
Enterprising communities:
A tax incentive for community investment
A consultation document

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FOREWORD FROM THE CHANCELLOR

From a platform of economic stability, our ambition is to ensure that every part of the country shares in the rising prosperity of the nation. Our challenge is to extend new opportunities to those areas that in recent decades have too often been left behind.

Business creation in our most disadvantaged communities lags far behind the rest of Britain. To tackle the causes of unemployment and low economic activity, we need a new approach to encourage enterprise and stimulate business-led growth in our most challenged communities.

Sir Ronald Cohen's Social Investment Task Force reported to me last October with an innovative set of proposals for doing just that.

We must now extend fiscal and other financial incentives that open up economic and business opportunity in our most disadvantaged communities. We are determined to put in place the best possible incentive structure to encourage business growth.

That is why we are now consulting on Sir Ronald's proposal for a new and generous tax credit for community investment. I believe this proposal has the potential to unlock significant new flows of private investment where it is needed most – in our most disadvantaged communities.

I urge you to take part in this consultation and help make this proposal a success.



GORDON BROWN

Chancellor of the Exchequer

EXECUTIVE SUMMARY

This consultation document seeks views on a proposal for a new tax credit for community investment. This follows the report by the Social Investment Taskforce before the November 2000 Pre-Budget Report. The goal is to help transform our most disadvantaged communities – by making enterprise a key driver of regeneration.

The aim of the tax credit would be to attract greater flows of private investment into enterprises in these communities – but to do this in a way that also helps to build skills and capacity, to promote long-term success.

The document explains:

- the case that the Government sees for taking action
- why the Government is suggesting a tax credit
- how in practice the tax credit might operate

The Government believes this is an important proposal, including for three key groups:

- **Investors** – whether individuals, companies, banks, charitable trusts or institutions, and whether motivated by financial return or by a mix of financial and social impacts. *Is this a market in which you might be interested in investing? Would a tax credit make a difference to your behaviour?*
- **Potential beneficiaries** – such as community organisations and small enterprises, who might benefit from extra investment. *How useful do you think this proposal might be? Are you interested in making more use of finance that requires a financial return, like a loan, but unable to access it? If so, why?*
- **Intermediaries** – who might apply for the tax credit and raise extra finance using it. *What do you think of the structure that is proposed here? Would you apply for tax credits, and if so for what amount?*

The Government would welcome comments from these groups and others on these and other questions. Some key points from the document are set out below.

The case for action

The central argument is that there is a gap in the market between the finance for regeneration and community development that is available on fully commercial terms, and the support that is available from Government and philanthropic grants.

Many projects that benefit community development can be funded on fully commercial terms. This should continue to be the way in which they are financed. But there are other projects that cannot attract fully commercial finance – but which are still capable of servicing some investment on near-commercial terms and have a good prospect of graduating to fully commercial finance.

The tax credit would aim to expand the supply of finance serving this market where this could bring real benefits in tackling deprivation and disadvantage. The focus would be on enterprises such as micro-firms and start ups, social and community enterprises, and small and medium enterprises, where these could not otherwise get the finance they need.

In practice, the Government believes support is best delivered through intermediaries known as community development finance institutions (CDFIs). This is because CDFIs are in a position to assemble the combination of technical skills and community relationships

needed to succeed. They can also provide advice and support to the businesses they serve – a vital dimension.

The CDFI sector is small at present in the UK. The growth of the sector, while achieving high professional standards, will be important for the success of these proposals.

Tax credits

The key to attracting more private investment into this sector is to enhance the returns that investors could earn. This should increase the supply of private sector finance – including investment that is itself seeking to achieve a mix of financial returns and some kind of social impact.

This goal could in principle be achieved either by a grant scheme or through the tax system, but the Government believes that a tax-based scheme is likely to be more effective. Investors are more familiar with considering tax as a factor in deciding on investments. Many investors also already have to provide an annual return to the Inland Revenue, so a tax-based scheme would avoid any need for an additional interface with Government.

How the tax credit might operate

As proposed by the Social Investment Taskforce, the tax credit would be a major innovation in the UK tax system. Unlike other aspects of the tax system, it would operate on a competitive basis, as follows:

- the Government would set in advance a maximum total for the amount of investment that could benefit from the tax credit
- CDFIs would then bid for allocations from this total, submitting evidence of their capabilities and a business plan
- a body appointed by Government would then evaluate these bids, on the basis of published criteria; bidding rounds might be held annually or less often
- successful bidders would be given the right to raise a specified amount of tax-advantaged investment
- once they had their allocation, CDFIs would be free to raise their tax-advantaged investment from investors.

The Government recognises that this would be a novel approach, but considers that it would have a number of advantages over alternative structures that might be less flexible and more complex. But there are still a number of key practical issues on which the Government would particularly welcome views.

These include:

- the criteria to be used to evaluate CDFIs and their proposals
- the process for evaluating proposals – should it involve one stage or two?
- the definition of “disadvantaged communities”
- whether CDFIs should be able to invest in property and other types of investment, and what legal forms of CDFI we should cater for
- whether we should provide for tax-advantaged investment that comprises equity as well as debt
- whether we should provide for investment by individuals as well as companies

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- the level of the tax incentive
 - whether relief on capital gains is relevant or justified
 - the level of the cap on total amount of investment and evidence for claims about demand
 - the length of holding period required for the tax incentive

Timetable and next steps

Responses to this consultation document are requested by 2 July 2001. Subject to the outcome of this consultation, the Government would expect to be able to bring forward legislation in the Finance Bill in 2002. Tax credit allocations are unlikely to occur before end 2002 or early 2003.

Introduction

1. The Social Investment Task Force (SITF), chaired by Sir Ronald Cohen, reported to the Chancellor of the Exchequer on 24 October 2000. Its report, *Enterprising Communities: Wealth Beyond Welfare*, recommended a five-point programme of action aimed at stimulating enterprise, investment and wealth creation in “under-invested” or disadvantaged communities.
2. The Chancellor of the Exchequer welcomed the report in his Pre-Budget Statement on 8 November 2000; and endorsed its central message – that a thriving community development finance sector is vital to boosting enterprise and wealth creation in disadvantaged communities.
3. The report’s first main recommendation was for:
“a new Community Investment Tax Credit (CITC) to encourage private investment in both not-for-profit and profit-seeking enterprises in under-invested communities”.
4. In response, the Government said in the November 2000 Pre-Budget Report:
“a tax incentive for community investment could prove effective in helping to bring more investment and expertise to the economic renewal of disadvantaged communities.”
5. The Chancellor said in his Pre-Budget Statement that the Government would consult on “a new and generous tax credit for community investment”. This consultation document takes forward that commitment.
6. The Government has decided to consult for 4 months, to allow interested parties sufficient time to consider the many important and complex issues raised by this proposal. The Government urges all interested parties – including potential investors and recipients of investment – to contribute to this consultation exercise and help make this proposal a success. Responses should be sent, by 2 July 2001 to:

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The Government’s vision for regeneration

7. The first priorities of this Government were to establish economic stability, sound finance and steady growth. In order to sustain and share the benefits of a successful economy, the Government now wants to extend prosperity and open up opportunities to all, especially those in disadvantaged communities.
8. The Government believes that one of the root causes of poverty is a lack of economic activity and jobs. Supporting the creation and growth of enterprises is thus a key step in tackling poverty. It contributes to the regeneration of disadvantaged communities, as well as to the development of a more dynamic, enterprising economy.
9. The Government recognises that many of our poorest communities face fundamental problems – such as high crime and a low skills base – that discourage private investment.

Regeneration strategies need to tackle these problems, as well as promoting enterprise, if they are to succeed. But enterprise is a key component of this approach – for regeneration to last it must have a real economic base, and that means more business growth and success.

10. This consultation document is about one strand of the Government's strategy for regeneration: encouraging **greater flows of private investment into disadvantaged communities**, through tax incentives for community development finance. There are many other actions that the Government is taking to strengthen the climate for enterprise in disadvantaged communities, including:

- creation of the **Small Business Service**, with a new remit to promote enterprise across society, especially disadvantaged groups
- the **£96 million Phoenix Fund**, run by SBS, supporting innovative types of business support, volunteer mentors and grants for community development finance
- **New Deal options** for 18-24 year olds and the long-term unemployed to start a business
- new resources and flexibilities for the **Regional Development Agencies**, to deliver regional strategies for growth and regeneration.

11. More also needs to be done to recognise the economic potential and vitality of our poorest communities. Even the poorest areas can offer opportunities to develop new markets and grow successful businesses. Rundown inner cities can, for example, have a competitive edge over other areas, due to their strategic location near transport links, their labour supply and under-served retail markets. The Government is therefore also supporting the **Inner City 100** – a project to identify the 100 fastest growing businesses in deprived inner cities and help raise awareness of the potential for investment.

12. This is all part of a wider agenda, taking a new approach to physical and social regeneration. In the November 2000 Pre-Budget Report, the Chancellor proposed a comprehensive package of tax incentives to regenerate our towns and cities, in particular high unemployment areas. In addition to this community investment tax credit, the proposed package includes targeted cuts in **stamp duty**, accelerated tax relief for **cleaning up contaminated land**, **VAT cuts** to reduce the costs of **residential property conversions**, and tax relief to bring **empty flats over shops** back into use.

13. Other key elements of the approach include:

- Setting **new targets for public services** like health and education, to raise their performance in poor areas. Substantial **extra resources** were committed in July 2000 to achieve these goals.
- Encouraging the creation of **Local Strategic Partnerships**, to bring together public services, business, the voluntary sector and the community to develop and deliver neighbourhood renewal at the local level.
- Publishing the **Action Plan on the National Strategy for Neighbourhood Renewal** in January 2001. This is an ambitious programme for bringing jobs and economic activity, skills, better health, less crime and a better physical environment into the most disadvantaged communities.

Many aspects of this agenda are devolved matters outside England. The devolved administrations have strategies for achieving similar goals.

Barriers to enterprise in disadvantaged communities

14. There are a number of barriers to enterprise in disadvantaged communities. Many of these are complex and inter-related. Studies (including the Policy Action Team 3 report (HM Treasury, November 1999) and the Bank of England report “*Finance for Small Businesses in Deprived Communities*” (November 2000)) have emphasised:

- The availability of **key skills** – such as financial management and marketing. These skills tend to be in short supply in poor communities.
- The **cultural environment** – for example, is starting a business seen as a norm? This is closely linked to a community’s role models, to general levels of confidence and ambition, and to attitudes to business in schools.
- The more fragile nature of **poor communities’ economies** – with lower savings and income levels, and perhaps extra costs (such as higher crime).
- The role of the **public sector** – for example, does it dominate the local economy, and does it undermine incentives for enterprise?
- The **supply of suitable finance** – do the mainstream debt and equity markets work efficiently with all clients and in all locations? What about businesses that fail conventional tests for finance, but could benefit from loans or equity coupled with advice and support?

15. These problems can all be made worse by **perceptions**. Where expectations are low, it will tend to be more difficult to get the skills and resources needed to start and succeed in business.

16. Some of these barriers affect the **demand** for finance for enterprise, and some affect the **supply**. The Government’s view is that both demand and supply side issues need to be tackled. More work is also needed to improve our understanding of the role that different barriers play – in many areas hard evidence is lacking.

17. Developing the community development finance sector is a way of tackling problems on both the demand and supply side. This is a major reason why the Government believes that, given the right enabling environment, community development finance could play a bigger role than now in helping to generate and sustain enterprise in disadvantaged communities.

Community development finance

18. The community development finance sector provides:

- private finance to projects for the sake of benefits in community development and regeneration, as well as financial returns; and
- valuable support services for both investors and businesses.

19. The scope of community development finance is potentially very wide – the projects could include helping people to start in self-employment, backing the growth and creation of small for-profit enterprises in deprived communities, or helping to finance social and community enterprises, such as local childcare schemes.

20. Many projects that deliver benefits in community development can of course be funded on fully commercial terms – and this should continue to be the way in which they are financed. The more efficient are the UK’s finance markets, the more projects that should be capable of being funded in this way.

21. But there are also projects delivering benefits in community development and regeneration that cannot attract fully commercial financing – but which are still capable of servicing some debt or equity. This market may not be served for a number of reasons: because the transaction costs and complexity are too great; because the intrinsic returns are simply too low, on a risk-adjusted basis, and there are more profitable opportunities elsewhere; or because there are barriers to innovation among those who might demand such finance, supply it, or both.

22. Whatever the causes, there are good reasons for wanting projects like these to be able to use more debt or equity investment, on terms that are as near-commercial as possible.

23. There are also good reasons for supposing that the best way to do this is to encourage the community development finance sector as an **intermediary**. The key points are:

- Expanding the supply of debt and equity should help to increase the total supply of finance for regeneration, by leveraging in private finance alongside government funding.
- If done effectively, it should also help to bring more commercial models and disciplines into activities and communities that might otherwise look just for grant funding.
- The key features of community development finance include being close to the community served, thus acquiring specialised knowledge, but also having the technical skills required to assess proposals for financing.
- Community development finance institutions (CDFIs) also typically provide business support and advice to clients as well as financing, so they work on the demand side of the problem as well as the supply side.

24. The Government therefore believes that a key way of helping enterprise in disadvantaged communities would be to channel support through the community development finance sector. The community development finance sector in the UK is small at present, relative both to mainstream financial services and to the equivalent sector in the US. Estimates of its asset size vary between £250-400 million (the Social Investment Task Force report *“Enterprising Communities: Wealth Beyond Welfare”* (October 2000); and the Bank of England report *“Finance for Small Businesses in Deprived Communities”* (November 2000)). It also contains a wide variety of different business models and legal forms. The box on pages 9-10 describes examples of community development finance institutions (CDFIs) that are currently active, together with a description of the main business models.

25. The Government recognises the need for the community development finance sector to do more to identify and spread best practice. As recommended by the Task Force, the Government is therefore encouraging the sector to form a single, high-quality and inclusive trade association.

26. It is important to note two caveats. First, if community development finance grows as a result of Government intervention, it should do so in a way that improves the efficiency of the rest of the market rather than reduces it. We should expect market segments and individual enterprises that become capable of fully commercial financing to graduate to it. Second, we should ensure that there is pressure for CDFIs themselves to be efficient, for example by operating at appropriate scale. Good information and performance indicators will be vital here, given that conventional measures of performance in the private sector (profitability, earnings growth etc) are less relevant.

Examples of community development finance institutions (CDFIs)

There are four main types of CDFI:

- **Community loan funds** make capital available to community regeneration initiatives and businesses. Loans are often coordinated with or used to leverage additional sources of private capital. In 1997, a number of community loan funds together formed the Rebuilding Society Network.
- **Micro-finance funds** make very small loans, usually at near-market rates of interest, to micro-enterprises – typically sole traders or small family businesses. The Prince's Youth Business Trust is the largest of these funds in the UK.
- **Social banks** are for-profit financial service providers or subsidiaries, dedicated to social or environmental objectives. They do not focus primarily on the economic regeneration of low-income communities. Triodos Bank is the largest (but it is very small compared to high street banks). Others include the Ecology Building Society and Unity Trust Bank.
- **Credit unions** are not-for-profit, co-operative institutions for saving and borrowing, where members with a common bond save in the form of shares, which are then re-lent to members. While primarily geared to personal finance, a few credit unions are beginning to provide loans for self-employment and micro-enterprise.

Annex B lists some examples of CDFIs. These include:

Aspire Micro Loans for Business Limited, Belfast

Aspire, launched in February 2000, provides access to finance for the self-employed and micro-businesses in Greater Belfast, at commercial interest rates. Aspire targets for-profit businesses that have been established for at least 6 months. It sets a £5,000 and 9-month limit on initial loans. In its first year, Aspire made 63 loans totalling £215,000. The repayment rate is 96 per cent (less than one day late) and the write-off rate is 2.5 per cent. The average processing time for loans is 11 days.

Aston Reinvestment Trust, Birmingham

Aston Reinvestment Trust (ART), launched in 1997, provides loans and business advice and support to projects that are unable to access full borrowing requirements from the banks. It is based in one of the most disadvantaged areas of the UK, and serves both for-profit and social enterprises.

Since 1997, ART has made 65 loans totalling over £1.1 million – which has levered an additional £1.7 million of other funding. ART has raised £1.5 million of capital from both the public and private sectors – for example, Barclays Bank, NatWest, the City of Birmingham and the Charities Aid Foundation. Loans are on commercial terms. Default rates currently stand at around 8 per cent. ART provides loans for start-ups, but has so far concentrated on providing working or development capital to established small businesses and social enterprises, such as the following:

- **BABA Enterprises Limited** is the UK's largest manufacturer of fresh poppadums. ART worked with a bank, the local authority and the DTI to help BABA move to new premises and acquire more equipment to meet increasing demand.
- **Betel** is a registered charity that helps people recover from addiction by employing them in various enterprises, such as second-hand furniture, gardening and mail order businesses. Betel has now graduated to bank borrowing for many of its current trading requirements.

Hackney Business Venture, East London

Hackney Business Venture (HBV), founded in 1984, is a non-profit company limited by guarantee. It provides start-up and development grants and loans – as well as training, business advice and mentoring – to new and existing businesses in the London Borough of Hackney. HBV loans range from £500 to £25,000. Over the last 5 years, HBV has managed a total of £1.1 million in soft loans – which in turn has attracted a further £3.3 million from banks and private sponsors. Over 120 businesses have been helped in this way and more than 450 jobs either created or secured.

Merseyside Special Investment Fund

The Merseyside Special Investment Fund (MSIF), set up in 1996, is a partnership between Merseyside and the European Regional Development Fund. It was financed by the Objective 1 programme with £16 million of ERDF as the major source of funding – other funding included a loan from the European Investment Bank and some private sector investment. The MSIF provides finance to viable, privately owned businesses on Merseyside whose funding needs cannot be fully met from other sources.

The MSIF Small Firms Fund provides loans of £3,000-£50,000 for up to five years, normally at a fixed rate of interest of up to 6 per cent over base and unsecured. The MSIF also includes a Venture Fund – which makes equity investments of £100,000-£500,000 – and a Mezzanine Fund makes loans of 350,000-£250,000 with equity options. By end-July 2000, the MSIF had made 441 investments totalling £22.9 million – which had leveraged an additional £57.1 million of other investment and created 2,346 jobs and preserved 2,294 further jobs.

Q1. Do you agree with the analysis set out above in paragraphs 14-26, and in particular with the view that the community development finance sector could play an important role in helping to promote enterprise in disadvantaged communities?

Q2. Do you have any views – as potential investors, intermediaries, or final beneficiaries – on the potential scale of the market here?

What kind of support?

27. What kind of support should the Government give to community development finance, to achieve these goals? There are two dimensions to this question:

- What do we want the support to achieve, in terms of impact?
- How can support most effectively be delivered, for example through grants or the tax system?

28. The Government is already providing some support to community development finance through the Phoenix Fund. To date the purpose of this funding has been to help establish the capital base of the sector, through direct grant finance. This suggests that **the next step should be to try to attract another, more commercial, tier of capital, in the form of private sector investment seeking a positive financial return.**

29. To achieve this, incentives should go to the investor, rather than to the intermediary CDFI or the businesses in which the CDFI ultimately invests.

30. A structure on these lines is obviously central to the goal of encouraging private investment flows into disadvantaged communities. But it should also have positive incentive effects on CDFIs – given that those trying to attract investment will need to demonstrate to investors that projects meet their requirements for risk and return, whatever these may be.

Tax systems or grants?

31. Should such incentives be delivered through the tax system or through public spending, as a grant?

32. In principle, either route could be used to achieve the same economic result. Most schemes that provide incentives aimed at investors (such as Venture Capital Trusts, or the Corporate Venturing Scheme) are operated through the tax system. However, these schemes rely on detailed provisions defining investments that fall inside their limits, and specifying the operation of the scheme with some precision. For various reasons, discussed below, the Government does not favour attempting to follow that approach here.

33. This means that one of the advantages often cited for using the tax system to incentive behaviour does not apply here – namely, giving investors and investees a framework for decision-making that eliminates the need for case by case decisions by Government. In this case, we would need to marry the use of some discretion by Government with the tax system. How this might be done is discussed in detail below.

34. There are, however, other reasons why the Government considers that a tax-based incentive would be more effective than trying to achieve a similar result using grants to investors. In particular:

- Many investors are familiar with considering tax as a factor in deciding on investments. Many are also familiar with the concept of tax-advantaged investments, such as Venture Capital Trusts. Using tax as the basis for a scheme in this area would build on that familiarity, and should require less by way of fresh explanation.
- Most potential investors in community development finance already have an interface with the tax system, through an annual tax return submitted to the Inland Revenue. If the Government were to incentive investors through grants, they may need to have an additional interface with another part of Government, which they are unlikely to welcome.

Q3. *Do you agree with the analysis in paragraphs 27-34? In particular do you agree that:*

- *additional support for community development finance should focus on attracting private sector investment seeking some kind of financial return?*
- *an incentive aimed at investors should use the tax system rather than grants?*

What kind of tax incentive?

35. The proposal for a tax incentive raises a range of novel and significant issues. Many of these are discussed in detail below. Among the most important are:

- How would the **delivery mechanism** and **competitive allocation process** work for investors and CDFIs?
- Which organisations should be **eligible** to apply for the tax credit? What **evaluation criteria** should be used to judge them and their bids? Should the **assessment process** be in one stage or two?
- How should **disadvantaged communities** be defined?
- Should the tax credit benefit investment in **property**?
- What **legal form** should eligible organisations (or “community investment vehicles”) take?

- Should the tax credit be available to both **debt and equity finance**?
- Should it be available to **individual as well as corporate investors**?
- What should be the **level and form** of the tax credit?
- What should be the total amount of funds – **the cap** – attracting the tax credit?
- How long should the **holding period** be?
- Which body – the **allocation authority** – should operate the competitive allocation process?

In considering these issues, a range of objectives needs to be kept in mind. The tax incentive:

- must be as simple to use as possible;
- must be pitched at a level which incentivises investment without excessively distorting the market;
- the scope for abuse must be minimised;
- the allocation process must be clear and transparent.

Delivery mechanism

36. The Social Investment Task Force proposed that this tax incentive – the Community Investment Tax Credit (CITC) – should be delivered in a way that would be fundamentally new to the UK tax system.

37. As mentioned above, existing schemes such as Venture Capital Trusts or the Corporate Venturing Scheme that provide tax relief for investments have detailed rules for targeting the incentive precisely, including provisions to guard against abuse. The total value of the relief depends on the number of investments that satisfy these criteria.

38. The Task Force proposed instead that the Government should fix a maximum total for the value of the tax credit in advance. This would then be allocated on a competitive basis to CDFIs whose plans were judged by a body nominated by Government as most likely to serve the broad goals of the scheme.

39. The Government recognises that this approach would be innovative in the context of the UK tax system. However, it considers that it would have a number of distinct advantages for a scheme with the broad goals of the CITC:

- it would give it the flexibility to support a range of projects without needing to specify the full conditions in advance;
- it would avoid the need for complexity, both in the legislation and for those seeking to make use of the scheme – something that is important for a scheme aimed at helping some of the UK's poorest communities;
- although provisions to guard against abuse would be needed, the prior approval process would enable these to be kept to a minimum; and
- the competitive process should also help ensure that only the strongest applications would be approved, and so maximise the impact of the resources.

40. In detail, the process might work as follows:

- the Government would specify a maximum amount of new investment that would qualify for the tax credit

- a body appointed by the Government to allocate the tax credit (the “allocation authority”) would call for bids from eligible CDFIs
- clear criteria would be published for evaluating the bids
- bidders would submit a business plan to the allocation authority, showing how they would raise and use the tax-advantaged investment
- the allocation authority would assess the bids against the criteria
- successful bidders would be given the right to raise tax-advantaged investment up to a specified amount (the total amount for all successful bidders would not exceed the maximum amount set out in legislation)
- once they had their allocation, successful bidders would be free to raise their tax-advantaged investment from investors; and
- investors in these CDFIs would be able to use the tax credits to reduce their tax liabilities.

41. The allocation authority would need to monitor and evaluate the activities of the successful bidders, to ensure that they fulfilled their plans. There would also be powers to withdraw the tax credits where the conditions on which the credits had been awarded had been breached. Bidding rounds might take place annually, or perhaps every 2-3 years, with the limit expressed as a certain amount of tax-advantaged investment available for allocation each year.

42. There are, of course, also some disadvantages to this approach. In particular, it would put a great deal of weight on the allocation process, and it would not be clear until that process had been completed whether or not bids had been successful. This would create some uncertainty and nugatory bidding costs. Clarity about the criteria for allocation and good communications between the allocation authority and the market of potential applicants will be vital to keep these to a minimum.

Q4. Do you agree with the proposals on delivery mechanism? In particular, do you agree with the proposed competitive allocation process, based on business plans and published criteria, allocating a maximum amount of tax-advantaged investment? Do you think that investors will be attracted to a scheme run on these lines?

43. The Government believes that one of the keys to a successful scheme is to keep the burden on investors to a minimum. In the proposal set out above, the responsibility for preparing a bid and obtaining approval would rest with the CDFI. The CDFI would also have to manage the uncertainty about whether or not a bid would be successful. Before a bid had succeeded, there would be no need for investors to enter into any agreement with a CDFI, though no doubt CDFIs will want to establish that a market exists for raising the funds.

- 44.** If this delivery model is adopted, there are a number of other issues to resolve, such as:
- how should we define the CDFIs eligible to bid for the tax credit?
 - what should be the evaluation criteria for judging bids?

There is also the question of which body should be the allocation authority. This is dealt with below in paragraphs 95-99.

Eligible CDFIs – “Community Investment Vehicles”

45. Existing CDFIs differ enormously in size, legal form, objective, and in their capacities. The market is small at present, though it is growing.

46. The Government expects that a relatively small number of CDFIs are likely to succeed in any given competition for tax credits, and that the standard for success will be high. Successful bidders – “community investment vehicles” (CIVs) – will be able to invest directly in enterprises, or to on-lend to other CDFIs. Some limitation on numbers would also be consistent with the goal of helping CDFIs to become more professional and sustainable, by achieving greater scale and increasing their expertise. It would also help to reduce bidding costs and make the process of evaluation more manageable, if the bidding rounds attracted fewer, higher-quality proposals.

47. There are two levels to the evaluation of any proposal: evaluating the organisation making the proposal, and the business plan that it has put forward. There will need to be criteria covering both levels.

48. At the level of the organisation, the Government considers that the criteria could be based on the Phoenix Fund bidding guidance, which states that an applicant CDFI must demonstrate:

- the promotion of enterprise, economic development and social inclusion in disadvantaged communities as its main goal;
- the extent of disadvantage in its target community, using data such as the Indices of Local Deprivation;
- the capacity to deliver clear outcomes, including a mix of certain financial returns and high social returns;
- strong management capability and back office procedures;
- strong investment track record and the capacity to leverage significant future private investment through the tax credit;
- how it would invest funds within a specified period;
- viable plans for long-term sustainability; and
- effective links to business support services and local and regional regeneration bodies, including Local Strategic Partnerships and Regional Development Agencies (or the devolved equivalents).

49. In assessing business plans, evaluation will need to focus on the outputs that proposals expect to achieve, such as: number of businesses assisted; expected impact on employment and value added; and number of business starts.

Q5. *Do you consider these proposed evaluation criteria to be appropriate? Do you have any other suggestions?*

50. There is a choice over how to organise the evaluation process. It could be conducted either:

- as one step, in which both the prospective CIV and its business plan are assessed; or
- as two steps, with the prospective CIV evaluated first; only those organisations selected to pass the relevant criteria would then be invited to submit bids for tax credits.

The two-stage process could help to reduce bidding costs and provide greater reassurance to bidders that passed the first stage. On the other hand, it could be seen as increasing complexity and creating a double hazard.

Q6. *Do you think a one or two stage assessment process would be more appropriate?*

Eligible investments

51. What should be the targets for investment supported by CITC? This involves two questions:

- how to define “disadvantaged communities”
- what sorts of investments within these communities should be supported.

Defining “disadvantaged communities”

52. The Government believes that the CITC should be targeted at a wide definition of disadvantage, covering

- geographical disadvantage – for example, the Action Plan for Neighbourhood Renewal targets a wide range of policies on the 88 most deprived areas in England; and
- disadvantaged groups, including groups which often face barriers to enterprise such as disabled people or ethnic minorities.

53. These two definitions are not mutually exclusive, as disadvantaged groups are often disproportionately located in deprived areas. However, this flexible approach will help support communities of interest that cross geographical boundaries. This approach has been adopted by the Small Business Service on the Phoenix Fund and it appears to work well. It also has the advantage of providing a wider field for investors.

54. It is very important that proposals put forward for the CITC are consistent with the Government’s wider regeneration strategy, the National Strategy for Neighbourhood Renewal and the strategies of the devolved administrations. In the case of England, the Government would expect proposals to show clear links with emerging Local Strategic Partnerships, and coherence with their strategies.

55. In assessing proposals, the Government would look for evidence that there is a focus on disadvantage, whether by geography and/or social group. Indicators used could include average unemployment and employment rates, income levels and other indicators of social exclusion.

Q7. *Do you agree with this approach to defining “disadvantaged communities”?*

Types of investment

56. The goal of this policy is to encourage enterprise in disadvantaged communities. Enterprise is a broad concept that can encompass any type of trading activity. But the Government believes that the scheme should be focused on areas where the policy case for support is clear. This means segments of the market where there is good general evidence of market failure in access to external finance. This points to the following sectors:

- start ups and micro-enterprises
- small and medium sized enterprises
- small social and community enterprises

Individual CDFIs should also demonstrate that they will only support enterprises that cannot obtain the finance they need from commercial sources, and that they have a strategy for ensuring that enterprises graduate to fully commercial sources of finance as soon as they are

able. Enterprises should only be supported where they have a good prospect of becoming viable in the longer term.

57. There are particular issues around the treatment of property. Property will almost always be a less risky investment than the other assets of social or commercial enterprises. So if there were no constraints on property investment it is likely that this would become a dominant use of the scheme. This was not the intention of the Task Force, nor would it be the Government's desired outcome.

58. That said, the Government recognises the role that property-related investment can play in helping to achieve regeneration and create the right environment for enterprise. For example, it could help to make workspaces available for small-scale community enterprises, or to finance development projects that might otherwise depend on grants.

59. Targeting could be achieved by restricting the funding of certain types of property, such as general residential property, or by restricting investment in particular activities, such as commercial property development. One approach might be to distinguish property investment in non-profit making enterprises from other property investment, and to restrict the latter. The Government proposes that no more than 25 per cent of the funds attracting a tax credit should be invested in property-related or property-backed enterprises. There would also need to be clear evidence of the social and community benefits in the business plan submitted.

Q8. *Should investment in property-related, or property-backed enterprises be limited to those delivering significant social and community benefits? What would be the best way of identifying such enterprises? Should such investment be limited to around 25 per cent of a CIV's total tax-incentivised funding?*

60. There are some important issues over the scope of the tax credit:

- how should we handle the wide range of legal forms of CDFIs?
- should it cover investments in both debt and equity?
- should the tax credit be available for investments by both individuals and companies?

61. In general, there is a trade-off here between, on the one hand, having the widest possible coverage and flexibility, and on the other hand, limiting complexity.

Form of community investment vehicle (CIV)

62. The legal form of the community investment vehicle (CIV) is important because it affects how the vehicle itself will be taxed and also the types of finance it can raise and hence the ease of giving tax relief to this finance. It could in principle take a number of forms.

63. First, it could be a **company**. It could be:

- a company **limited by shares**, commonly used for commercial business or investment activity;
- a company **limited by guarantee**, often formed for charitable, social or other non-trading purposes; or
- an **Industrial and Provident Society (IPS)**, a more specialised corporate body which must be either a cooperative society or have a business intended to be of benefit to the community.

64. All three types of company are normally subject to corporation tax on their profits, although there are some special rules and exemptions. A company limited by shares and an IPS both have share capital, but in practice only the former would have the flexibility to issue both debt and equity. A CIV that was a company limited by guarantee would be limited to raising debt finance.

65. Second, a CIV could be a **partnership**, probably a limited partnership. Investment would be through debt or through the acquisition of an interest in the partnership (ie by becoming a partner). The key feature of partnerships is that they are transparent for tax purposes. There is no taxation of the partnership itself, instead partnership profits are allocated between partners and each partner is taxed on their share.

66. The attractiveness to investors of a CIV in partnership form would depend on their tax status. One group that could be particularly interested would be tax-exempt investors, such as pension funds. Although they would not benefit from the tax credit, they might be prepared to co-invest as they would not be taxed on any return on their investment.

67. Against this, the rules for computing a partner's share of gains and losses would be more complex. Dealing with issues such as changes in the number of partners and in the value of the partnership's investments would make the operation of the tax credit more difficult than with a company.

68. Of the alternatives, a company limited by shares would be the most flexible and simple form for a CIV. The Government does not wish to rule out other legal forms for the community investment vehicle. But nor does it wish to complicate the scheme by providing rules for forms of CIV if those forms are unlikely to be widely used.

Q9. *What legal form are community investment vehicles most likely to wish to adopt? How strong is the case for making provision for more than one legal form for the CIV?*

69. In addition, there may be concerns about the extent to which any one individual or company has control and ownership of a community investment vehicle. Although CIVs will probably have a sufficiently large spread of owners to guard against this, it is possible that a body – for example a charity or a large group of companies – might want to own all, or the greater part, of a CIV (perhaps because for perfectly proper reasons, it was unable to apply for designation itself).

Q10. *Is the ownership or control of a community investment vehicle by a single entity consistent with the purpose of the tax credit? In what circumstances would a requirement that the CIV be independent cause difficulties for those wishing to use the scheme?*

Type of investment

70. The Task Force proposed that the tax credit should be available to investors providing both loans to the CIV (debt) and also equity investments (either through non-redeemable shares or partnership interests).

71. The choice between debt and equity will affect both the CIV's ability to raise and maintain funding for investment and also the type of funding it can provide for enterprises with important consequences for the overall impact of the scheme.

72. **Debt** would enable the CIV to take a wider range of legal forms. It would also provide a clear exit route for investors – repayment in full at the end of the loan period. This contrasts with equity investment, where investors would need to dispose of their shares in what might be a limited market. As a result, it is probable that CIVs would find it easier to borrow money than to attract equity investment.

73. But a CIV funded by debt would need to make funds available for investors to meet loan repayments. This could involve raising new money, but the CIV might need to call in some of its own investments. In anticipation of this the CIV might be less likely to make long-term loans and equity investments, and it might restrict its investments in riskier enterprises.

74. By contrast a CIV funded by **equity** would not need to return capital to its investors and its investment strategy could reflect this, allowing more stable long-term investments. Against this while some investors might be attracted to equity investment in CIVs, for example because of the opportunities for returns in the form of capital gains, many could be put off by the more limited opportunities to recover their investment.

75. Thus while there are attractions in including both debt and equity in the credit, there may also be risks. The attractiveness of debt for investors could mean that the credit was almost entirely used to support loan finance. Not only could this limit the investment strategies of the CIVs but also it could reduce the effectiveness of the credit in raising new money. Although the evidence is limited, the indications are that it is currently much easier to raise loan than equity finance for investments in disadvantaged communities. There may be a risk of finance mainly being offered to the sorts of CDFI or enterprise that are already able to obtain money from other sources.

76. The Government would welcome views on the likely supply and demand for debt and equity and on the extent of these risks.

***Q11.** What would be the preferred form of investment for the different stakeholders? How strong is the case for making the credit available to both debt and equity finance?*

Types of investor – corporates and individuals?

77. The Task Force proposed that the tax credit should be available to both individual and corporate investors. There is limited evidence on the potential level of demand for this tax credit, from either individual or corporate investors. However, of the two, the corporate sector seems to offer the larger potential pool of investment.

78. It appears that including individuals would:

- attract philanthropic or socially responsible investors, though it is not clear how much might be raised in this way;
- might result in a large number of investors with small investments, providing a relatively small proportion of a CIV's funds, increasing its administrative costs; and
- complicate the rules for the scheme, as there would need to be separate provision for a tax reduction against income tax and capital gains tax, as well as against corporation tax.

***Q12.** How strong is the case for making the incentive available to individuals? What is the evidence that there are significant numbers of individuals willing to invest in this way and how much additional investment might be raised from them?*

How the tax credit would work

79. The Task Force proposed that:

- the tax credit should take the form of a relief from tax that would be a fixed proportion of the amount invested by the investor in the CIV; and

-
- this relief should be spread over a number of years.

80. The Government is attracted to this approach. It would mean that the amount of the tax incentive would be clear and relatively simple to operate; and it would help to foster a continuing relationship between the investor and the CIV.

81. The tax credit would work in broadly the following way:

- Following the allocation of tax credits, successful CIVs would seek investors wishing to qualify for the credit;
- Those investing within the rules would receive confirmation from the CIV of their entitlement to the tax credit. This could be used to reduce their tax liability. For corporate investors the tax credit could be set against corporation tax on profits from any source; and for individuals it could be set against income tax or capital gains tax. Investors would normally claim the relief in their annual tax return.
- The credit could only be used to reduce an existing tax liability. It would not be payable if there was not a tax liability in that year or if the investor was exempt from tax.
- The tax credit for any given year would be available only for that year. To keep the rules as simple as possible, it is not proposed to allow the relief to be carried forwards, backwards or sideways.
- Investors who wanted to exit at the end of the holding period could do so without jeopardizing their tax credits. If investors disposed of their investment **before** the end of the holding period, then their entitlement to credits would be withdrawn.
- Entitlements to credits would also be withdrawn where the CIV was found to have breached the terms of the agreement on the basis of which it was allocated tax credits.

Level and form of the tax credit

82. The Task Force proposed that the tax credit should offer a level of return that would help bridge the gap between the return available from a CDFI today and a commercial market return.

83. It recommended a tax credit equal to 25 per cent of the value of the investment spread equally over 5 years. So an investment of £1,000 in year 1 (or for a company, accounting period 1) would give rise to a reduction of £50 in the investor's tax liability in each of years 1 to 5. This would provide a total of £250 in relief provided that the investment was retained throughout the holding period.

84. It is important that the incentive provided by the tax credit is set at an appropriate level. It needs to be sufficiently high that CIVs will be able to achieve their goals, while providing a return to investors, including the credit, that is broadly comparable to other commercial investments. But it must not be so high that it fails to provide a challenge to CIVs and enterprises in disadvantaged communities to develop to the stage where the enterprises are self-sustaining.

85. The Government would therefore welcome views on whether a tax credit of 25 per cent spread over 5 years would provide an adequate incentive. In order to test this, it is necessary to establish the scale of the gap between the return available from a typical CDFI today and

the average commercial market return. The Task Force said that UK community loan funds (after all costs) currently offer an average industry annual rate of return of around one per cent.

Q13. What in your experience are the current returns available from CDFIs or similar bodies? Please give actual examples where possible.

Q14. What rate of return would you require from investments in CIVs for them to be commercially viable?

86. The proposal is for the relief to be based on the amount invested. Any return on the investment, whether in the form of interest or dividends or capital gains on equity holdings, would be subject to the normal tax rules.

87. Such an approach has considerable attractions. It would be simple to understand and operate. The scale of the incentive would be transparent. But there would be other options. Some of the return from the investment could be exempt from tax in return for a lower credit on the investment.

88. For example, if it was felt important to encourage equity investments then exemption from tax on capital appreciation by the CIV could be offered. Another option might be to offer deferral of the tax on chargeable gains if those gains were invested in CIVs. Relief of this type is offered by the Enterprise Investment Scheme and Venture Capital Trusts, but for equity investment only. Deferral relief would offer a very strong incentive in its own right, and this, together with the incentive effect of any exemption, would need to be reflected in fixing the level of the tax credit. Both types of relief would require considerably longer and more complex rules than otherwise.

Q15. What demand do you see for equity investments in CIVs? What evidence is there that either exemption from tax on capital appreciation or deferral of tax on chargeable gains, if invested in CIVs, would generate large new investment flows?

Total amount of funds attracting the tax credit (the cap)

89. The Task Force proposed that the Government specify in a Finance Bill a maximum amount of investment that could qualify for the tax credit each year. The Task Force believed that the Government should be ambitious in setting this maximum amount; so it suggested £50 million worth of tax credits a year for five years, to support £1 billion of investment.

90. The Government is committed to supporting the growth of community development finance. But there is no evidence that the community development finance sector could absorb a £1 billion injection of new investment in Year 1, as the Task Force has suggested. In principle, the Government would be keen to see investment at this level, but it expects some time will be needed to achieve this. The experience of venture capital schemes, to which the Task Force report alluded, suggests that investment is slow to build up.

91. The Government therefore proposes an **incremental approach** to setting the annual aggregate amount of tax-advantaged investment, based on evidence of supply and demand. The Government invites respondents to submit proposals, backed by evidence where possible, for the starting amount of tax-advantaged investment. The Government would expect to increase the aggregate amount as evidence of high quality demand emerges.

Q16. Do you agree with the Government's proposed incremental approach to setting the aggregate amount of tax-advantaged investment?

Q17. To help inform the Government's decision on a starting amount of tax-advantaged investment, what evidence do you have of current demand for additional investment?

Q18. What would be the effect of this new source of funding on existing funding arrangements?

Length of holding period

92. The Task Force suggested that there should be a five-year holding period and that the relief should be spread equally over this period.

93. The Government believes that it is right for there to be a holding period. This would encourage investors to hold on to their investments, helping to provide the CIVs with a stable and longer-term source of finance for their investment projects.

94. But it would welcome views on the appropriate length of this period as there are a number of competing factors to consider:

- investors will be deterred from putting money in if they are tied in for too long;
- CIVs and their enterprises will be looking for long-term stability;
- CIVs may have to expend considerable time and effort in attracting funds so they will not want much churning of funds; and
- the Government will need to ensure that the tax credit delivers value for money and meets the objectives of the scheme.

Q19. Is five years an appropriate holding period of investment? If not, what alternative term would you suggest – and why?

Allocation and devolution

95. Although business support and regeneration are devolved matters, the tax system is a reserved matter and so operates throughout the UK. The Government therefore expects the tax credit to operate throughout the UK. This tax credit proposal is about the treatment of a reserved tax matter and the arrangements for involving the devolved administrations are designed to reflect this distinction.

96. The Government would like the tax credit scheme to be as uniform as possible across the UK, to ensure consistency in handling applications from across the UK – especially from UK-wide organisations. However, there would need to be an appropriate degree of involvement of the devolved administrations in the competitive allocation process, bearing in mind their responsibilities for business support and regeneration.

97. Since taxation is reserved, the Government considers it would be preferable to have a single transparent model (rather than four separate ones), which would accommodate the UK perspective (and fiscal arrangements) but would be sensitive to the needs of the devolved administrations.

98. The Government therefore proposes that the “allocation authority” should be a UK-wide administrative body, run by the UK Government, with formal arrangements for consulting the devolved administrations and RDAs.

99. The Government believes that the Small Business Service would be well-placed to oversee this allocation process for the UK Government, working closely with the devolved administrations and the RDAs. The SBS already has a remit to promote enterprise in disadvantaged communities in England, and is responsible for operation of the Phoenix Fund. It may however make sense for much of the detailed work to be done by an expert panel that would advise on decisions, and would be suitably resourced for the task.

Q20. Do you agree with the proposed UK-wide allocation authority? Do you think that an expert advisory panel would be appropriate?

Monitoring and enforcement

I00. The “allocation authority” for approving bids would need to monitor the activities of CIVs, to ensure that the tax-advantaged investment was used for the purposes proposed in their business plans and was generating the projected level of investment; and, crucially, that it was invested in a timely and appropriate way.

I01. The “allocation authority” would also need to have certain enforcement powers at its disposal, so that the tax credit could be withdrawn in the event of abuse.

Timetable

I02. Once this consultation ends on 2 July 2001, the Government will need to consider all the responses and decide how to take forward the Task Force proposal for a community investment tax credit.

I03. The Government will be taking forward discussions with the European Commission on the State Aid aspects of the scheme. Respondents will wish to note that this process could take some considerable time.

I04. The Government aims to be in a position to bring forward most of the necessary enabling legislation in Finance Bill 2002. This will need to gain Royal Assent before the scheme can get underway – which means that tax credit allocations are unlikely to take place before the end of 2002 or early 2003. The Government believes it is important that community development finance continues to grow in momentum between now and then. The evaluation criteria for proposals are likely to include CDFIs’ track record in raising and managing funds.

Responses

I05. Please send your responses by 2 July 2001 to:

Community Investment Tax Credit Consultation
H M Treasury
1st Floor, Allington Towers
19 Allington Street
LONDON SW1E 5EB
Fax: 020 7451 7534
Email: citc@hm-treasury.gov.uk

Please state the capacity in which you are responding and which organisation, if any, you represent. Responses may be made publicly available, unless you request confidentiality.

The Task Force recommendations

A1. The Task Force report's five main recommendations were:

- a new Community Investment Tax Credit (CITC) to encourage private investment in both not-for-profit and profit-seeking enterprises in under-invested communities;
- a new Community Development Venture Fund – a matched funding partnership between Government on the one hand and the venture capital industry, entrepreneurs, institutional investors and banks on the other;
- disclosure by individual banks of their lending activities to businesses in under-invested communities and the creation of a rating system to reward excellent performance. The Task Force believes this should if possible be done on a voluntary basis, but if not, then legislation should require disclosure;
- greater latitude and encouragement for charitable trusts and foundations to invest in community development initiatives; and
- support for Community Development Financial Institutions (CDFIs), which provide finance and business support to enterprises just outside the margin of conventional finance; and the appointment of a high ranking “champion” for community development finance, with strong links to Government.

The Government's response

A2. The Chancellor set out the Government's initial response to this report (and to Lord Rogers' Urban Task Force report) in the November 2000 Pre-Budget Report:

“The rate of small business creation in high unemployment communities is still a sixth of the more prosperous areas, and unemployment is still twice as high. Future jobs and long term prosperity will come, not from benefit cheques or from the old subsidies, but by a radically new approach – encouraging economic activity and business development along the lines proposed by the Rogers and Cohen reports.

So I now propose a radical reform of tax incentives designed to raise business investment in high unemployment areas by £1 billion. I propose to introduce:

- *stamp duty exemption for all properties in our most disadvantaged communities;*
- *accelerated tax relief for cleaning up contaminated land;*
- *VAT cuts to reduce the costs of residential property conversions;*
- *tax relief to bring empty flats over shops back into use.*

And to consult on:

- *further business rate relief for small business;*
- *a new and generous tax credit for community investment; and*
- *the creation of the first Community Development Venture Fund.”*

A3. The November 2000 Pre-Budget Report went on to set out the Government's response in more detail:

“The Government believes that a tax incentive for community investment could prove effective in helping to bring more investment and expertise to the economic renewal of disadvantaged communities. The Government will consult widely to gather the views of others, with a view to taking forward this proposal as early as possible.”

The Government will work closely with the venture capital industry and others on setting up the first Community Development Venture Fund.

The Government attaches great importance to making financial services available to all. To provide greater transparency, the Government will encourage banks to disclose their individual lending activities to businesses in under-invested areas. The Government will look at what obligations should be laid on banks in the context of the overall requirements being asked of them, for example in relation to Universal Banking Services.

The Government welcomes the Charity Commission's plan to produce early next year new guidance on when charities can make programme related investments; and to issue further subsequent guidance on the role which charities can play in community development finance.

The Government believes that the Task Force has set out very clearly the challenges that lie in front of the community development finance sector in the UK, if it is to achieve its potential. It must be a matter for the sector to respond to those challenges, but the Government will continue to play an active role in support, for example through assistance with training. The Government also recognises that there may be a role for an informal “champion” and will consider how to take this suggestion forward.”

A4. The Government has since begun to take forward all five recommendations:

- the Government has now launched the consultation on the proposal for a Community Investment Tax Credit;
- the Government is working closely with Sir Ronald and others on setting up the first Community Development Venture Fund;
- the Government is encouraging the banks to disclose their individual business lending activities in disadvantaged communities on a voluntary basis. The Government believes that this would make a major contribution to improving the information flows in disadvantaged communities – which would in turn help to identify barriers to, and opportunities for, growth;
- the Government welcomes the Charity Commission's planned programme of guidance, which will help unlock more charitable investment in enterprises in disadvantaged communities. This guidance means that the relief of unemployment, urban/rural regeneration and community capacity building all now count as charitable purposes. Further guidance in March 2001 will make clear that many charities can now undertake “programme-related investments” – the provision of equity finance and loans, as well as grants, to further their charitable objectives;
- the Government is encouraging the community development finance sector to form a single, high-quality and inclusive trade association, and looks forward to receiving a proposed business plan.

The tax credit proposal

A5. On the tax credit proposal, the Task Force report said:

“A Community Investment Tax Credit (CITC) to encourage private investment in under-invested communities, via Community Development Financial Institutions (CDFIs) which can invest in both not-for-profit and profit-seeking enterprises.”

Many enterprises in under-invested communities find it difficult to access finance because their financial returns are insufficiently attractive for lenders and equity providers. There is a need, therefore, for strong incentives to be provided in order for significant finance to flow to CDFIs and enable them to guide and finance the growth of businesses as well as social and community enterprises.

After considering many alternatives, the Task Force proposes a tax credit which would provide lenders to, and equity investors in, CDFIs with a guaranteed minimum rate of return. Loans would be for a minimum five year term. This would, in our view, be the best way of generating significant flow of capital to CDFIs.

The Tax Credit would work in the following way. If a lender provides a five-year loan to or invests in the equity of a CDFI, the sum of £100,000 for example, the lender would receive a 5% credit against its tax liability in each year. In this way, £50 million of tax credit in each of five years would support £1 billion of capital investment. The Tax Credit would cover both equity investment and loans by companies, banks and individuals.

In principle, we think the programme could operate as follows. Legislation in a Finance Bill would set the objectives and framework for the programme, and allow the Government to specify an amount of investment that would qualify for the tax credit each year. There would then be a competitive process for allocating the tax credit to individual CDFIs based on the applications they submitted. Lenders to or equity investors in the CDFI would then receive the tax credit proportionate to their investment and the CDFI would channel the money raised into selected enterprises. A key decision will be which organisation will evaluate CDFI applications and allocate the tax credit. One option would be the Small Business Service, to parallel its responsibilities for the Phoenix Fund. Suitable arrangements will also be needed for the devolved territories.

We recognise that this programme would be innovative, and that there will be many practical issues to resolve. But we are convinced that tax credits are key to attracting more investment into community development.”

A6. The report went on to say:

“Tax incentives for under-invested communities are a necessary intervention to reverse a spiral of multiple deprivation. Without incentives, these communities will fall further behind the rest of the economy.

By stimulating new private investment into under-invested communities, the Task Force believes the Government can reverse the downward spiral, so that investment stimulates enterprise growth, which in turn provides employment and builds assets and wealth, resulting in increased purchasing power, bringing more jobs, more asset creation, more spending and eventually a higher tax yield. This process opens up new markets for more conventional investments, creating a bridge between investors (both corporate and individual), investment intermediaries and the customers they serve.

CDFIs are best-placed to provide the initial pump-priming investment. They are able to match a business-like approach to lending with social motivations. Typically, CDFIs look for higher social returns than traditional private investment and higher financial returns than traditional public expenditure and grants. These organisations are able to direct finance effectively because they know their markets and can deliver services to them cost-effectively.

However, evidence to the Task Force showed that, while the CDFI market is beginning to demonstrate resourcefulness and skill in leveraging in new money, unmet needs continue to outstrip available resources. Access to funding is limited because, to date, CDFIs have only been able to seek grants and low or zero-return capital. This means that private sector companies and individuals take investment in CDFIs out of their “charitable giving” or “public relations” budgets. This is a very limited pool. To expand the pool of investors willing to invest in the sector, there is a need for Government incentives to bring returns closer to market rates. The clearest way to do this is through tax credits.

Investment in all UK CDFIs currently totals about £250 million. Tax credits could multiply this source of funding enormously, at relatively little cost to the Government, allowing existing CDFIs to expand and stimulating the creation of new institutions.

Using tax credits to attract private investment also brings other advantages:

Linkages: Fostering business-like links between private investors and CDFIs can promote investment from the initial investor’s networks. In addition, this relationship-building brings with it expertise such as financial skills, technical support and marketing expertise for the CDFI and all its clients.

Financial prudence: In general, loan or equity finance promotes financial discipline and prudent policies, increasing pressure on the CDFI to work efficiently and maintain portfolio quality.”

B

ANNEX B: EXAMPLES OF COMMUNITY DEVELOPMENT FINANCE INITIATIVES (CDFIs)

Aspire Micro Loans for Business Limited	Belfast
Aston Reinvestment Trust	Birmingham
Black Country Mutual Guarantee Society	Willenhall
Business Debtline	Birmingham
Cambridge Housing Society	Cambridge
CEED (Charity) Limited	Bristol
Charities Aid Foundation, Investors in Society	National
Citylife	Sheffield & Newcastle
Community Enterprise in Strathclyde	Glasgow
Co-operative Housing Finance Society	London
East London Small Business Centre	London
Ecology Building Society	Keighley
Elephant Jobs	London
Enterprise Ventures Limited	Preston
Envolve	Bath
Glasgow Regeneration Fund	Glasgow
Greater London Enterprise	London
Hackney Business Venture	London
INBIZ (South) Limited	Thornton Heath, Surrey
Industrial Common Ownership Finance	National
Local Investment Fund	National
Merseyside Special Investment Fund	Liverpool
National Association of Mutual Guarantee Societies	National
North London Chamber and Enterprise CU	London
Portsmouth Area Regeneration Trust	Portsmouth
PRIME	National
Prince's Trust/Prince's Scottish Youth Business Trust	National
Sheffield Co-operative Ventures	Sheffield
Street Cred	London
Street UK	National
Sustainable Strength, Birmingham Settlement	Birmingham
Triodos Bank	National
Women's Education Enterprise and Training Unit	Norwich
Wellpark Enterprise Centre	Glasgow

This list is not comprehensive. There are many other community loan funds not listed here – see the British Bankers' Association's report "Micro Credit in the UK: An Inventory of Schemes for Businesses supported by Banks" (1999).

- C1.** Do you agree with the analysis set out above in paragraphs 14-25, and in particular with the view that the community development finance sector could play an important role in helping to promote enterprise in disadvantaged communities?
- C2.** Do you have any views – as potential investors, intermediaries, or final beneficiaries – on the potential scale of the market here?
- C3.** Do you agree with the analysis in paragraphs 26-33? In particular do you agree that:
- additional support for community development finance should focus on attracting private sector investment seeking some kind of financial return?
 - an incentive aimed at investors should use the tax system rather than grants?
- C4.** Do you agree with the proposals on delivery mechanism? In particular, do you agree with the proposed competitive allocation process, based on business plans and published criteria, allocating a maximum amount of tax-advantaged investment? Do you think that investors will be attracted to a scheme run on these lines?
- C5.** Do you consider these proposed evaluation criteria to be appropriate? Do you have any other suggestions?
- C6.** Do you think a one or two stage assessment process would be more appropriate?
- C7.** Do you agree with this approach to defining “disadvantaged communities”?
- C8.** Should investment in property-related, or property-backed enterprises be limited to those delivering significant social and community benefits? What would be the best way of identifying such enterprises? Should such investment be limited to around 25 per cent of a CIV’s total tax-incentivised funding?
- C9.** What legal form are community investment vehicles most likely to wish to adopt? How strong is the case for making provision for more than one legal form for the CIV?
- C10.** Is the ownership or control of a community investment vehicle by a single entity consistent with the purpose of the tax credit? In what circumstances would a requirement that the CIV be independent cause difficulties for those wishing to use the scheme?
- C11.** What would be the preferred form of investment for the different stakeholders? How strong is the case for making the credit available to debt as well as equity finance?
- C12.** How strong is the case for making the incentive available to individuals? What is the evidence that there are significant numbers of individuals willing to invest in this way and how much additional investment might be raised from them?
- C13.** What in your experience are the current returns available from CDFIs or similar bodies? Please give actual examples where possible.
- C14.** What rate of return would you require from investments in CIVs for them to be commercially viable?
- C15.** What demand do you see for equity investments in CIVs? What evidence is there that either exemption from tax on capital appreciation or deferral of tax on chargeable gains, if invested in CIVs, would generate large new investment flows?
- C16.** Do you agree with the Government’s proposed incremental approach to setting the

aggregate amount of tax-advantaged investment?

C17. To help inform the Government's decision on a starting amount of tax-advantaged investment, what evidence do you have of current demand for additional investment?

C18. What would be the effect of this new source of funding on existing funding arrangements?

C19. Is five years an appropriate holding period of investment? If not, what alternative term would you suggest – and why?

C20. Do you agree with the proposed UK-wide allocation authority? Do you think that an expert advisory panel would be appropriate?