



SOCIAL INVESTMENT TAX RELIEF

GUIDANCE ON OPERATING CONCESSIONS

April 2017

For more information and resources on SITR, please visit 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.





INTRODUCTION

If a social enterprise wishes to raise funding under Social Investment Tax Relief (“SITR”) it needs to meet a number of criteria with regards to its trading activities. In this note we refer to these criteria as the **“SITR trading requirements”**.

A number of social enterprises – particularly those operating some form of visitor attraction – will generate revenues by allowing other businesses to operate food and drink (or other) concessions on their premises.

However, trading in this way may mean that the social enterprise does not meet the SITR trading requirements.

In this note we’ll explain why. So we will:

- start by explaining (briefly) the SITR trading requirements,
- then illustrate the issues an example, based (loosely) on a real life scenario, and
- finally, look briefly at the extent to which a social enterprise might be able to do things differently in order to meet the SITR trading requirements.

LAWYER’S SMALL PRINT – THE USUAL STUFF

This note is for information purposes only to give the reader a better understanding of the process by which a social enterprise may approach HMRC for an advance assurance that a proposed investment will qualify for SITR. This note is not a comprehensive review of the law relating to SITR and it does not explain any of the numerous conditions that a social enterprise must meet in order to qualify to raise SITR funding.

This note has been produced by Big Society Capital in its capacity as champion for the social investment market. Neither Big Society Capital nor any of its directors, employees, consultants or advisers can give any advice in this area and they will have no liability to any third party who may seek to rely on the contents of this note. If a reader of this note wishes to act on any of the comments in this note, she or he should take appropriate advice from experts in the field before preparing and submitting any application or documentation to HMRC. The contents of any such application will vary from one enterprise to another and each will be unique to the circumstances of the social enterprise submitting it. So we can only offer general guidance.

And finally, please bear in mind that:

- This note is based on our understanding of law and HMRC practice as at the date it is published. All information is current as of the date of publication, subject to change without notice, and may become outdated over time, and
- This is still a new area of law, so very little custom and practice has yet been developed by HMRC or HM Treasury. Policy and practice will develop over time.





OPERATING CONCESSIONS

The SITR trading requirements

As mentioned, any organisation that wishes to raise funding under SITR must meet a whole range of criteria at the time the investment is made. Many of those criteria must also be met throughout the three years after the investment is made.

We're not going to explain all of the criteria in this note. Rather, we will look specifically at what we have called the "**SITR trading requirements**" i.e. those conditions within the SITR legislation that relate to the trading activities of the social enterprise that is raising SITR funding.

There are four:

The First SITR trading requirement¹

The social enterprise must meet **one** of the following conditions:

- It is a charity, or
- It is an accredited social impact contractor, or
- If the social enterprise is a single entity (i.e. has no subsidiaries) then, unless it is a charity or an accredited social impact contractor, its activities must consist wholly or mainly of "qualifying trades", or
- If the social enterprise is the parent of a trading group, the activities of the group as a whole must (unless the social enterprise is a charity or an accredited social impact contractor) consist wholly or mainly of qualifying trades.

A "**qualifying trade**" is any trading activity unless it appears on a list of "excluded activities" in the SITR legislation. It's worth noting here that in many cases, generating income from letting, leasing or licensing buildings is not treated as a "trade" at all by HMRC. And if an activity is not a "trade", then it cannot be a "qualifying trade" for the purposes of SITR.

Typically, HMRC will accept that if qualifying trades account for more than 80% of overall activity, this requirement will be met. So a social enterprise may carry on activities that are not qualifying trades, provided those other activities remain below the 20% threshold throughout the three years after the investment is made.

¹ Section 257MJ Income Tax Act 2007





The Second SITR trading requirement²

The SITR money must be raised for the carrying on of a “qualifying trade” which, at the investment date, is carried on (or is intended to be carried on) by:

- the social enterprise, or
- a 90% owned subsidiary of the social enterprise that is also a “social enterprise” (a “90% social subsidiary”)

This trade is referred to as the “**chosen trade**”.

And the purpose for which the SITR money is raised is referred to as the “**funded purpose**”.

The Third SITR trading requirement³

All of the money raised from the SITR fund raise must be employed for the “funded purpose”.

The Fourth SITR trading requirement⁴

The “chosen trade” must not be carried on by anyone other than the social enterprise (or a 90% social subsidiary).

Why is this a problem?

Those are the SITR trading requirements. But how would operating a restaurant or other food or drink outlet be in breach of these SITR trading requirements?

We’ll answer the question by using an example, based (loosely) on a real life scenario.

Facts

ABC Charity (“**ABC**”) is a registered charity.

ABC owns and operates an educational visitor attraction. ABC has no subsidiaries and is owned and controlled by its members.

ABC raised approximately £200,000 by way of loans from individuals who were intending to claim SITR on their loans to ABC. The monies are to be employed in refurbishing the premises that form the visitor attraction and fitting out the kitchen and dining areas of its restaurant and coffee shop.

² Section 257ML Income Tax Act 2007

³ Section 257MM Income Tax Act 2007

⁴ Section 257MN Income Tax Act 2007





ABC intends to generate income by way of a small entrance charge, a shop selling souvenirs and educational materials, and its newly refurbished restaurant and coffee shop. 50% of total profits will be generated via the restaurant and coffee shop.

The concession arrangement

As a charity, the trustees of ABC want to mitigate, as far as possible, the risks associated with operating a commercial venture – particularly the risk of making a loss which might have to be subsidised out of other charitable reserves.

So ABC emails a local catering company (the “Caterer”) inviting it to operate the restaurant and coffee shop for ABC on the basis they will “share the profits”. After some negotiation, the parties agree to enter into an agreement that they call a “catering services agreement”. Under this agreement the Caterer will staff and run the restaurant and coffee shop in return for paying ABC a monthly fee equal to 20% of the profits generated by the Caterer, after deducting all staff costs and other operating expenses.

Does this meet the First SITR trading requirement?

Yes.

ABC is a registered charity, so it meets the First SITR trading requirement.

Does this meet the Second SITR trading requirement?

No.

We have to identify exactly what “trade” the SITR monies were being raised for. In this case, the “chosen trade” was the activity of ABC in operating the visitor attraction.

50% of profits from the “chosen trade” will be generated by sales from the restaurant and coffee shop. But this restaurant is operated by a Caterer under a catering services agreement. Under this agreement:

- The Caterer charges restaurant customers for the cost of food and drink sold.
- The Caterer orders and pays for all ingredients.
- All sales revenues are booked in the accounts of the Caterer.
- The Caterer pays to ABC a monthly fee equal to 20% of net sales (i.e. net of salary costs and other operating expenses).
- The only revenues booked in the accounts of ABC are the monthly fees invoiced to the Caterer (on which ABC charges VAT).





- ABC's primary obligation is to provide and maintain suitable premises out of which restaurant facilities may be operated.
- ABC has no contractual relationship with any customer of the restaurant and there is nothing on any notice, or on sales receipts, that suggests that ABC is providing food or drink directly to restaurant customers
- If the Caterer makes a loss in operating the restaurant, ABC does not share in that loss (its fee is simply reduced to zero, but ABC bears no further liability for that loss).

In ABC's eyes, it is making profits from running a restaurant and coffee shop on its site. But from a tax perspective, it is the Caterer, and not ABC, who is operating a trade of running a restaurant. ABC'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.

Letting or licensing property is not treated as a "trade", for tax purposes, but rather as an investment activity.

Which means that operating the restaurant and coffee shop is not a "qualifying trade". As this accounts for 50% of total trading activity, and the SITR funding was raised partly to support this activity, the Second SITR trading requirement is not met.

Does this meet the Third SITR trading requirement?

Strictly speaking, the SITR funding is being employed for the purpose of the trade for which it was raised. However that trade is not a "qualifying trade". So the Third SITR Trading Requirement is not met.

Does this meet the Fourth SITR trading requirement?

Even if HMRC accepted that we meet the Second SITR trading requirement (on the basis that ABC is involved in the actual trade of running a restaurant) HMRC could argue that the trade is being operated jointly i.e. partly by ABC and partly by the Caterer.

Which means the Fourth SITR trading requirement would not be met.

How could this have been done differently?

If ABC (or a 90% social subsidiary) had operated the restaurant without sub-contracting it to an outside caterer, that trade would be a "qualifying trade".

But this would have involved ABC:

- employing a manager to operate the restaurant





- booking all sales revenues from the restaurant in its own accounts
- paying the manager a fee for its services, or directly employing more staff to work in the restaurant
- bearing the risk of the restaurant operations making a loss

It is possible that ABC might have been able to use a catering company as a manager of the restaurant whilst still being able to argue that it (and not the caterer) was carrying on the trade. But the agreement between ABC and the caterer would have to operate on the basis that the caterer would at all times be acting solely as the agent of ABC – meaning ABC would bear the risk of the trading operations. And this is very much a “grey area”. Meaning it would depend very much on the facts as to whether or not the trading activities could be structured in such a way as to meet the SITR trading requirements (without falling foul of anti-avoidance rules).

Conclusions

If a social enterprise allows other social enterprises or businesses to operate from its premises on the basis of a lease or licence, it may well mean that the SITR trading requirements are not met.

Whether or not that is the case will vary from one social enterprise to another, and depend very much on the unique circumstances of each business.

That said, social enterprises should be wary that HMRC will look at the underlying substance of trading arrangements – so calling an arrangement a “concession”, or an “agreement for services”, will not necessarily mean that HMRC place the same interpretation on it.

It also emphasises the need to ensure that if a social enterprise is seeking an advance assurance from HMRC that SITR will be available to investors, the application to HMRC should be as full and as detailed as possible and make clear exactly how, and by whom, specific trading activities will be operated (and, where possible, be supported by draft legal documents).

Finally, if any social enterprise is looking to structure a new trading venture, and raise SITR funding to support that venture, it is important to get advice on these issues before the structure is implemented and the funding raised. There may be occasions where the same commercial objectives can be achieved, but in a way which satisfies the SITR rules. We should emphasise that when we suggest this we do **not** mean that social enterprises should look at any form of “artificial” arrangements that might (legitimately) be regarded by HMRC as tax avoidance, or as going against the spirit of the SITR legislation. Rather, we mean simply that as part of its feasibility planning for any new venture, a social enterprise should take advice on all the issues, and the implications for SITR eligibility, *before* settling on how best to structure its trading arrangements.





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