



SOCIAL INVESTMENT TAX RELIEF

A GUIDE TO ADVANCE ASSURANCE

May 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

Social Investment Tax Relief (or “SITR”) allows investor to support trading social enterprises and claim tax relief on their investments.

The rules relating to SITR are complex and are not always clear.

As a result, many social enterprises prefer to approach HMRC before an investment is made, and ask for an advance assurance that the proposed investment will qualify for SITR.

In this note we will explain how to go about making an application for advance assurance, and what to include when you are writing your application.

We should add that HMRC are currently in the middle of a consultation on whether, and, if so, how, the advance assurance process might be improved. This note is based on the process currently adopted by HMRC.

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.



ADVANCED ASSURANCE

Do you have to get an advance assurance?

No. Making an application for advance assurance (or “AAA”) is not compulsory. But it is often advisable, because:

- It gives investors certainty that the tax relief will be available (so may help the fund-raising process as some investors may not invest without the advance assurance), and
- HMRC will, in their response, flag up any feature of the investment that does not comply with the various criteria described in this Chapter. This would, therefore, enable the social enterprise to make changes in order to conform with the legislation (in many cases it is not possible to put things right after the investment has been made).

Who makes the application?

The application is for the benefit of the social enterprise that is raising the SITR funding (the “Applicant”).

So the application can be submitted either by:

- the Applicant itself, or
- the Applicant’s advisers (usually lawyers or accountants)

Some general thoughts on the approach to drafting the AAA

An assurance given by HMRC can generally be relied on. But all assurances are based solely on the information supplied as part of the AAA. So if that information is out of date, inaccurate, incomplete or misleading, HMRC will not be bound by the assurances they give. Which means that HMRC would be free to withdraw the tax relief at a later date.

So there are a few general pointers that you should bear in mind when preparing an AAA:

Put everything in writing

The AAA should be in writing by way of a letter or email (the “covering letter”) with supporting documents.

Go into detail, and do not over-simplify

The covering letter should go into a decent level of detail. If it is too general, perhaps because it omits something material or it oversimplifies the position, HMRC are free to take the view that it does not adequately describe the proposed transaction and therefore HMRC are not bound by the assurances they give. So too much detail is better than not enough.

Don’t miss stuff out

If HMRC come back with requests for more information, or clarification on a point made in the AAA, it can add weeks to the timetable for getting the final form of assurance from HMRC. So if you think HMRC might regard a piece of information as relevant, include it.



Remember who is going to read your AAA

The person who reads your AAA is a tax Inspector. They know lots about the tax rules. But they may not understand much about the environment in which your organisation works, or the trade sector in which it operates. So when you write your AAA make sure you explain stuff in a way that someone outside of your immediate world can understand it. And if you use jargon, please make sure you explain it in plain English

Set the scene

It will help the Inspector if you start the AAA with a brief summary explaining who the Applicant is, how much is being raised, who the investors are, and when and how the SITR investment will be spent. Then go into the detail.

Cover all the qualifying criteria

The covering letter should address all of the key criteria that an investment must meet in order to be eligible for SITR. And don't just tell HMRC that you meet a qualifying condition. If all you do is write a covering letter telling HMRC that all criteria are met, you'll get a letter back from HMRC telling you the same thing. But investors could place very little reliance on it because HMRC will simply rely on your statements in the covering letter. So wherever possible give HMRC the facts and supporting documents that show why or how you meet each requirement.

Make sure specific areas of concern/uncertainty are flagged up

If there are any concerns as to whether or not the proposed investment meets any particular qualifying criteria for SITR (for instance, maybe you are unclear as to whether certain aspects of the Applicant's trading activities are "qualifying trades"), it is important to ensure that those areas are flagged up to HMRC. You may want to include an explanation as to why you believe the relevant qualifying condition is met. If you do that, you can take comfort that if the assurances are granted, it means that HMRC are aware of the potential issue and are satisfied that there is not a problem.

If circumstances change, follow up with HMRC

If the terms of the proposed investment change once the AAA has been submitted, or you discover that some of the information in the original AAA was inaccurate, you may need to update the AAA and let HMRC know about the changes. If you do that then, although it may delay the transaction, you can at least be confident that the assurances eventually given by HMRC are based on the final investment terms.

If draft investment documents are amended, follow up with HMRC

Similarly, if any draft documents that you submit alongside the covering letter (such as a draft loan agreement) are amended to any material extent, then again you may need to update the AAA and let HMRC know about the changes.

Keep an eye out for changes in the SITR rules

Tax law changes. Regularly. So make sure your AAA is based on the law as you expect it to apply on the date the investment is going to be made.

What you should include in the covering letter

As mentioned, the AAA will usually comprise a covering letter, and supporting documentation. In this section of the note we'll run through the areas that you might want to cover in the covering



letter. In the following section we'll list the documents you might want to send to accompany the covering letter.

But please remember, the content of each AAA will vary from one Applicant to another and each will be unique to its own facts. So what follows can be nothing more than general guidance about the key areas to address within your covering letter. It is not, and could not be, a complete or exhaustive list of everything you should include.

The applicant

After your introduction (see comments above), start with some details about the Applicant. Give the full name, registered number or charity number, and registered office of the Applicant. Also give its corporation tax reference. You also need to explain why the Applicant is a "social enterprise" (is it a charity, CIC etc..?).

Explain whether or not the Applicant has a share capital. And give details of shareholders or members of the Applicant and any members who hold large or controlling interests.

Give the number of "full time equivalent" employees – this should be as at the date you expect the proposed investment to complete.

Confirm that the Applicant is not "quoted" on any stock exchange or market.

Explain how the Applicant meets the "gross assets" requirement (i.e. that the gross assets of the Applicant and its subsidiaries are below limits set out in the SITR legislation). You might want to include a balance sheet showing the forecast position as at the date the SITR investment is due to be made.

Interests in other companies or organisations

If the Applicant has any subsidiaries or interests in any other organisation, explain the group structure and give details about each subsidiary (name, registered number, whether or not it trades, whether or not it is a "social enterprise" etc..).

If the Applicant has a minority shareholding or interest in another company or social enterprise, include details.

If the Applicant is planning to acquire another trade or company, say so, and give details of the proposed target and the terms on which it will be acquired.

Make sure you also explain the exact ownership structure of each subsidiary. Are they 100% owned? If yes, say so. If not, explain who are the other members of the subsidiary in question.

Confirm whether or not the Applicant (or any subsidiary) is or has ever been a partner or member of any partnership or trading consortium.

If the Applicant has never had any interest or shares in any other organisation, say so.

The fundraise

Explain how much money you're intending to raise, whether this is by way of issue of loans or shares, and the timetable for the fundraise. If the monies are being invested in stages (rather than in one lump sum), explain the timing of the investments and when and how cash will be raised.

Tell HMRC who the investors are (if you know).



Trading Activities

The SITR rules include a number of requirements around the activities of the Applicant and its subsidiaries, and the trades that they carry on. So it is important to explain in some detail what those activities are (both trading and, in the case of charities, non-trading).

If you have any doubt that certain activities are “qualifying trades” then make sure you flag up those activities within the body of the covering letter so that HMRC understand fully the details of your business, and also give an idea of the context i.e. what proportion of the whole does each activity or subsidiary represent.

Use of monies

There are a number of rules governing when, how and by whom SITR funding is actually spent. So it is important to include within your covering letter some details of how the money is intended to be spent. If at all possible, this should be supported some form of business plan or cash flow forecast showing how and when the monies are to be spent.

If the Applicant is the parent of a group of companies or social enterprises, you should identify which group companies will be using the SITR money.

Summaries of the key documents

You can simply attach supporting documentation and leave HMRC to go through each document without any further commentary. However it is often helpful for HMRC to see, within the covering letter, a short summary of the key terms of the investment documents.

If you do include a summary along those lines you should make sure it summarises the key features. In the case of a loan document, you should (as a minimum) summarise interest and redemption premium, when and how the loan becomes repayable, and the priority for repayment in the event of a winding up. You should also confirm that the loans are unsecured and not supported by any guarantees. In the case of a fundraise by way of an issue of shares you should summarise the rights of each class of share to participate in income and capital distributions and other returns.

If the Applicant is an accredited social impact contractor, summarise the key terms of the “social impact contract” that the Applicant is proposing to enter into. This summary should include details of the parties to the contract, the outcomes that are intended to be achieved under the contract, the payment structure for achieving those outcomes, how progress towards those outcomes is to be measured and any other services to be provided under the contract. Alternatively you might simply include within your AAA a copy of the separate application for the Applicant to be accredited as a social impact contractor.

Again, if you have a concern that a particular clause or paragraph in any investment document might not be fully compliant with SITR rules, you might want to make sure that a description of that clause or paragraph is included in the covering letter. In that way you will be confident that if HMRC issue the assurances, they have considered the clause in question and are happy with it.

State Aid

In your covering letter you will need to include details of certain types of state aid that the Applicant and all its subsidiaries have received. You will need to do this to demonstrate that Applicant is within the caps on the amount of SITR funding that it can raise.

With effect from 6 April 2017, there are two limits on the amounts of SITR funding that any social enterprise can raise:

- **The lower limit** - A social enterprise cannot raise more than around **approximately £290,000** under SITR in any rolling three-year period (this cap is calculated using a formula which depends on the GBP/euro exchange rate and the prevailing tax rates on the date the investment is made so fluctuates). But this includes any other “de minimis” state aid that the Applicant (and any subsidiaries) may have received over the last three years
- **The higher limit** - A social enterprise cannot raise **more than £1,500,000** under SITR throughout its life. But this includes any other “risk finance” state aid that the Applicant (and any subsidiaries) may have received over their lifetimes

If the Applicant is seeking to raise **less** than the lower limit, you need to include details of de minimis state aid received within the three years up to the date the SITR fundraising is due to complete, and also details of any “risk finance” state aid received.

If the Applicant is seeking to raise **more** than the lower limit, you only need to include details of any “risk finance” state aid received.

The rules in this area are complex so you should take advice on exactly what entities you need to consider when looking at the Applicant’s state aid history. But you must ensure that the covering letter demonstrates that the limits are met.

How long the Applicant has been trading

With effect from 6 April 2017, if the amount of SITR funding that an Applicant is seeking to raise is greater than the lower limit, you will have to show that the “first relevant commercial sale” was made less than seven years before the date the SITR investment is due to be made.

Again, the rules in this area are complex. But if the total SITR fundraising will be greater than the lower limit, you will have to address this issue within your covering letter.

You can do this by:

- explaining the history of the Applicant’s group (identifying existing and former subsidiaries and any trades or businesses that may have been brought into, or sold out of, the Applicant’s group over its entire lifetime); and
- confirming the date that each such entity made its first sale on a product or service market (excluding limited sales to test the market).

Accredited Social Impact Contractors

If the Applicant is an accredited social impact contractor, you will need to include details of the accreditation issued by the Cabinet Office (or, if accreditation has not been issued, an explanation as to how far the Applicant has progressed its application for accreditation). And, as mentioned, you may also want to include details of the “social impact contract” that the Applicant is proposing to enter into.

The Assurances

Make sure you tell HMRC exactly what it is you would like them to confirm.

We’ve set out in Schedule 1 to this note an example of the list of assurances that you might ask HMRC to provide. Obviously, those examples will need amending to fit the precise circumstances



of your proposed investment and your AAA, and you might want to add others. But this hopefully gives you a useful starting point.



SUPPORTING DOCUMENTS

We've already said that the AAA consists of a covering letter and supporting documentation.

Make sure you include copies of the following documents:

- The certificate of incorporation, and constitution (articles of association, trust deed etc.) of the Applicant and each subsidiary
- The latest drafts of the investment documents, which might include:
 - Subscription or investment agreement (particularly if the investment is by way of shares)
 - Loan agreement
 - Priority or inter-creditor agreement (setting out priorities for repayment of loans)
 - Revised or amend constitution of the Applicant, flagging up any changes that are proposed to accommodate the terms of the SITR investment
 - Latest annual accounts of the Applicant and any active subsidiaries
 - If the Applicant is an accredited social impact contractor, either the “social impact contract” that the Applicant is proposing to enter into, or the application made by the Applicant for accreditation as a social impact contractor.

You might also want to include:

- If the Applicant has subsidiaries, a group structure chart showing the ownership structure of the subsidiaries
- Balance sheet showing the assets and liabilities of the Applicant (and its subsidiaries) around the date the investment is to be made

How to submit the AAA

The AAA must be in writing, and can be submitted by post or email.

If the AAA is submitted by post, it should sent to:

HM Revenue & Customs

Small Company Enterprise Centre (Admin Team)

Mid-size Business S0777

PO Box 3900

Glasgow

G70 6AA

- We'd recommend you use some form or recorded or special delivery so you can demonstrate when it was delivered to HMRC.



If the AAA is submitted by email:

- It should be sent to HMRC at enterprise.centre@hmrc.gsi.gov.uk
- The Applicant will need to send a note confirming that it accepts the risks involved with communicating electronically. An example of such a letter (which can be signed and sent in pdf format to HMRC) is set out in Schedule 2 to this note
- All accompanying documents should be sent in pdf format (and you may want to put them in a zip file, as the limit on the size of documents that can get through HMRC's firewall is quite low)

HMRC are planning to launch a process for submitting the application electronically. But it's not yet been launched.

How long does it take?

It can take HMRC up to eight weeks to respond to your AAA.

Which isn't great. But there is little to be gained by phoning them up regularly and demanding a quicker response. The team at HMRC dealing with AAAs has limited resource, and a growing caseload. So they tend to deal with AAAs strictly in the order that they are received.

Bear in mind the guidelines we set out above on the general approach you take when writing your AAA – if HMRC respond with a request for more information or clarification it can add several more weeks (or even longer) to the timetable for receiving your assurances.

Also, if you submit the application by post, HMRC will reply by post. Which can add a week or more to the time it takes to actually receive HMRC's response.



SUPPORTING DOCUMENTS

Schedule 1

Form of request for HMRC advance assurances

- 1.1 On the basis of the information provided we should be grateful for assurances from HMRC that:
 - 1.1.1 The [***add name or definition of the SITR loans being made***] will be “qualifying debt investments” for the purposes of Part 5B of the Income Tax Act 2007 (“ITA”);
 - 1.1.2 The [***add name or definition of the SITR shares being issued***] will be “new shares” meeting the requirements of s.257L(1)(a) of ITA;
 - 1.1.3 [***add name of the Applicant***] meets all of the conditions set out in Chapter 4 of Part 5B of ITA,
 - 1.1.4 All requirements for SITR in Part 5B of ITA are met in relation to the [***add name or definition of the SITR loans being made***], and
 - 1.1.5 All requirements for SITR in Part 5B of ITA are met in relation to the [***add name or definition of the SITR shares being issued***],
 - 1.1.6 HMRC would, on receipt of a compliance statement under section 257PB of ITA, authorise [***add name of the Applicant***] to issue compliance certificates (under section 257PC of ITA) to all investors who subscribe for [***add name or definition of the SITR loans being made***] and [***add name or definition of the SITR shares being issued***].



Schedule 2

Form of Letter to HMRC authorising email communications

HM Revenue & Customs, Small Company Enterprise Centre

Dear Sirs,

[add name of social enterprise] – [Company][Charity] registered number: **[add number]**

I understand that HMRC takes the security of personal information very seriously and that the main risks of using email that concern HMRC are as follows.

- Confidentiality/privacy - there is a risk that email sent over the internet may be intercepted.
- Authentication - it is crucial that HMRC only communicate with established business contacts at their correct email addresses.
- Repudiation - there is no guarantee that an email received over an insecure network, like the internet, has not been altered during transit. It may not therefore carry the same evidential weight as a letter.

I understand and accept the risks associated with email and I am happy for HMRC to send information concerning the company to us by email. I also confirm that I am happy for HMRC to correspond with my agent by email. Please direct all e-mail communications from e-mail to the following persons at these e-mail addresses.

Name	Email address
□	□@□
□	□@□

I understand that when replying to me, HMRC may desensitise information by, for example, quoting only part of unique reference numbers wherever possible. I also understand that HMRC may continue to contact me by email until such time as I notify you that I no longer wish to receive email communication.

Yours faithfully

..... (Signature)

[DIRECTOR][TRUSTEE] on behalf of **[add name of social enterprise] [LIMITED]**

..... (Name)

..... (Date)

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