

Social Enterprise UK
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Letter to HM Treasury: Consultation on Tax-advantaged venture capital schemes

Background

Social Enterprise UK was established in 2002 as the national body for social enterprise in the UK. We are a membership organisation. We conduct research; develop policy; campaign; build networks; support individual social enterprises; share knowledge and understanding, support private business to become more socially enterprising, and raise awareness of social enterprise and what it can achieve.

Social enterprises are businesses driven by social or environmental objectives whose surpluses are reinvested for that purpose in the business or in the community. They operate across a wide range of industries and sectors from health and social care, to renewable energy, recycling and fair trade, and at all scales, from small businesses to large international companies. They take a range of organisational forms from co-operatives and mutuals, to employee owned structures and charitable models. Our members come from across the social enterprise movement, from local grassroots organisations to multi-million pound businesses that operate across the UK.

The UK social enterprise movement is recognised as a world leader and our members are united in their commitment to changing the world through business. The current climate presents the social enterprise movement with a unique opportunity. We know it can solve some of the UK's most pressing problems, promote social justice and help to bring about the more diverse, bottom-up economic growth that we urgently need. In particular, social enterprises are well placed to deliver on the Government's three priorities for civil society: empowering communities, opening up public services and promoting social action.

Our response

We welcome the opportunity to respond to HM Treasury's consultation on Tax-advantaged venture capital schemes. As finance is the motor for all business development and social enterprise is no different, we welcome proposals which seek to further encourage investment in small and start-up businesses



with high growth potential, including reforms to the Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCTs), and new proposals to support seed investment through the tax system. However, we are concerned that such proposals, although provides encouraging support for traditional, small and start-up businesses, continue to ignore the investment needs of social enterprises.

While access to finance has improved for social enterprises in recent years, our members have told us that more needs to be done. They have a number of important concerns:

1) There are no specific tax incentives to encourage direct investment into social enterprise. Because of their combined business and social aims, financial returns to investors from social enterprises are likely to be lower than in the private sector. This can act as a disincentive to investment. Creating an appropriate investor tax relief would provide investors with a basic return, making social investment a much more attractive option.

2) There is a lack of risk capital available to invest in long-term business growth. Many venture capitalists are reluctant to invest in small companies due to the perceived high-risk nature of investment. Because many investors are unfamiliar with social enterprise, they perceive the risk levels to be even higher for these businesses. In particular, risk capital such as equity finance is hard to access for social enterprises.

3) Limitations of the Enterprise Investment Scheme

As with other risk investment schemes, the conditions for relief and form of investment of the Enterprise Investment Scheme exclude many social enterprises. Many social enterprises either do not have legal structures which allow them to issue shares in return for investment, or have governance arrangements which make it difficult to give up ownership to an investor.

Even where equity can be released, there are limited ways in which investors can sell on their shares. Most social enterprises are unlikely to become listed on the stock market and there is no alternative 'social stock exchange'. As such, because the Enterprise Investment Scheme only allows investors to invest in a company's shares, either directly or through an EIS fund that subscribes in a range of qualifying companies on behalf of investors, a significant majority of social enterprises are excluded from the scheme.

In addition to this, some social enterprises operate within sectors which fall under the list of activities which are excluded from the Enterprise Investment Scheme. In particular, there are social enterprises working in the fields of woodland management and operating care homes which are prohibited from participating in the scheme.

4) Limitations of Venture Capital Trusts

'Investing in Social Enterprise: the role of tax incentives', a research report by NESTA, in collaboration with CSFI, May 2010, revealed that the VCT scheme is not well suited to social enterprises, and outside the renewable energy sector, the use of VCT for investment in social enterprise has been limited. Other limitations also identified in the report, include:

- The requirement for a minimum equity component in each VCT investment precludes social enterprises with a legal structure that does not permit share issuance. It also precludes those investors who provide loans and quasi-equity with no, or only a small proportion of, equity.

- The exclusion of a range of activities from “qualifying trades”, for example, nursing or residential care homes, restricts the universe of allowable investments in social enterprises.
- Proposed changes to VCT rules outlined in the 2009 Pre-Budget Report might further restrict the scheme’s applicability to social enterprises. The changes would require VCTs to invest a greater proportion of their capital as equity compared with loans. Even for social enterprises with a legal structure that permits equity issuance, potentially restricting the amount of investment they can receive in the form of loans or quasi-equity may be incompatible with their desired capital structure.

Social Enterprise UK acknowledges such findings as real barriers to VATs as mechanisms to encourage investment in social enterprise.

Suggestions for improving access to finance for social enterprise

Social enterprises currently fall between the incentives for investment which exist for charities, where donors are eligible for up to 40 per cent tax relief on their donations, and measures which support traditional businesses such as the tax relief available to investors in the Enterprise Investment Scheme and Venture Capital Trusts.

Social Enterprise UK urges the government to address this gap with new schemes, or make adjustments to the EIS, which takes into account the legal constraints on social enterprises as regards shares. Any proposals to encourage seed investment through the tax system should also consider such legal constraints. To further improve the applicability of EIS (and VCTs) to social enterprises, certain excluded activities could be made eligible for the tax reliefs - nursing, residential care homes and woodland management would be good examples. We recognise the definitional problem of what constitutes a social enterprise may need to be addressed for the availability of such reliefs, in this situation, such reliefs could be considered on the basis of certain legal forms or arrangements, for example CICs limited by shares, given they fall under the oversight of the CIC regulator.

This is vital in ensuring that social enterprises are able to receive the levels of investment necessary to create sustainable and viable businesses.

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