New Legal Developments Boost Social Investment in the UK

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The past two years have seen the introduction of social investment tax relief and the creation of a statutory social investment power in the Charities (Protection and Social Investment) Act 2016. These changes have the potential to significantly strengthen the social investment market. It is likely that a number of other jurisdictions will wish to develop similar tax reliefs and investment powers.

Introduction

Charities and social enterprises are at the heart of the social investment market in the UK.

In the past, there have always been questions about the ability of, and the extent to which, charity investors are able to engage in social investment. There has often been a misconception that charities must invest to maximise financial return and do not have the flexibility to invest in pursuit of social as well as financial objectives. Charities have often felt uncomfortable about social investment, despite the fact that it is a critical tool for charities to advance charitable objects and benefit the public.

It has also historically been the case that there have been tax reliefs for giving (in the form of Gift Aid on donations to charities) and tax reliefs for investment in small and medium sized enterprises (in the form of enterprise investment scheme and seed enterprise investment scheme) – but the tax system has never specifically encouraged *investment into charities and social enterprises*.

Recent developments have significantly changed the picture for charity and individual investors.

Social Investment Tax Relief

The UK Government has taken an active role in facilitating the development of the social investment market in recent years and has actively sought to create a world leading legal and regulatory regime.

In July 2014, following extensive engagement with financial advisers and the social sector, social investment tax relief ("**SITR**") was introduced with the passage of the Finance Act 2014.

SITR is designed to encourage individuals to invest in charities and social enterprises. An investor who makes a qualifying debt or equity investment can deduct 30% of the amount invested from his or her income tax liability. SITR seeks to level the playing field for investment into social enterprises when compared to investment in the shares of more traditional businesses.

Only an investment into a charity, community interest company or a community benefit society, all of which operate for public benefit or community benefit, is capable of being a qualifying investment.

The government has applied for EU state aid clearance for an enlarged SITR scheme to increase the limit on the amount of SITR investment an organisation can receive to £5 million per year and £15 million in total and to enable new social impact bonds (SIBs) to qualify, along with community energy and small-scale community agriculture schemes.

The Charities (Protection and Social Investment) Act 2016

Following the recommendation of the Law Commission, the body responsible for law reform in England and Wales, the Act introduces a new statutory power for charities to engage in investment involving a combination of financial return and social return related to the purposes of the investing charity. The new statutory power places the ability of charities to engage in social investment beyond doubt and should give confidence to trustees and encourage more social investment over time.

The power extends not only to situations where some return on capital is expected but also to situations where only all or part of the capital is expected to be returned. This is a critical distinction as, in many social investment contexts, return on capital is hard to achieve and may not be expected. As such, the new power should embolden charity trustees to take informed risks where the 'mission benefit' - the benefit to the charitable objects - and the financial benefit justify an investment.

Conclusion

The introduction of a statutory social investment power is a big legal leap forwards and should lead to the spread of innovative approaches to financing good things already being deployed by foundations.

The creation of social investment tax relief is a major development, as it means that financial advisers, wealth managers, lawyers and accountants will more than ever need to understand its place in the tax system and be able to advise clients about the opportunities presented by social investment.

At BWB, we have been intimately involved behind the scenes in shaping the arguments for social investment tax relief and the social investment power. It will be interesting to see how the legal and regulatory landscape develops and what other supportive legal innovations might materialise.

Questions for practitioners

- Tax systems often encourage donations to charities and investment in small and medium sized enterprises. Is a tax relief needed to encourage investment in social enterprise?
- Investors often believe that legal duties require them to seek to maximise financial returns when investing. Is legal reform needed to clarify how social impact can be pursued?
- Are other legal innovations needed to create a good environment for social investment?

Resources

For more information on this topic, you may wish to consult the following links/publications:

- https://www.gov.uk/government/publications/social-investment-tax-relief-factsheet/social-investment-tax-relief
- https://www.bigsocietycapital.com/what-we-do/current-projects/social-investment-tax-relief
- https://www.gov.uk/government/news/updated-guidance-as-new-social-investment-power-for-charities-comes-into-force