**Consultation on social investment tax relief**Community Development Finance Association

1. **Introduction**

The Community Development Finance Association (CDFA) is the trade body representing Community Development Finance Institutions (CDFIs) in the UK. CDFIs are independent, non-profit financial institutions that provide credit and financial services to underserved markets.

The **CDFA** exists to create a thriving community finance industry, which brings social and financial benefits to neighborhoods across the UK.

This response is on behalf of the 60 members of the Community Development Finance Association. Our members, Community Development Finance Institutions (CDFIs) lent around £200m to 33,400 individuals, businesses and social ventures in 2011/12.

Our response is largely focussed on question 26 of the consultation:

*”What are the advantages and disadvantages of continuing to operate both CITR and a new tax relief for investment in social enterprise?”*

The CDFA believes that the scrapping CITR would be disastrous for the CDFI sector. SITR in its proposed construct is a long way off being a suitable replacement for CITR and by removing CITR the Treasury would significantly reduce the ability of CDFIs to provide access to finance for enterprises shut out by the banks for years to come. This consultation and new tax relief brings with it a unique opportunity to improve and remarket CITR as a more effective investment tool into CDFIs.

1. **The difference between CITR and the proposed SITR**

Community Investment Tax Relief (CITR) is a tax relief launched in 2002 to encourage corporate and individual investments into CDFIs for the purpose of on lending to micro, small and medium enterprises based in disadvantaged communities that are unable to access mainstream finance. The Social Investment Tax Relief (SITR), on the other hand, is designed as a relief to encourage individual investments into social enterprises to enable them to become sustainable. The two schemes differ in their structure but are complementary in their purpose to grow the social economy. As CITR investments have to be specifically used for the purpose of on lending through financial intermediaries (CDFIs) the scheme in no way clashes with the intended purpose of social investment tax relief. In fact launching a new relief gives the Treasury a unique opportunity to revitalise and improve CITR so ensure both reliefs work well together in growing the social economy. The main differences between the two schemes are summarised in table 2.2, and a visual depiction on how both schemes can work side by side is shown in figure 2.3.

**2.1 The main differences between CITR and the proposed SITR scheme**

|  |  |  |
| --- | --- | --- |
|  | **CITR** | **SITR (proposed)** |
| **Purpose** | Encourages private investment into accredited Community Development Finance Institutions. These investments then have to be on-lent to enterprises and social enterprises in disadvantaged communities. The scheme is designed to increase access to finance for enterprises in disadvantaged communities | Encourages private individual investment into social enterprises helping them become sustainable in the long term |
| **Type of investors** | Individuals and Corporate | Individuals only |
| **Relief** | 25% spread over 5 years | Unknown (if pegged with EIS would be around 30% with a three year lock in) |
| **Restrictions on investee organisations** | The organisation must be a CDFI accredited by the Department of Business Innovation and Skills | The organisation must be a social enterprise with either a bencom, CIC or registered charity structure |
| **Restrictions on use of funds** | Capital raised must be on-lent to qualifying businesses and social enterprises in defined disadvantaged communities over a set time period | For the purpose of an existing qualifying trade or for the purpose of preparing to carry on such trade. Or to carry on R&D intended to lead to such a qualifying trade being carried on |
| **State aid restrictions** | CITR is not an EU notified scheme and therefore operates under de-minimus requirements. | Initially operating under de-minimus rules of £200,000 with potential for EU notification later.  Certain trading activities will be excluded in line with state aid requirements. |
| **Reasons restricting the effectiveness of CITR** | -Rate of relief is too low  -Lack of promotion of the scheme  -Too strict on lending requirements with regards to the entities that can be lent to | N/A |

**2.2 A visual depiction on how both schemes can work side by side**

Loans made using CITR raised capital

CITR

SITR

Enterprises unable to access to finance from mainstream sources

CDFIs

Individual social investors

Corporate social investors

Levels of tax relief to be aligned with CITR and SITR to be co- promoted as social investment opportunities

Social enterprises

1. **The advantages of keeping CITR in place**

CITR is a tax relief launched in 2002 to encourage corporate and individual investments into CDFIs for the purpose of on lending to small businesses and social enterprises based in disadvantaged communities that are unable to access mainstream finance. As access to finance for small businesses remains an essential part of the government’s growth policy, for CDFIs to continue delivering access to finance programs into this space CITR needs to remain in place.

Since 2002 £95m has been raised mainly though bank loans to CDFIs and deposits into CDFI banks. This has facilitated around £96.4m on onward lending. Despite CITR falling short of its potential the scheme continues to be an essential source of capital for a growing number of CDFIs. There are currently twenty six accredited CDFIs with eight (31% of those accredited) coming on stream in the last three years, and three (Midlands Together, Energising Education CDFI and GLE loan finance) registering to use the tax relief in 2013. The take up of the scheme has proved increasingly popular since £72m of loan capital became available to the sector through a joint initiative between Unity Trust Bank, Cooperative Bank and the government’s Regional Growth Fund. CITR is essential to ensure CDFIs can access these funds at affordable rates. Unity Trust Bank has become an important investor into the CDFI sector over the last five years, investing almost £11m into seven CDFIs. Linking its investment deals to CITR is essential to ensure lending to CDFIs can be undertaken at a level of risk that is investable.

SITR would not make a suitable replacement for CITR. Corporate investments have made up 99% of all investments into non deposit taking CDFIs to date whereas the SITR scheme is being targeted at individual investments. In addition, currently only 45% of CDFIs have the appropriate company structures to take on SITR investments, with most simply constituted as company limited by guarantees. Charity Bank, the largest user of CITR, reports that around 50% of its capital to onlend is sourced through CITR accounts, many of which are held by corporates. As Charity Bank is no longer a registered charity SITR will be an inappropriate investment vehicle for the bank. Charity Bank lent almost £14m to 73 social ventures last year, so clearly removing the CITR scheme would have a huge impact on the organsiation.

1. **An opportunity to improve CITR**

Currently around 46 CDFIs (82% of all CDFIs) provide finance to either businesses or social enterprises and could therefore technically use CITR to raise investment. However, only 26 of these (57%) are currently accredited to use CITR and only seven (15%) actually rose investment in 2012. It is clear therefore that CITR only works well in its current form for relatively small number of CDFIs and one large deposit taking bank. Whilst CITR is still an essential tax relief for the sector in its current state (highlighted by the three new organisations accredited to raise funds in 2013) improvements and simplifications to the scheme would broaden its appeal both across the CDFI sector and towards investors, significantly increasing both the number of CDFIs using the scheme and the overall amounts raised.

We suggest the following four simple improvements be made to the scheme immediately:

* 1. **Increase the level of tax relief to ensure it is aligned with Social Investment Tax Relief**
* The current level of tax relief of 25% set over five years is grossly uncompetitive when compared to similar schemes. The Enterprise Investment Scheme offers 30% relief upfront with investment locked in for three years and the Seed Enterprise Investment Scheme offers 50%. CITR should at least be aligned with SITR in part to ensure social investors are rewarded on a level playing field and also to avoid cannibalisation of individual investments already channelled through CITR.
  1. **Drop the ‘disadvantaged community’ restrictions on CITR investments**
* CITR was conceived in 2002 before the banking crisis fundamentally changed the access the finance climate in the UK. Now, in 2013, micro enterprises and SMEs across all regions of the UK are finding themselves increasingly unable to access the finance they need. CITR legislation is such that it restricts CDFI lending into either areas of disadvantage or to groups of individuals deemed to have historically experienced disadvantage when accessing finance. This traditional approach to CDFI lending is partly out of date. Put simply, CDFIs make loans where banks are unable to, and the type and nature of businesses they finance has changed since 2002. For example last year only 44% of CDFI business customers were based disadvantaged communities, and many more previously bankable established SMEs sought CDFI finance. A more simplified tax relief, dropping these outdated restrictions, is required in order to effectively channel capital to businesses in need. By relaxing and simplifying the rules on where CDFIs can lend their CITR capital more CDFIs will feel able to meet the on lending requirements set under CITR. In addition a relaxation of the rules will remove the additional measurement and administrative burdens associated with the reporting requirements under the current scheme.
  1. **Allow tax relief to be claimed through National Insurance contributions or VAT payments allowing trusts and foundations to invest in CDFIs**
* Trusts and foundations have the potential to be large investors in the CDFI sector, but as they do not pay either income tax or corporation tax they are unable to take advantage of the incentives offered through CITR. By allowing tax to be reclaimed through either national insurance contributions or VAT receipts, trusts and foundations would be incentivised to invest in CDFIs.
  1. **Jointly promote the CITR scheme alongside Social Investment Tax Relief**
* CITR has been poorly marketed and promoted to investors. After making the changes to the scheme outline above the Treasury has a unique opportunity to breathe new life into the scheme by co-promoting it alongside Social Investment Tax Relief. CITR can be pitched as a relief for corporate and social investors looking to help SMEs access finance and SITR can be pitched at high net worth individuals looking to support front line social enterprises. **However, in order for a joint marketing approach to be effective the level of tax relief must be aligned for both schemes.**
  1. **Potential impact of improving CITR**

Forty six CDFIs lent to businesses and social enterprises in 2012, all of which are potential recipients of CITR investment. Consultation with our members suggests that interest and uptake in CITR would significantly increase from the thirteen who have raised funds to date to the vast majority of those eligible if the changes outlined above were to be made. Based on a typical amount raised by a business lending CDFI of around £600,000 per year, we expect that these forty six CDFIs could raise £138m over the next five years if the above changes we enacted. Given that last year £30m was lent to 1,797 businesses creating and protect 8,300 jobs we would expect this CITR investment (all of which must be on lent to businesses or social enterprises) to create and protect around 38,000 jobs. This assumption does not include the recycling CITR funds.

1. **CDFIs ineligible for CITR must be allowed to use SITR to raise investment**

Community Investment Tax Relief is a Department for Business Innovation and Skills administered scheme designed to increase access to finance for enterprises. However a number of CDFIs provide finance in the form of personal or home improvement loans and therefore, even with the suggested changes outlined above, would never be eligible to raise investment using CITR. Many of these organisations, for example Scotcash, a provider of affordable personal loans, and Wessex Resolutions, as social enterprise offering home improvement loans and money management services, are structured as either Community Interest Companies or registered charities. **The Treasury needs to ensure that these CDFIs are not exempted from raising funds under SITR. This is particularly relevant in response to question 8 of the consultation paper that looks at exemptions.**

1. **Conclusion**

CITR should be kept in place, simplified and improved. A list of simple, but extremely important improvements are outlined above. An improved CITR and a new SITR can be co-marketed alongside each other as social investment opportunities, one for helping front line social enterprises and the other enabling small businesses to access the finance they need. An improved CITR will bring significant economic and social benefits to the economy and increase the level of capital available to businesses struggling to access finance.

CITR, as a BIS administered scheme, only applies to those CDFIs lending to businesses and social enterprises. The Treasury must ensure that those CDFIs who are unable to use CITR, for example those offering personal and home improvement products to tackle financial exclusion, not be excluded from being able to use SITR as a means to raising investment.

1. **Contact details**

For all enquiries relating to this response contact Ben Hughes at [b.hughes@cdfa.org.uk](mailto:b.hughes@cdfa.org.uk) or 020 7430 0222