Social investment tax relief consultation: enlarging the scheme
Charity Finance Group & NCVO submission

Charity Finance Group (CFG) and the National Council for Voluntary Organisations (NVCO) are charities and membership bodies representing charity finance professionals and the wider voluntary sector and volunteers respectively. NCVO has over 11,000 members and CFG has more than 2,000 members, managing over £19bn in charitable funds.

Under the definition of 'social enterprise' for the social investment tax relief, charities and Community Interest Companies (CICs) are eligible investee organisations. As membership bodies which represent large numbers of these eligible organisations, we welcome the government's efforts to enlarge the social investment tax relief scheme so that charities and CICs are able to access investment.

We support the policy principles outlined for the social investment tax relief. It is particularly important that the scheme is simple and straightforward to administer, so that small and medium sized charities feel confident in using the relief. We also urge the government to work with the voluntary sector on promoting the relief to small and medium sized organisations that may not be aware of its existence and potential to support their objectives.

We regularly consult our members on financing needs, and we believe that charities and CICs are most likely to use social investment tax relief to access unsecured loans rather than complicated debt instruments or investment for Social Impact Bonds. In particular, growing the unsecured loan market would help charities and CICs which are seeking to expand into new markets, access working capital to deliver public service contracts or scale up their activities.

However, the unsecured loan market is currently highly underdeveloped for charities and CICs. NCVO's Civil Society Almanac 2014 estimates that in 2011/12, organisations with less than £10m in income were liable for £111.2m in unsecured loans. This accounted for less than 6% of total loan liabilities, with the majority of loans being secured against assets or mortgages. Estimates for the potential size of the unsecured loan market vary; however, Boston Consulting Group estimated demand for unsecured loans from charities and social enterprises could be over £600m by 2015.[1] This indicates that there is a significant unmet need for unsecured lending in the voluntary sector and demonstrates the importance of an effective social investment tax relief to support the work of charities and CICs.

[1] Boston Consulting Group, Big Society Capital, 2012

At present, demand for unsecured loans is unlikely to be met by existing social finance intermediaries, which do not have the required scale. An effective tax relief that encourages high net worth individuals to provide unsecured lending, therefore, is necessary to support the work of the voluntary sector.

We do not believe that the current investment limit of £275,000 over three years is sufficient to attract organisations to the use the tax relief and provide access to unsecured loans.

Our data indicates that charities with incomes over £100,000 are most likely to be interested in accessing social investment, particularly those organisations with incomes over £500,000, as they have a large enough income and asset base to be able to take on unsecured liabilities. NCVO Almanac data estimates that less than 10% of unsecured loans are made to organisations with income lower than £100,000. However, the current investment limit is unlikely to make the relief attractive to medium and large charities interested in accessing social investment due to the lack of transformative value.

For example, the average charity which meets the SITR employee and asset criteria, with an income of between £500,000 and £1,000,000 has 13 members of staff and income of around £700,000. However, the current social investment tax relief investment limit only covers the cost of potentially 2 or 3 members of staff over three years (depending on overheads and other costs). This is unlikely to assist charities that wish to significantly scale up their activities or access capital to deliver public service contracts, which have become larger in value over recent years due to contract aggregation.

The transformative value of social investment accessed through social investment tax relief is reduced the larger the income of the eligible organisation. This means that the more likely the organisations is to need access to unsecured loans, the less likely they will see social investment tax relief as a viable mechanism for accessing finance.

Moreover, unless a charity or CIC has an investor (or handful of significant investors) waiting to provide unsecured lending, the cost, in both time and resources, of sourcing social investment through the relief are likely to be unattractive for medium sized and large organisations. Increasing the investment limit and, therefore, the scale of the finance that can be raised, would make it more attractive for organisations to raise finance through this relief.

Significantly increasing the investment limit to the same level as Enterprise Investment Scheme (EIS) would greatly enhance the potential impact of the social investment tax relief for eligible organisations.

We recommend that the investment limit per investee organisation is raised to £5,000,000 per year.

We also believe that this would assist with the government's policy principles of encouraging simplicity in the tax system by making social investment tax relief consistent with existing tax reliefs.

In line with our response to the previous social investment tax relief consultation, we believe that due to the nature of charities and CICs, which have to pass a "public benefit test" that no activities need to be excluded from social investment tax relief. Under existing rules, regulators have already determined the charitable or community purpose objectives of these organisations and this should be sufficient to ensure that investments made under social investment tax relief create public benefit. As a consequence, we do not believe that any change to eligible activities is necessary, should the investment limit be raised significantly.

We would also urge the government to uses this opportunity to expand the relief to include wholly owned trading subsidiaries. Trading subsidiaries are separately established legal companies, established to enable charities to undertake trading activities, either to generate funds through non-primary purpose trading, or in some cases for trading in support of the charities objectives. The threshold for non-primary purpose trading within a charity is only £50,000 for charities with a turnover over £300,000 so trading subsidiaries are a common vehicle for charities wishing to invest.

The majority or all profits are returned to the charity to fund work on its charitable objectives. They meet the government's objective of fulfilling a genuine social purpose (raising money for the parent organisation's charitable objectives), and will in many cases be best placed to take on social investment (for example, drawing on the additional business skills of their non-executive directors, managing financial risk, and pursuing commercial opportunities).

We believe that many larger charities that wish to raise social investment would wish to invest it in their trading subsidiaries and excluding these subsidiaries makes social investment tax relief unattractive.

We believe that social investment tax relief is needed to unlock much needed sources of unsecured loans for charities and CICs. However, as it is presently constructed, we do not belief that it is likely to reach its full potential.

We hope that the government will use this consultation to put in place a framework for a sustainable and effective tax relief that is able to serve the needs of charities and CICs across the country.