Social Ventures Australia
Funding • Investment • Advice

1 June 2015

Tax White Paper Task Force
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam,

Tax White Paper Process – Re Think: Tax Discussion Paper

Social Ventures Australia welcomes the opportunity to make a submission in response to the Re Think: Tax Discussion Paper.

Please find attached Social Ventures Australia's submission.

If Treasury wishes to discuss the matters raised in this submission further, please contact me on (02) 8004 6729 or ilearmonth@socialventures.com.au.

Yours faithfully,

Ian Learmonth
Executive Director, Impact Investing

Introduction

Social Ventures Australia (SVA) welcomes the broad and inclusive consultation that is being undertaken in the current tax reform process. SVA recognises the need to optimise tax revenue to fund vital government services through an effective and simple tax system. We also recognise, however, the unique role that the private sector can play in alleviating some of the constraints faced by government in social service delivery through impact investments. Two specific tax offsets are proposed in this submission that would incentivise impact investments and grow the market so that private capital can more readily assist with delivering necessary services in our communities.

SVA notes that the Government is keen to hear from all interested parties on any issues regarding the tax system, including views on tax matters raised in other review processes, such as the Financial System Inquiry. SVA actively participated in the Financial System Inquiry and was pleased by the inclusion of impact investment in the final recommendations. SVA made several recommendations in the Financial System Inquiry prosecuting the need for Government to participate in the growth of the impact investing market so that greater social outcomes can be delivered to the community. One of the greatest levers that the Commonwealth Government can use to grow the market is through specific tax reform designed to stimulate the market.

This submission recommends the introduction of tax concessions for impact investments in qualifying social enterprises (direct or through an intermediary), social impact bonds and social and affordable housing projects. These recommendations will be framed in response to three questions raised in the Re Think: Tax Discussion Paper relevant to the growth of impact investing in Australia:

1. Are the current tax arrangements for the NFP Sector appropriate? Why or why not?
2. Under what circumstances is it appropriate for assistance to be delivered through tax offsets?
3. What, if any, changes could be made to the current tax arrangements for the NFP sector that would enable the sector to deliver benefits to the Australian community more efficiently or effectively?

Background

Social Ventures Australia works to improve the lives of people in need. We focus on keys to overcoming disadvantage in Australia, including great education, sustainable jobs, stable housing and appropriate health, disability and community services.

By offering funding, investment, and advice we support partners across sectors to increase their social impact.

We are a not-for-profit organisation established in 2002 by The Benevolent Society, The Smith Family, WorkVentures and AMP Foundation.

In our first 12 years:

- We generated over $50 million of investment from philanthropists, trust and foundations and government into the social sector,
- We worked with over 80 social ventures like Beacon Foundation, Ganbina, STREAT and AIME, and distributed more than $20 million to support their work,
- We delivered $4 million of support through government and cross-sectorally funded social enterprise programs in ACT, NSW and QLD,

- We leveraged $4.6 million of private investment to match government funding into the SVA Social Impact Fund to support innovative social enterprises,
- We helped to broker $165 million of investment into early childhood learning to fund the non-profit consortium buyout of ABC Learning Centres to create Goodstart, providing 15% of Australia's early childhood places,
- We worked alongside UnitingCare Burnside on Australia's first Social Benefit Bond, with the NSW Government,
- We were the lead partner of a consortium providing advice and support to the WA Government to deliver the $10 million Social Enterprise Fund, and
- We delivered over 550 consulting engagements for over 300 clients to strengthen the non-profit sector.

SVA believes a new social capital market needs to thrive alongside traditional financial markets and we are keen to develop the new asset class of social impact investment as it becomes increasingly part of the mainstream.

1. Are the current tax arrangements for the NFP Sector appropriate? Why or why not?

The current tax arrangements favour charitable not-for-profit organisations, particularly those that have deductible gift recipient (DGR) item 1 status. Such organisations can benefit from payroll, income and GST tax exemptions and can also produce tax deductible receipts for those that donate funds to their operations. Organisations that deliver similar if not the same services under a social enterprise or social impact bond structure benefit from few of such tax exemptions despite often operating in a more sustainable manner.

The not-for-profit sector has changed dramatically in the last decade. With a shrinking pool of philanthropic donations and government grants many not-for-profit organisations have sought to establish social enterprises as a more sustainable means of delivering social services to the communities in which they work. At the same time, a greater emphasis on outcomes based contracting has stimulated growth in social impact bond financing for some of the larger service providers in Australia.

Social enterprises like all businesses require access to capital to operate and grow. Present tax arrangements do not provide any deductions, offsets or incentives to investors that could meet the capital demand in the social enterprise sector. The current tax arrangements are not sufficiently appropriate for organisations that do not adopt the not-for-profit charity structure.

2. Under what circumstances is it appropriate for assistance to be provided for tax offsets?

Tax offsets should be provided in circumstances where the net benefit created from the behaviour encouraged by the tax offset outweighs the foregone tax revenue to the Commonwealth. Impact investments have the potential to generate critical social outcomes for those that need it most in our communities, yet the supply of appropriate capital for social entrepreneurs and social impact projects is in limited supply. Tax offsets could play a central role in encouraging investors to invest in enterprises that might only allow for sub market returns as an added tax offset could compensate the risk of the investment and improve the net return to the investor. Impact investing is an appropriate circumstance for tax offsets as such offsets will encourage investor activity that would meet the demand from the sector.

Tax offsets should be made available for specific investment scenarios; either investment in social enterprises (either direct or through an intermediary), social impact bonds and social and affordable housing projects. Each of these investment scenarios will be considered in detail in the next section.

3. What, if any, changes could be made to the current tax arrangements for the NFP sector that would enable the sector to deliver benefits to the Australian community more efficiently or effectively?

Two specific changes could be made to the current tax arrangements for the NFP sector that would enable the sector to more efficiently and effectively serve the Australian community. These changes relate to direct investment in social enterprises and social impact bonds and investment in social and affordable housing projects.

Investment in social enterprise and social impact bonds:

A tax concession should be provided to investors who make investments in either social enterprises or social impact bonds. Social enterprises and social impact bond structures promote more effective and sustainable service delivery as they promote more commercial operations and less reliance on grants and donations. Ideally, investors should be able to offset the amount invested in a social enterprise against their assessable taxable income in the year that the investment is made and enjoy a tax exemption from interest repayments or dividends as they are repaid during the life of the investment. Capital gains tax should also be offset when the impact investment is realised.

In order for an impact investment tax offset to be regulated, clear qualifying criteria would need to be established. Australia should emulate the tax relief scheme that was established in the UK which overcame challenges of definition and eligibility. The below summarises the social investment tax concessions introduced in the UK for consideration in the Australian context.

In 2014 the UK introduced the Social Investment Tax Relief (SITR). The policy objective was to increase external investment in social enterprises in the UK by providing tax incentives to private individuals who invest in them.

SITR makes available a range of tax reliefs for individuals who make qualifying investments in qualifying social enterprises. Broadly:

- Income tax relief is available as a percentage of the amount invested, to be deducted from the individual's income tax liability for the year of investment;
- CGT relief is available by allowing CGT on chargeable gains to be deferred in certain circumstances where the person liable to CGT invests the gain in a social enterprise; and
- Capital gains on social enterprise investments are free from CGT if the investment is held for three years.
- Income tax is payable as usual on dividends and interest received in respect of the social investment

Both social enterprises and social impact bonds can qualify as an investee.

The organisation receiving the investment as a social enterprise must meet certain criteria; it must have a defined and regulated social purpose; and it must be a charity, community interest company or community benefit society carrying out a qualifying trade, with fewer than 500 employees and gross assets of no more than GBP 15m.

A qualifying trade is one which is conducted on a commercial basis with a view to the realisation of profit. Most trades qualify although there are some specific exclusions. The organisation must use the money invested within 28 months of the date of subscription for the purposes of its qualifying trade.

The organisation must apply to HMRC to confirm they meet the requirements of the scheme and investors can only claim tax relief once this confirmation is received.

Social impact bonds are eligible for SITR where the SPV is a company limited by shares and has been accredited by the Minister for the Cabinet Office as a "social impact contractor".

In order to receive this accreditation, a range of criteria must be satisfied, including:

- The SPV must have been established for the purpose of entering into and carrying out a "social impact contract";
- the SPV must hold a signed contract with a Contracting Authority;
- the contract must set out "defined outcomes" with a "social and/or environmental purpose" which are capable of being objectively measured; and
- of the total payments that could be made under the contract by the Contracting Authority to the company seeking accreditation, at least 60% by value must be conditional on achieving the defined outcomes.

When assessing whether accreditation should be granted, the Minister will need to be satisfied that the SPV is tackling a complex issue and that achieving the defined outcomes would deliver significant improvements in the social or environmental well-being of one or more disadvantaged groups and result in long term positive social and/or environmental impacts. In most cases the Minister will require evidence that positive impacts are likely to endure for at least 12 months after the contract comes to an end.

Qualifying investments are:

- Subscriptions for newly issued full-risk ordinary shares in a social enterprise; or
- Unsecured subordinated loans with a commercial rate of interest to a social enterprise,

Provided that the investment does not give the investor more than a 30% interest in the social enterprise (including interests of associates). Investments must be paid up in full in cash at the time of investment. Investors cannot be connected to the social enterprise prior to making the investment – eg they cannot be an employee, a director or trustee.

They are limited to:

- An amount of investment per investor – investors can invest up to GBP 1m and can invest across more than one social enterprise;
- A maximum amount of investment for each individual social enterprise – this currently sits at around GBP 300k over a period of three years.

Investors receive two tax concessions, income tax and capital gains tax.

Individuals making an eligible investment can deduct 30% of the cost of their investment from their income tax liability. Investments must be held for a minimum of three years in order to claim the income tax relief. If an investment is disposed of within that period, relief will be withdrawn or reduced.

Income tax is however payable on any dividends or interest on the social investment.

In terms of CGT:

- if a sum equal to the amount of a chargeable gain is invested in a social enterprise within a specified time then the individual making the gain and the investment may claim for the gain to be treated as accruing (and taxed) when the social enterprise investment is disposed of, instead of at the earlier time; and
- capital gains attributable to an increase in value of the social investment itself will not be taxed, provided the investment is held for a minimum period of three years.

The cost of introducing the tax changes:

- It is estimated that the cost to HMRC of implementing the changes will be in the region of GBP 500k – GBP 1m for system changes. There will also be operational costs in administering the relief but this impact will depend on the number of social enterprises who qualify for investment.
- Eligible social enterprises will face some one off and ongoing administrative costs in order to qualify for the relief and to familiarise themselves with legislation, processes and requirements.

The benefit of introducing the tax changes:

Some sources state that these changes are expected to generate an additional GBP 480m in social investment. Some market commentators say that SITR has had a slow start, and the proposed request to the EU authorities to increase the small investment limits is part of a plan to speed up and scale up investment.

To date, several social impact investments have been launched as a result of these changes:

- In November 2014, in the first deal of its kind, Bristol based charity FareShare South West received an investment of GBP 70k from a small group of angel investors piloting a social investment tax relief fund (SITR Fund). The pilot was to identify the demand for social enterprise investment, and to understand how different fund structures might impact on scaling up the social impact achieved by investees. The pilot had an initial investment pot of GBP 200k.
- In February 2015, wealth manager UBS announced it is sponsoring a social impact investment specialist (Resonance) to develop the first in a series of SITR Funds in cities across the UK. The first SITR Fund aims to launch in Q1 2015 in Bristol, and the vision is for 6-8 more funds in cities with a likely next focus on Manchester. Each fund is aiming to launch with around GBP 5m to invest in local social enterprises and will offer loans with interest rates between 4% and 7% unsecured. This followed an 18 month pilot phase, including the FareShare deal above.

- In February 2015, two social impact bonds were launched using SITR – the first of their kind. The two SIBs are worth more than GBP 900k and will help just under 500 young homeless people find accommodation, education and employment in East Midlands and Gloucestershire. GBP 150k of that funding will provided by 10 individual investors benefiting from the SITR changes. Investors will receive 7% returns, as well as the upfront 30% tax benefit, if the SIB delivers the expected results.

Investment in Social and Affordable Housing Projects

Australia is presently suffering from a significant social and affordable housing crisis which is perpetuating disadvantage in our communities. New housing stock is required to replenish dilapidated stock and meet the rising demand; however, funding from the State Governments is extremely limited and the commercial realities for community housing developers make new development uneconomical.

To stimulate private investment in social and affordable housing a new social infrastructure tax offset scheme should be implemented so that investors would be able to lend at sub-market rates to incentivise developers to build new social and affordable housing stock. The proposed tax offset would be reminiscent from the previous Infrastructure Borrowing Tax Offset Scheme, where interest paid on infrastructure bonds is tax exempt in the hand of the lender and not tax deductible in the hands of the borrower. The intention of the scheme would be that lenders will pass back the benefit of tax exempt interest in the form of lower lending rates to community housing developers.

A similar tax offset scheme has been successful in the US. The Federal New Markets Tax Credits and the Community Reinvestment Act were designed to increase the flow of capital to low socio-economic areas. Since 2000 over $31.1 billion in new market tax credit transactions have been reported. In 2013 $55 billion was channelled from banks to poorer communities through social investment under the Community Reinvestment Act.