TAX RELIEF ON COMMUNITY SHARES INVESTED IN PUBS

1. Disclaimer

The Plunkett Foundation is not authorised by the Financial Conduct Authority (FCA) to provide tax advice. This guidance sets out the general principles behind the tax reliefs on investment in shares in Co-operative and Community Benefit Societies and summarises practical issues which have arisen in the application of these tax reliefs to community owned pubs.

This guidance should not be relied on as tax advice for Societies or individuals as how these tax reliefs apply may vary according to a Society's or an individual's particular tax circumstances.

2. The Principles Behind Tax Relief on Investments And How They Work

The Enterprise Investment Scheme (EIS) was introduced in 1994 to encourage investments in small private companies carrying on a qualifying trade in the United Kingdom. Such investments often carry a high risk of loss of capital meaning that it may be difficult or time consuming to sell or achieve the investment a small business needs. The tax reliefs available under EIS were intended to offer investors an incentive to counterweigh those risks.

In 2012 the Seed Enterprise Investment Scheme (SEIS) was introduced providing a higher rate of tax relief on the first £150k invested in a qualifying company (this is explained later in this guidance note).

As the tax relief was introduced before the start of the community shares movement, shares in Societies were not included as eligible for the tax relief. Following lobbying by the community shares movement Society shares were included but with some additional restrictions because of the withdrawable and non-transferable nature of Society shares.

Social Investment Tax Relief (SITR) was introduced in 2014 and was intended to encourage more social investments from investors to support social enterprise and applies to charities, Community Interest Companies and Community Benefit Societies. Unlike (S)EIS, SITR also applies to debt products (loans, loanstock or bonds) as the vast majority of charities don't have shares.

Although (S)EIS is the earlier and more common tax relief, this guidance will deal with SITR first because it is more relevant for community owned pubs.

More detail from the government on SEIS, EIS and SITR can be found here:-

https://www.gov.uk/guidance/venture-capital-schemes-raise-money-by-offering-tax-reliefs-to-investors

3. **Social investment Tax Relief (SITR)**

a) How It Works

Social Investment Tax Relief (SITR) was launched in April 2014 with the aim of encouraging investment in social enterprises. In April 2017 the scheme was enlarged to allow up to £1.5m of qualifying investments in a social enterprise within seven years of its first commercial sale.

The rules for SITR are generally the same as those for EIS and SEIS in most, but not all, areas. For instance, the rules the risk to capital criteria rule do not apply to SITR, making it more suitable for Societies with low-risk capital development plans, such a buying pubs.

As with EIS and SEIS, the social enterprise must carry out a qualifying trading activity to be eligible for SITR (see below). This means that social enterprises solely reliant on voluntary, donated or investment income are not eligible. But a social enterprise with a wholly or majority owned trading subsidiary is eligible, as long as the funds raised are invested in the trading activity. There are some minor differences in the definition of qualifying trading activities. so the provision of legal and accountancy services, and the operation or management of hotels or comparable establishments are eligible trading activities.

There are major differences in the type of enterprise that qualifies for SITR and the nature of the investments. SITR is only available for investment in social enterprises. SITR defines social enterprises as charities, community interest companies and community benefit societies with an asset lock. At the heart of this definition is the requirement that the enterprise has a statutorily defined asset lock, which is why only community benefit societies with the prescribed asset lock or charitable community benefit societies fit the definition, along with community interest companies. Co-operative Societies are not included in this definition because there is no statutory asset lock for a co-operative Society. Other eligibility criteria include a requirement that the social enterprise must not have more than 250 employees or more than £15m in gross assets.

SITR is available for both debt and equity investment in social enterprises. The eligibility of debt finance makes SITR radically different from EIS and SEIS, both of which are only for equity investment. To qualify for SITR, debt finance must be unsecured and there must be no pre-arranged exit for the investor for at least three years. It must be subordinate to all other debts held by the social enterprise and not attract more than a commercial rate of interest.

SITR is a tax relief for UK based individual taxpayers (not corporate bodies) and the rate is up to 30% of the amount invested. The maximum amount an investor can invest in SITR schemes is £1m per annum. Individuals are not eligible to invest in a social enterprise under SITR if they have previously invested in the same enterprise, and these investments were not made under SITR or one of the other tax relief schemes.

'Connected persons' are not eligible for SITR. This includes someone who is an employee, paid director/management committee member, or large shareholder (defined as holding more than 30% of the share capital) of the enterprise, or anyone who is an associate of such a person. An associate is defined as a spouse or civil partner, lineal ancestor or descendant, a business partner, or certain persons with whom the individual has connections through a trust. It also includes any investor with more than 30% of the total loan capital or voting rights.

SITR is not available on any investment for which the investor has already received SEIS, EIS or Community Investment Tax Relief, although this would not apply to any new investments in a subsequent share offer. But a social enterprise can offer SITR on debt finance in combination with SEIS for equity finance, so long as cumulative tax relief benefit does not exceed the maximum restrictions applicable to each scheme. A social enterprise can also offer SITR on loan capital at the same time as offering (S)EIS on share capital as these tax reliefs are independent of each other.

Most trades will qualify for SITR but your Society may not qualify if more than 20% of your trade includes things like:

- coal or steel production
- farming or market gardening
- leasing activities
- legal or financial services
- property development (this has implications for pubs – see below)
- running a hotel
- running a nursing home
- generation of energy, such as electricity and heat
- production of gas or other fuel
- exporting electricity
- banking, insurance, debt or financing services

The rationale behind SITR is more regulatory than (S)EIS – whilst it is to encourage investment in social enterprises, HMRC patrols the boundaries to make sure that the tax relief is not being used by those for whom it was never intended. Culturally HMRC is less understanding that a social enterprise may include some non-qualifying trades in its portfolio of activities even if these are well under the 20% threshold.

b) Issues Peculiar To Pubs

There are some specific issues for SITR for community owned pubs.

Importantly, there is the issue of whether the Society will directly manage the pub or let it out to a tenant to operate as their own business. Direct management means that the Society buys and sells the beer and food, employs the manager and other staff and is responsible for all aspects of the business. However, the tenancy model where the pub is let to a tenant to run as their own business with the Society holding the asset and managing the community engagement is also common.

Unfortunately, HMRC view buying a pub, refurbishing the building then letting it out to another business to run as property development, which is a non-qualifying trade. Therefore if your community owned pub opts for the tenanted model of operation, the Society's shares will not qualify for tax relief.

The absence of the risk to capital conditions and the eligibility of hotels and similar establishments are useful for pubs applying for SITR and recent experience is that pubs applying for both (S)EIS and SITR have been approved for the latter and reused for the former.

However, SITR's more regulatory approach to assessing the 20% threshold for non-qualifying trade has led to HMRC questioning even small amounts of what are quite normal pub activities, such as renting rooms to local groups or for functions.

4. Seed Enterprise Investment Scheme (SEIS) and Enterprise Investment Scheme (EIS)

a) How It Works

Qualifying enterprises can use the EIS to attract up to £5m of equity investment in any twelve-month period. It provides tax relief for UK based individuals (not for corporate bodies). It is worth up to 30% of the amount of shares invested, to be set against the individual's income tax liability for the tax year in which the investment is made, but if the individual is liable for less tax than the value of the tax relief then their tax relief will be capped at the amount of tax that individual is liable for in that tax year. The maximum total amount of tax relief that a UK based taxpayer can claim in any one tax year is currently £300,000.

'Connected persons', defined similarly as for SITR, cannot claim EIS tax relief.

The shares must be new and additional capital and must be held by the individual for at least three years after the date they were issued or the enterprise started trading, whichever is longer. The shares must be invested in a qualifying business activity (see below). Early withdrawal of share capital by a member will result in a loss of tax relief for that member (which means that the member would have to pay the tax relief back), but it should not jeopardise the tax relief of other members, especially if the amount withdrawn was not substantial, normally taken to mean less than £1,000. However, this is a bit of a grey area and it is advisable not to encourage members to withdraw their shares within the qualifying three year period except in exceptional circumstance.

Most trades will qualify, including any research and development which will lead to a qualifying trade. However, your Society may not qualify if more than 20% of your trade includes things like:

- coal or steel production
- farming or market gardening
- leasing activities
- legal or financial services
- property development (this has implications for pubs – see below)
- running a hotel
- running a nursing home
- generation of energy, such as electricity and heat
- production of gas or other fuel
- exporting electricity
- banking, insurance, debt or financing services

The business must have fewer than 250 full-time equivalent employees and gross assets must not be more than £15m. The enterprise must be an independent entity, not controlled by another person or body.

The rationale behind EIS is permissive – it is to encourage investment in new private companies. Culturally HMRC is understanding that a commercial business may include some non-qualifying trades in its portfolio of activities so long as these are well under the 20% threshold.

In March 2018 HMRC introduced a "risk-to-capital" condition to ensure that the tax relief was bring used to raise capital which was genuinely being put at risk within the enterprise and not being wholly secured, for instance through the acquisition of property.

The Seed Enterprise Investment Scheme (SEIS) requirements are in effect the same as those of EIS because it is anticipated that enterprises may use EIS after an initial investment under SEIS and some issues of shares combine the schemes. There are same definitions of qualifying trades, restrictions on connected persons, being an independent organisation and the three year period shares must held for. The maximum individual investment under SEIS is limited to 30% or £45,000.

However there are a number of key differences between SEIS and EIS. The most important is that the tax relief through SEIS is worth up to 50% of the amount of shares invested. The business must have been trading for less than two years when the SEIS shares are issued, must have fewer than 25 employees and must have gross assets of less than £200,000. The maximum amount it can raise under SEIS is £150,000 and this figure is reduced further by any amount of state aid (which is government or EU funding) the business may have received in the preceding three years. The annual maximum amount an individual can invest in SEIS shares is £100,000.

Obviously a tax relief rate of 50% is more attractive than 30%. For a small share offer of under £150k the entire share offer can qualify for SEIS. For a large share offer, SEIS and EIS can be combined, so the first £150k of shares can qualify for EIS with the rest qualifying for EIS. This provides an incentive for people to invest early. The Society must make sure that it can identify precisely who invests the first £150k of shares.

b) Issues Peculiar To Pubs

There are some specific issues for SEIS and EIS for community owned pubs.

Firstly, there is the issue of whether the Society will directly manage the pub or let it out to a tenant to operate as their own business applies in just the same way as for SITR.

(S)EIS also has a growth and development criteria which requires that the company employ the investment raised for the purpose of long-term growth and development of the company's trade. The Society must have and be able to demonstrate its objectives for long term growth in terms of turnover and company employees, but it also must be using the investment to expand its trade. The Society's business plan would need to show this.

Since the introduction of the 'risk to capital' criteria in March 2018, it has been increasingly difficult for Societies buying pubs to qualify for (S)EIS. This is because the 'risk to capital condition' views the purchasing of a pub building as acquiring a capital asset that is likely to retain its value mitigating the risk attached with making an investment. The upshot of the 'risk to capital' condition is that community owned pubs buying their pub are highly unlikely to qualify for (S)EIS. However (S)EIS is still an option if the community would be taking in a lease for a pub.

5. How To Apply for Advanced Assurance

SITR is administered by the Small Company Enterprise Centre at HMRC. The arrangements are similar to those for (S)EIS except that there is no requirement to provide a list of potential investors as SITR is not overburdened with speculative applications.

HMRC determine whether an enterprise and its share issue (or loan finance) qualify for the SITR by reviewing that the enterprise's accounts, governing document, business plan and other documentation relating to the share issue are compliant. HMRC do not assess the viability of the scheme only its compliance with the criteria for SITR. Hence minor changes to the business plan after submission to HMRC are possible but not anything material as to the trades of the Society (as these can affect compliance). So adjusting the profit margin on food sales is not an issue for HMRC, but deciding to convert an upstairs room to a flat for rent would be.

HMRC can award advance assurance to a share offer. An enterprise can submit their plans and documents in advance of the community share issue and HMRC will determine whether or not the proposed share offer is likely to be compliant.

For SITR the Society should send its documents by email or post, including the following information:

- the certificate of incorporation of your company, society or charity
- the memorandum and articles of association of your company or Rules of a Society or the equivalent governing documents of your charity, such as a trust deed
- a summary describing the investment and how it will be used
- a copy of any loan agreement or share offer document you're using
- any other supporting documents

(S)EIS is also administered by the Small Company Enterprise Centre (SCEC) at HMRC. They determine whether an enterprise and its share issue qualify for the S(EIS) by reviewing that the enterprise's accounts, governing document, business plan and other documentation relating to the share issue are compliant (see Appendix One for the list of documents HMRC require).

HMRC can award advance assurance to a share offer. Unlike SITR, in 2018, HMRC introduced requirements to reduce the number of speculative applications for (S)EIS by requiring applicants to provide names of potential investors to demonstrate that there was genuine interest in the share offer. There are no hard and fast rules on this requirement but in practice having a list of people who state they are willing to invest circa 10% of the total shares required has proved enough for HMRC. For example, if the minimum target for the share offer is £150k and the Society submits a list of 20 people who between them are willing to invest around £15k that should satisfy HMRC. As many Societies gather pledges to invest as part of their campaign this often means no extra work. There is no requirement for anyone on this list to eventually make an investment nor is this list publicly available.

Applications for advance assurance are made on-line. The Society must complete the advance assurance application. This form is designed to be filled in on screen. You must answer all the questions except any marked 'optional'. You cannot save the form while you're filling it in but, once you've completed it, you'll get a copy that you can save and email or print out and post to HMRC along with all the other documents supporting the application.

HMRC has a target of 45 days (currently) to determine if an application for advance assurance is compliant. It is an advantage for the Society to be able to state that it has advanced assurance but this may not be possible before a share offer is launched as most Societies cannot wait 45 days from completing their documents to launching the share offer. However, it is easier to time your share offer so that the application for advance assurance can be approved by HMRC before the share offer closes.

6. What The Society Needs To Do To Secure The Tax Relief

For SITR the Society must complete an online compliance statement. This form is designed to be filled in on screen. You must answer all the questions except any marked 'optional'. You cannot save the form while you're filling it in but, once you've completed it, you'll get a copy that you can save and email or print out and post.

This form cannot be submitted before the qualifying trade has been carried out for at least 4 months, but it must be submitted within 2 years after the completion of that 4 month period, or 2 years after the end of the tax year in which the investment is made, whichever is later.

HMRC will then send you a letter and compliance certificates (form SITR3) to give to your investors.

The letter will include a unique investment reference number. You must include this on the compliance certificates you give to investors. Investors need the compliance certificate and reference number to be able to claim tax relief.

If HMRC decides the investments do not meet SITR requirements, they will write to you explaining why. If you disagree, you can ask HMRC to review the decision, or appeal against it.

You must follow the scheme rules for at least 3 years after the investment is made - otherwise tax relief will be withdrawn from your investors. You must tell HMRC if you no longer meet the conditions within 60 days.

For (S)EIS the Society must submit an on-line compliance statement (form EIS1) to HMRC This form is designed to be filled in on screen. You must answer all the questions except any marked 'optional'. You cannot save the form while you're filling it in but, once you've completed it, you'll get a copy that you can save and email or print out and post.

This form should not be submitted until the trade itself (or the research and development if that is the qualifying business activity) mentioned in Qualifying business activity has been carried on for four months, unless the society has commenced winding up. But it must be submitted within:

- two years after the completion of that four-month period
- two years after the end of the tax year in which the shares were issued, whichever is later

For a pub this normally means the date the pub re-opens its doors after the community purchase). HMRC will then send you a letter and compliance certificates (form EIS3) to give to your investors.

The letter will include a unique investment reference number. You must include this on the compliance certificates you give to investors. Investors need the compliance certificate and reference number to be able to claim tax relief.

You must follow the scheme rules for at least 3 years after the investment is made - otherwise tax relief will be withdrawn from your investors. You must tell HMRC if you no longer meet the conditions within 60 days.

7. How Your Investors Claim their Tax Relief

In order to claim (S)EIS or SITR tax relief investors must be sent either a form EIS3 or SITR3 from the Society. The investor should use this form to claim the tax relief for the year in which the shares were issued, or it can be carried back to the previous tax year. Please note that your investors are likely to be people who have never applied for tax relief before. You can just send them the EIS3 or SITR3 form but without a covering letter explaining what it is and why they need to deal with it, some members ***will*** not complete the form and claim their tax relief. They may come back to the Society months later asking about their tax relief. So whilst a covering letter may seem like extra work at the time, it normally saves work at a later date.

If the investor normally pays income tax by PAYE and the total tax relief is less than £5,000 then the tax relief can be claimed in one of two forms: either as an adjustment to the PAYE code if the tax relief is being claimed in the current financial year, or as a carried back claim against income tax on the previous year, in which case the investor will receive the tax relief as a lump sum repayment. If the investor is claiming more than £5,000 in tax relief and currently pays income tax through PAYE, they will be asked to complete a Self Assessment tax form. If the investor already completes an annual Self Assessment form then they should claim the tax relief the next time they submit this form.

Appendix One

What you'll need to apply for advance assurance for SEIS

For all schemes, you need to give information about your company and its subsidiaries.

You need to include:

- how much you hope to raise
- the business plan and financial forecasts
- a copy of the latest accounts if available
- which companies will use the investments
- details of all trading and activities to be carried out, and how much you expect to spend on each activity
- a list of the amounts, dates and venture capital schemes under which you've previously received an investment
- an up to date copy of the memorandum and articles of association and details of any changes you expect to make
- a copy of the register of members from the date you apply for advance assurance
- the latest draft of any documents you use to explain your proposal to potential investors
- details of any other agreements between the company and the shareholders
- a signed letter from one of your directors or trustees if you're allowing an agent to act on your behalf
- a completed checklist for EIS, SEIS, or SITR with your advance assurance application form if you are applying for any of the venture capital schemes
- any other documents to show you meet the qualifying conditions for the scheme

Appendix Two

Contacts for HMRC Small Enterprise Centre

Send your application

Email your application to: enterprise.centre@hmrc.gov.uk.

You can also post your application to:

Venture Capital Reliefs Team
HM Revenue and Customs
WMBC
BX9 1BN

Weblink - https://www.gov.uk/guidance/venture-capital-schemes-tax-relief-for-investors

Appendix 3 – Case Study – Coming soon!

The Crauford Arms at Maidenhead used SITR to support its community share offer. Please see details in the weblink below. However, there have been more recent changes to the way that SITR and SEIS are interpreted by HMRC and these are highlighted in the body of this guidance note.