



# SOCIAL INVESTMENT TAX RELIEF

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## RESTRICTIONS ON LEASING, LETTING ASSETS ON HIRE OR LICENSING

June 2018

For more information and resources on Sitr, please visit: [www.bigsocietycapital.com/get-sitr](http://www.bigsocietycapital.com/get-sitr).

This note has been prepared to help provide some further clarity around which property transactions can and can't qualify for Sitr, as we understand many have asked questions about this. The note has been prepared for information purposes only and does not constitute legal advice.



# INTRODUCTION

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Social Investment Tax Relief (or “SITR”) offers social enterprises the ability to raise funding from investors, but allows the investors to claim tax relief on their investments.

There are a number of conditions that a social enterprise must meet in order to be eligible for SITR funding. We’re not going to explain all of the criteria in this note. If you want to know about the SITR rules as they currently stand, see: [Proposed changes to the rules in 2017](#).

Rather, in this note we will look specifically at whether a social enterprise whose trade involves **leasing, letting or licensing** can be regarded as carrying on a “qualifying trade” i.e. can it meet those conditions within the SITR legislation that relate to the trading activities of the social enterprise that is raising SITR funding?

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## Lawyer’s small print – the usual stuff

This note is for information purposes only to give the reader a better understanding of the issues which a social enterprise may face in qualifying for SITR when it carries on any leasing, letting or licensing. This note is not a comprehensive review of the law relating to SITR and it does not explain many of the numerous conditions that a social enterprise must meet in order to qualify to raise SITR funding.

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And finally, please bear in mind that:

- This note is based on our understanding of law and HMRC practice as at the date it is published. All information is current as of the date of publication, subject to change without notice, and may become outdated over time, and
- This is still a new area of law, so very little custom and practice has yet been developed by HMRC or HM Treasury. Policy and practice will develop over time.



## SITR RULES ON TRADING

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A social enterprise looking to raise SITR funding must meet a number of conditions in relation to its trading activities.

There are a number of tests to be met. But for the purposes of this note, there are two key issues.

First, the social enterprise must meet **one** of the following conditions:

- It is a charity, or
- It is an accredited social impact contractor, or
- If the social enterprise is a single entity (i.e. has no subsidiaries) then, unless it is a charity or an accredited social impact contractor, its activities must consist wholly or mainly of “**qualifying trades**”, or
- If the social enterprise is the parent of a trading group, the activities of the group as a whole must (unless the social enterprise is a charity or an accredited social impact contractor) consist wholly or mainly of **qualifying trades**.

Secondly, the SITR money must be raised for the carrying on of a “**qualifying trade**” which, at the investment date, is carried on (or is intended to be carried on) by:

- the social enterprise, or
- a 90% owned subsidiary of the social enterprise that is also a “social enterprise”

Typically, HMRC will accept that if qualifying trades account for more than 80% of overall activity, the trading requirements will be met. So a social enterprise may carry on activities that are not qualifying trades, provided those other activities remain below the 20% threshold throughout the three years after the investment is made.

***So it is critical to look at the trading activities carried on by the social enterprise, and determine whether or not they are “qualifying trades”.***

### What is a qualifying trade?

A “**qualifying trade**” is any trading activity *unless* it appears on a list of “excluded activities” in the SITR legislation.

### What are excluded activities?

The SITR legislation contains a list of excluded activities<sup>1</sup>. It’s quite lengthy.

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<sup>1</sup> <https://www.gov.uk/hmrc-internal-manuals/venture-capital-schemes-manual/vcm3000>



But in this note we're not going to look at every excluded activity. Instead we will focus on two that have only recently been added to the list. They are:

- leasing (including letting ships on charter or other assets on hire), and
- receiving royalties or licence fees.

Except we're not going to look at the chartering of ships. We don't think there are many social enterprises out there for whom this is an issue!

### Quick overview

These new exclusions cover scenarios where a social enterprise owns something (an asset, a building, a patent etc.) and makes money simply by letting someone else use it.

So these exclusions could cover a wide variety of activities from software licences, to car hire, through to the use of a village hall for three hours on a Tuesday night.

On that last point, property (i.e. a building, a room, or a piece of land) **is** one of the assets that could be the basis of a "letting" or a licence".

But issues around trading by way of leasing or licensing property are a bit more complex, as this crosses over into other areas of the SITR tax rules.

So in this note we will:

- explain in more detail what we mean by "letting", and by "royalties" or "licences",
- give a bit more information about the specific context of the uses of land and buildings (because, as we say, it gets a bit fiddly), and
- give a few hypothetical examples to help illustrate the points we make.

Further information on "qualifying trades":

- [Social Investment Tax Relief Webinar](#)
- [SITR New Rules and Guidance November 2017](#)
- [Venture capital schemes: apply to use social investment tax relief](#)

### Leasing and letting assets on hire

This covers any trading activity which consists in the social enterprise allowing the customer the use of the social enterprise's property. It applies where, subject to reasonable conditions imposed by the social enterprise that owns the asset, the customer is free to use the property for the purpose for which it is intended.

So if a social enterprise owns an asset, and charges a customer simply for using that asset (with few or no conditions), it's leasing or letting (and so **is** an excluded activity).



### Example 1:

A social enterprise wants to encourage people to eat healthier, and cut down on food miles to protect the environment. It decides to encourage people to use local allotments by renting out gardening equipment to people who may not have grown their own vegetables before. Customers can rent, from the social enterprise, all the equipment they need to cultivate an allotment in return for a fee, paid by the week. They rent the gardening equipment for the summer and then return it to the social enterprise at the end of the season. During that time they're free to use the gardening equipment as they wish (subject to an obligation to take reasonable care not to damage it).

This is "letting assets on hire". So it is **not** a qualifying trade.

### Receiving royalties or licence fees

A "royalty" is a fee paid by someone for the right to use some form of knowhow or asset owned by someone else. For instance a song-writer is paid a "royalty" if her song is played on the radio, or performed by another artist. An author receives royalties each time one of her books is sold.

A "licence fee" is very similar to a royalty. The receipt of royalties or licence fees can arise in a trade through the exploitation of such assets as trademarks, patent rights, copyright and know-how.

### Example 2:

A social enterprise designs software used to minimise energy use in affordable homes. The social enterprise enters into an agreement with a registered social landlord ("RSL") to install the software in all of the RSL's systems. The agreement is a "licence" i.e. the RSL is licensed to use the software, but the RSL does not buy the software outright (so the RSL could not, for instance, copy that software or sell it on to others). The social enterprise that owns the rights to the software is free to enter into similar arrangements with any other customer.

This is licensing. So income generated from the software licences granted to the RSL would **not** be a qualifying trade.

### Example 3:

A social enterprise that has recently spun out of a university science faculty developed a new breakthrough in methods of delivery of drugs to individuals suffering from diabetes. The discovery is patented. It might have use in a number of different areas. The social enterprise does not have the know-how, or the financial backing, to develop the treatment to the stage where it is fit for patient use. So the social enterprise enters into an agreement with a much larger research and drug development charity under which that charity can use the patent to develop new and innovate ways to deliver treatment to diabetes sufferers. Under that agreement, the social enterprise will receive royalties or licence fees for the use of its patent.

This is a royalty or a licence. Income generated in that way would **not** be a qualifying trade.

### Licence fees and property

Licence fees can also arise in relation to the exploitation of rights over land or buildings.

If the owner of a building wants to generate money by letting someone else use that building (or space within that building) there are a number of different ways in which it might do that.



- The owner might grant a lease. This is a more formal arrangement under which the person occupying the building (the “tenant”) pays rent but in return gets exclusive use of the building, or offices. The tenant enjoys statutory rights to occupy and enforce their rights, and is protected from eviction by the courts.
- However the owner might want to enter into a more informal arrangement, without legal complexity or ties. For instance it might allow people to use the building (or part of it) only for a very short period – even a few hours. Or the space to be used might be shared with others e.g. using a spare desk within an office of another social enterprise. This more informal arrangement is a “licence”.

### Do you mean landlords?

Yes and no – we told you it gets a bit fiddly.....

We should make one point in relation to property letting businesses i.e. businesses that generate income from letting out buildings, apartments, houses, offices etc.

The rules on this are complex, but the starting point is that letting property in return for rent is not a “trade”. It is taxed as a property investment business, and subject to its own set of tax rules. But is not, technically, a “trade”. And if it’s not a “trade” then it could never be a “qualifying trade”.

So a social enterprise that, say, acts as a landlord of an office building is not caught by the new additions to the list of “excluded activities – because it is not carrying on a “trade” for tax purposes at all. So was never eligible for SITR.

For more detail on property development, and property letting, see: [A guide to SITR and property development](#).

However there are numerous circumstances where a business can generate income from allowing others to use land, a building, a room, or a space within a building that falls short of being a “property letting business”. For instance, furnished letting, or the letting of holiday caravans, can amount to “trading”. But these would be caught by the new restrictions on leasing, letting and licensing. So would **not** be a “qualifying trade”.

### Example 4:

A social enterprise offers short term furnished letting of rooms or apartments to refugees waiting for more permanent accommodation. As a short term furnished letting this may be well be treated by HMRC as a “trade”. However, it is letting or licensing. So it is **not** a qualifying trade.

But the definition of “licence” goes even wider. Any arrangement under which an owner of a building or land allows others simply to use the land or building for a period of time (however short) can be treated as a “licence”. This could cover use of a room for an evening, flexible short term office accommodation, or use of a sports pitch.

### Example 5:

A social enterprise owns a building, close to a town centre, with a car park. The building is close to the local professional football club. The social enterprise does not use the site at weekends. So it enters into an arrangement with the local football club under which the football club (on match days) can provide parking to guests and season ticket holders. The football club supply stewards and security, and open and close the car park on match days, with no involvement from the social enterprise. The football club pays a fixed monthly licence fee to the social enterprise.



The arrangement between the social enterprise and the football club is a “licence” to use the car park. Income generated in that way would **not** be a qualifying trade

### Some examples

We appreciate this can get quite complicated. It will vary depending on the precise facts and circumstances for each social enterprise.

So in the rest of this note we’ll give a few more examples to explain ways in which social enterprises might fall one side of the line, or the other.

#### Is it a licence, or is there a service being provided?

As we have explained, licences are granted in many different situations by trading enterprises. But in some situations the grant of the licence is merely incidental to an activity of supplying services.

Which means it is very important to distinguish between:

- a situation where the customer is simply licensed to use a building or a room or a space for a short period of time (which is **not** a qualifying trade), and
- a situation where the customer is licensed to enter or use a room or building or space, but also receives a service from the social enterprise (and the service **is** a qualifying trade).

In those latter cases, where the licence is ancillary to some form of service being provided, HMRC will accept that the trade is **not** caught by the restriction on leasing/letting/licensing.

#### Example 6:

A social enterprise owns a small theatre that it has renovated and re-opened. Its object is to promote the arts. Every weekend it operates a cinema showing indie films, foreign language films, and documentaries. It is open to the public - who buy tickets to watch the films.

In this example, the customer who buys a ticket is buying a licence to sit in the movie theatre for two or three hours i.e. the social enterprise is granting a licence to the customer, in return for money, to enter and stay in their building.

But in reality the social enterprise is showing a film, and the customer is paying to watch a film. The “licence” that each member of the audience buys as part of their ticket price is ancillary to the main service being provided.

So this is **not** caught by the exclusion for leasing/letting/licensing so **is** a qualifying trade.

But a similar set of facts could produce a very different result.

#### Example 7:

The social enterprise that owns the refurbished theatre is approached by the local film society that wants to use the theatre to show indie films, foreign language films, and documentaries on Friday and Saturday nights to its members. The film society enters into an agreement with the social enterprise for the use of the auditorium every Friday and Saturday night. Under that agreement the film society pays to the social enterprise a fixed fee for every evening it uses the theatre



(irrespective of how many members of the film society attend any particular showing). The film society chooses the films, advertises the showings, provides the projector, the projectionist and the films and its members act as ticket sellers on the night. The film society sells the tickets and keeps the ticket receipts.

In this example, the social enterprise that owns the building is simply licensing the film society to use the auditorium. The social enterprise is not providing any other service or facility, and has no interest in the sale proceeds of tickets. So this is a licence. Meaning it is **not** a qualifying trade.

## Sports Facilities

Another major sector that could be affected by the new restriction on leasing/letting/licensing is in the provision of sports and leisure facilities.

Again, we'll give two examples of sports facilities that could fall either side of the line.

### Example 8:

A social enterprise runs a sports centre. Attached to the sports centre is a piece of land. It does not want to maintain that land, so licenses the field to the local football club and the local hockey club. The two clubs pay a fixed fee for the season (irrespective of how many games they play, or how many sides, in a day, may use the pitches). Between them, those two sports clubs then have exclusive freedom to use the pitches every weekend.

In the absence of any other services being provided, this is nothing more than a licence to use the land. And so it is **not** a qualifying trade.

But a similar set of facts could produce a very different result.

### Example 9:

The same social enterprise decides to offer football and hockey coaching. On Saturdays it runs soccer classes for various different age/gender groups. On Sundays it does the same but for hockey. Each participant signs up for a "term" of lessons and is placed into a team of similar abilities. Coaches employed by the social enterprise give training, as well as advice on nutrition, to all players. All revenue is paid to the social enterprise.

In this example, the social enterprise is providing sports coaching and fitness training. Any "licence" that each participant may enjoy as part of the coaching fee is ancillary to the main service being provided.

So this is **not** caught by the exclusion for leasing/letting/licensing so **is** a qualifying trade.

However HMRC have offered some comfort, in their guidance, to the providers of sports facilities. Their view is that:

*"..a simple activity of making sports facilities available to the general public, with no provision of services, would consist of little more than charging a fee in return for the right to use property. This would be an activity of receiving licence fees. **But such a situation would be exceptional.**"*

HMRC then go on to say that in some cases where fees for admission are received, even where there is no direct provision of services to customers, if continuous work is required to keep the property in a fit state for use by them it may still qualify. In this scenario, HMRC guidance states that *"... The main question to be considered in any such case is the extent to which the fees relate to the cost of such work"*.





So any sports or leisure facility that lets out space or rooms or sports pitches needs to look at exactly what is being provided to the customers, and whether there are grounds to argue that – even where there are no “services” being provided beyond use of the hall, room or pitch, it might still qualify.

### Is it a rental, or is there a service being provided?

As we have explained, if a licence is merely incidental to an activity of supplying services, the activity may well be a qualifying trade.

The same principal can apply to the letting of assets. Which means it is very important to distinguish between:

- a situation where the customer is simply allowed to use an asset for a short period of time (which is **not** a qualifying trade), and
- a situation where the customer may enjoy the benefit of the use of an asset, but also receives a service from the social enterprise (which **is** a qualifying trade).

In those latter cases, where the rental is ancillary to some form of service being provided HMRC will accept that the trade is **not** caught by the restriction on leasing/letting/licensing.

Again, we’ll give two examples that could fall either side of the line.

#### Example 10:

A social enterprise wants to help provide a transport solution to members of a rural community who cannot afford their own cars. So the enterprise buys three new electric cars. These are available for hire by the hour. Any member of the community (with a driving licence) can hire the vehicles for anything up to 24 hours at a time. But they can be hired for much shorter periods (an hour or two) to make single journeys. The social enterprise owns the cars and pays for their maintenance and fueling. Customers simply pay a fixed fee based on the length of time they want to use the car.

This is a car rental. So this **is** caught by the exclusion for leasing/letting/licensing so is **not** a qualifying trade.

But a similar set of facts could produce a very different result.

#### Example 11:

The social enterprise employs a number of retired members of the community as drivers. It then offers to drive any member of the community to their destination. Journeys can be one way or return and last anything up to a day. Fares are charged based on length of journey and time taken. Customers are not allowed to drive the cars themselves.

In this example, the social enterprise is not renting out the vehicle but is providing a taxi service. So this is **not** caught by the exclusion for leasing/letting/licensing so **is** a qualifying trade.

### What if I want to do some of this stuff – but I do other stuff too?

Many social enterprises that own or occupy a building may derive some income by allowing others to use their building (or part of it). But they also do a lot of their things too.



As mentioned above, HMRC will accept that if qualifying trades account for more than 80% of overall activity, the trading requirements will be met. Meaning that a social enterprise may carry on activities that are not qualifying trades, provided those other activities remain below the 20% threshold throughout the three years after the investment is made.

So here are a few things to think about in any situation where a social enterprise carries on some activities that may be caught by the new restriction on leasing/letting/licensing:

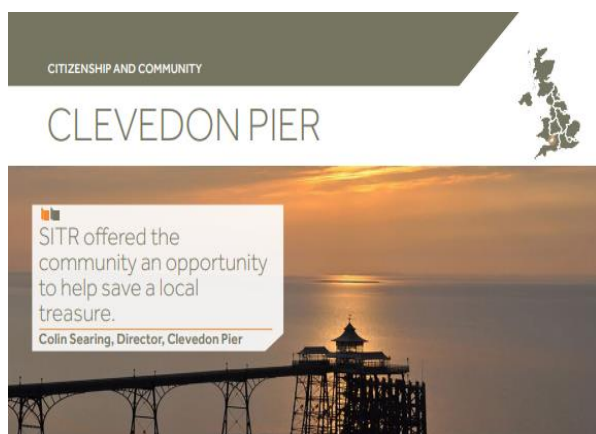
For new businesses, thought needs to be given to the business model. In other words, could the social enterprise achieve its aims without carrying on leasing/letting/licensing?

For established social enterprises looking to raise SITR funding:

- First, the social enterprise needs to assess how much of their trade could be regarded as leasing, letting or licensing (i.e. an “excluded activity”) and how much is a qualifying trade. HMRC will judge this by “*any measure which is reasonable in the circumstances of the case (for instance, by reference to turnover or capital employed)*”.
- If there is a question as to whether the social enterprise falls within or without the trading requirements, the social enterprise should consider applying to HMRC for an advance assurance on the point.
- Finally, on an ongoing basis, the social enterprise should monitor the amount of trading which falls to be treated as leasing/letting/licensing. If this starts to get close to the 20% threshold, the enterprise needs to consider the potential impact on SITR investors and whether it should (or, in fact, could) manage the non-qualifying trading activities to ensure they remain below that threshold.

Finally, it might be helpful to consider some existing SITR case studies and how the rules around licensing and leasing might now be applicable:

### Example 12:



In 2016 [Clevedon Pier](#) used SITR to raise £250,000 in the form of Community Shares as part of their refurbishment finance unfortunately a similar heritage scheme failed to qualify for the tax relief as the business model it planned meant income would be mainly (over 20%) derived through the operation of [concessions](#) demonstrating whilst organisations may look like they do similar things it is the operation of the trading activity that is key.

**Example 13:**

In 2017 Holbrook Community Society raised £277,000 as part of the capital needed to purchase and convert [The Spotted Cow](#) to become a community pub. The Spotted Cow has a wide range of trading activity including a bed & breakfast, café, cycling tours and tenanted pub. They gained pre-assurance for SISR by planning their business model and consequently tracking their income from to ensure they manage their SISR compliance for their investors.

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