seeing the investee's personal story can be fundamental in their motivation to invest. They may often use crowdfunding or other P2P lending platforms to invest relatively small amounts in early stage businesses.

This pool of retail investors is likely to increase as 'alternative finance' becomes more mainstream. It is a largely untapped resource of potential investors in SITR finance and social entrepreneurs should pounce on them!

In the conclusion to the Nesta report, the authors identify some key agendas for social enterprises:

> We have seen a substantial number of people offering to contribute non-financial resources, from their time to goods, services or space along with their money on many socially orientated or community-focused alternative finance platforms. We need to understand more about how these resources are contributed and utilised, and to what extent alternative financing activities can increase social action, foster community engagement and increase giving.
>
> We need to understand better how social enterprises, community organisations and voluntary groups can leverage alternative finance more effectively as part of their fundraising toolkit.
>
> Nesta...

What this all amounts to is that within our networks and those of our board, trustees and advisory panel, there are retail investors who would not traditionally be viewed (or view themselves) as 'investors' but may be interested in an SITR investment.

If you are using SITR to raise between £20,000 and £250,000 of patient capital, for startup or early scaling, there will be some investors who you can identify yourself. However, by pitching through crowdfunding or other P2P lending platforms, social enterprises and charities may be able to find investors on a mass scale.

While social enterprises may not be competitive with mainstream businesses, in terms of the interest they can offer, SITR means that we are able to offer a significant tax break on a loan which may make the investment more alluring than investment opportunities provided by many mainstream businesses.

Three ideas for increasing the impact of SITR

1. More research is needed to identify socially motivated 'retail investors' and connect them with social enterprises seeking investment. Social angel networks and alternative finance professionals could also target a wider pool of investors. In Scotland, this could be better supported by the Government.
2. In addition to creating SITR funds in-house, SIFIs could provide a consulting service at the Advance Assurance stage to help social enterprises get applications certified successfully for themselves. This service could be grant funded.
3. In Scotland in particular, there is a need for research into 'mission drift' and grant dependency amongst social enterprises. Such research could help us to plan an initiative to make the social sector more sustainable.

APPENDIX 1

Executive Summary – Investment Proposal

The Freedom Bakery is a social enterprise bakery starting up inside HMP Low Moss near Glasgow. The key features of Freedom are:

- Creating employability out of offenders by providing on the job training and qualifications.
- An extremely marketable and high quality product range, which will allow the enterprise to be profitable and sustainable.
- Trading wholesale as well as the establishment of a café concession within the prison itself.
- To work in partnership with the Scottish Prison Service (SPS) for mutual benefit, i.e. to reduce the risk of the enterprise by providing a kitchen, capital assets and added support and expertise of working with offenders.
- Expansion plans within the next four years, in line with a 4-year contract awarded by the SPS, with options for extension of up to 36 months.

Freedom is Community Interest Company limited by guarantee, with 3 directors, sharing diverse experience:

- Matt Fountain, FRSA, Managing Director and Founder, social entrepreneur with a background in branding strategy.
- *Information withheld here.*
- *Information withheld here.*

Investment Opportunity

Proposition

Freedom has entered into a contract with HMP Low Moss allowing it to establish a bakery within a vacant kitchen to begin wholesale trade. In addition Freedom has also won a 4-year contract to establish a café concession within the visitor prison centre. Based on trading history, this is a guaranteed income of £500,000 over the contract period (bearing in mind it is a captive market). In addition to wholesale trade and catering events, the current projected turnover approaches £750,000 in the next four years, with a profitability of 8%.

Opportunity

Investment is needed for startup. Freedom Bakery CIC is seeking a further £50,000 in investment through an unsecured 4-year fixed rate loan from a number of private individuals. The loan (a maximum of £12,500 capital or 25% of the loan capacity for this investment per individual investor)[9] is being offered at a fixed rate of 7% interest to the investor. The investor may also qualify for the Social Investment Tax Relief (SITR) Scheme. The defining characteristics of the SITR relief are as follows:

- 30% of the amount invested is deducted from the investor's income tax liability for the year in which the investment is made.
- Carry-back facility for investments made after 5 April 2015 (provided personal limit not used up).
- Comparison to Enterprise Investment Scheme (EIS) and Seed EIS (SEIS):
  - Not as generous as SEIS.
  - Same tax reliefs as EIS.
  - However, SITR allows for tax relief on debt (unlike SEIS and EIS).
- Investors must hold their investments for at least 3 years and 1 day in order to qualify for the relief. If they dispose of their investment within that 3 year and 1 day period, SITR is withdrawn.
- There is no seniority of investors in the SITR debt. SITR debt is subordinated to all other debts.
- Cash must have been advanced when the loan agreement becomes effective.
- An investor can have no control over the social enterprise.

The return of £12,500 loan with 7% ROI (return on investment), the net total return will be £13,375 plus a further £3750 in tax relief.

In addition to the financial return on the investment, for every £1 invested £34 will be saved by the taxpayer in the 4-year period.

Please find below summary financial projections for the investment. A full-scale business plan is consultable also. *Information not included here.*

[9] To meet the rules of SITR, an investor cannot have more than 30% invested in the loan capital of the social enterprise.

Loan Agreement

THIS LOAN AGREEMENT (this "Agreement") dated this 1st day of June 2015 BETWEEN:

[....................................] (the "Lender")

OF THE FIRST PART

AND

Freedom Bakery CIC of 152 Bath Street, Glasgow, SCT, G2 4TB (the "Borrower")

OF THE SECOND PART

IN CONSIDERATION OF the Lender loaning certain monies (the "Loan") to the Borrower, and the Borrower repaying the Loan to the Lender, both parties agree to keep, perform and fulfil the promises and conditions set out in this Agreement:

Loan Amount & Interest

1. The Lender promises to loan £00,000.00 GBP to the Borrower and the Borrower promises to repay this principal amount to the Lender, with interest payable on the unpaid principal at the rate of 7.00 per cent fixed rate, calculated in advance over a four-year period from the date of issue. The loan is unsecured.

Payment

2. Interest will be paid monthly on the fourteenth day of each month in the sum of £[ ] per month on the first day of each month commencing on July 1st 2015 and continuing until June 1st 2018.
3. From July 1st 2018 the principal then owing under this Agreement will be paid in twelve equal consecutive monthly instalments of principal only on the first day each month until June 1st 2019.

Subordination in a Winding Up

4. The Lender agrees that in the event of a winding up of the Borrower (and insofar as the law allows) the Loan is postponed and subordinated in right of payment to the debts of any other creditor of the Borrower save for any other debt in respect of which the lender shall have claimed Social Investment Tax Relief under part 5B of the Income Tax Act 2007 and any other unsecured debentures of the Borrower which rank equally. The Lender shall not take any steps to seek repayment of the Loan or to enforce this agreement as against the Borrower in contravention of this clause 5.

Governing Law

5. This Agreement will be construed in accordance with and governed by the laws of Country of Scotland.

Costs

6. All costs, expenses and expenditures including, without limitation, the complete legal costs incurred by enforcing this Agreement as a result of any default by the Borrower, will be added to the principal then outstanding and will immediately be paid by the Borrower.

Binding Effect

7. This Agreement will pass to the benefit of and be binding upon the respective heirs, executors, administrators, successors and permitted assigns of the Borrower and Lender. The Borrower waives presentment for payment, notice of no payment, protest, and notice of protest.

Amendments

8. This Agreement may only be amended or modified by a written instrument executed by both the Borrower and the Lender.

Severability

9. The clauses and paragraphs contained in this Agreement are intended to be read and construed independently of each other. If any term, covenant, condition or provision of this Agreement is held by a court of competent jurisdiction to be invalid, void or unenforceable, it is the parties' intent that such provision be reduced in scope by the court only to the extent deemed necessary by that court to render the provision reasonable and enforceable and the remainder of the provisions of this Agreement will in no way be affected, impaired or invalidated as a result.

General Provisions

10. Headings are inserted for the convenience of the parties only and are not to be considered when interpreting this Agreement. Words in the singular mean and include the plural and vice versa. Words in the masculine mean and include the feminine and vice versa.

Entire Agreement

11. This Agreement constitutes the entire agreement between the parties and there are no further items or provisions, either oral or otherwise.
12. The Borrower acknowledges that it has received the principal sum from the Lender on the date the agreement is made.

SIGNED, SEALED AND DELIVERED
WITNESS - address:

....

....

....

SIGNED, SEALED AND DELIVERED
WITNESS - address:

....

....

Freedom Bakery CIC per:

.... (SEAL)

ACKNOWLEDGEMENTS

The author

Matt Fountain - Social Entrepreneur, Founder and Managing Director of Freedom Bakery CIC

www.freedombakery.org

About Matt: "I believe that all business is its people and therefore business is social; because a social enterprise trades towards achieving a progressive goal it means every aspect of its model can be re-imagined to achieve that outcome. This philosophy largely underpins the development of the Freedom Bakery, which I set up in 2015. Freedom has been covered widely in the national media - including being the subject of a blog by Sir Richard Branson and The Guardian describing the Freedom Bakery as 'the future of social enterprise'.

Before working in the social sector, I was due to start a doctorate at the University of Oxford. I lean heavily on my research background for my analytical approach to achieving a sustainable, scalable and successful enterprise. I am keen to develop and disseminate innovative strategies to disrupt the status quo and move towards solutions that work and which are beneficial for society and the economy. It is my belief that social business can ultimately deliver important lessons to mainstream business too. I am a part of the Flip Finance team where I focus on 'DIY social investment' and enabling social enterprises and charities to better access mainstream finance."

The editors

David Floyd - Social Entrepreneur, Managing Director of Social Spider CIC & Co-founder of Flip Finance

www.socialspider.com

David is the co-founder and Managing Director of Social Spider CIC, where he supports, researches and writes about social enterprise development, social innovation and social investment. He was co-author of **Social Investment Explained**, a guide to social investment for charities and social enterprise published as part of Big Lottery Fund's Big Potential investment readiness programme, and has carried out research on social investment for the Ministry of Justice, RBS and the Centre for Public Impact at Boston Consulting Group. David was project manager for the Esmée Fairbairn Foundation-funded **Alternative Commission on Social Investment** and is a founding member of Flip Finance.

Kat Davis - Independent Practitioner & Co-founder of Flip Finance

Kat is an independent consultant working with social enterprises, charities and innovative organisations on a range of areas from service design and organisational development to business planning and strategy. She is passionate about enabling people to turn their ideas into actionable, user-focussed solutions. This approach of problem solving with people and not for them, runs throughout the diverse range of projects she has worked on. Kat is a founding member of Flip Finance, a trained design professional and an On Purpose fellow.

Big Society Capital launched GET IT as part of our market championing activity to raise awareness of Social Investment Tax Relief (SITR) a 30% tax relief for individuals investing in charities and social enterprises. We believe that SITR will help bring new investors, new patient investment and hopefully lower the cost of this type of capital. GET IT offers a free package of support for charities and social enterprises wanting to raise money using SITR. We are working to raise awareness by sharing the journeys of the trailblazers through case studies and through supporting and sharing new resources like this DIY SITR guide.

To find out more about SITR or to sign up to the campaign:
www.bigsocietycapital.com/social-investment-tax-relief

Flip Finance is a social enterprise-led approach to designing and developing practical social investment solutions that meet the real needs of social enterprises and charities, their funders and investors. Flip Finance is a collaborative project born out of the efforts of a small group of actors working across the social investment sector and wider social enterprise space in the UK.

Our 'DIY Social Investment' initiative seeks to enable social enterprises and charities to create their own investment opportunities and to offer them directly to people. This may be of interest to organisations seeking repayable finance (in the range of £5,000 to £150,000) who are unable to raise investment via other routes, and / or want to raise social investment on their own terms. DIY social investment may be in the form of SITR, debt and / or equity-based crowdfunding or community shares.

To find out more about Flip Finance:
www.flipfinance.org.uk






GET SITR
A tax break for charities and social enterprises

FLIP FINANCE