

Venture Capital Consultation  
Excise and Enterprise Team  
HM Treasury  
1 Horse Guards Road  
SW1A 2HQ

28th September 2011

## **Response to the consultation on tax-advantaged venture capital schemes with regard to community based renewable energy**

To Whom It May Concern,

We are a group of organisations responding to the consultation on tax-advantaged venture capital schemes, coordinated by Communities for Renewables (CfR).

**Regen SW**<sup>1</sup>, a not-for-profit company based in Exeter, is a leading centre for sustainable energy expertise and pioneering project delivery.

**Communities for Renewables**<sup>2</sup>, a joint initiative between Regen SW and Green Trust CIC to provide support, investment and delivery capacity for community energy initiatives across the South West.

**Green Trust CIC**<sup>3</sup>, a specialist community energy project development company based in Truro, working with communities in the South West to develop their own renewable energy projects.

**Co-operatives UK**<sup>4</sup>, the trade body for co-operatives, working to promote, develop and unite co-operative enterprises.

**UKSIF**<sup>5</sup>, **the sustainable investment and finance association**, is the UK's membership network for sustainable and responsible financial services, with over 260 members including financial advisers, investment managers and non-governmental organisations. It promotes responsible investment and other forms of finance that support sustainable economic development, enhance quality of life and safeguard the environment.

**Climate Change Matters**<sup>6</sup>, a renewable energy and carbon business advisory company set up by Jonathan Johns (founding partner of the Ernst & Young Renewable Energy Group).

**Carbon Leapfrog**<sup>7</sup>, a business-led charity supporting carbon reduction initiatives.

**Transition North Cornwall**<sup>8</sup>, a not for profit company limited by guarantee, bringing together individuals and organisations working together on sustainability initiatives in the local area,

**Wadebridge Renewable Energy Network (WREN)**<sup>9</sup>, a community co-operative in Cornwall developing an initiative to establish Wadebridge as a community energy powered town.

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<sup>1</sup> <http://www.regensw.co.uk/>

<sup>2</sup> <http://communities4renewables.co.uk/>

<sup>3</sup> <http://www.greentrustwind.co.uk/>

<sup>4</sup> <http://www.uk.coop/>

<sup>5</sup> <http://www.uksif.org/>

<sup>6</sup> <http://www.climatechangematters.biz/>

<sup>7</sup> <http://carbonleapfrog.org/>

<sup>8</sup> <http://www.transitionnc.org/>

<sup>9</sup> <http://www.wren.uk.com/>

**Low Carbon Ladock**<sup>10</sup>, community energy co-operative in Cornwall with the objective of establishing Ladock as a zero carbon parish, and generate sustainable sources of funding for local community initiatives.

**Wey Valley Solar Schools Energy Co-operative**<sup>11</sup>, an industrial and provident society based in the Guildford area aiming to install solar arrays on local state secondary schools.

**Friends of the Earth,**

**Community Energy Warwickshire**<sup>12</sup>, industrial and provident society planning to put solar PV on hospitals in warwick and Stratford.

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## Summary of our response

**We warmly welcome the revision to the proposed draft legislation as outlined in the document ‘Tax-advantaged venture capital schemes: a consultation’ (July 2011) which ensures community based renewable energy projects established as social enterprises are not excluded from the Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCT).**

We welcome the fact that treasury has listened to community energy groups following engagement with CfR and partners, and made this important provision to support the coalition Programme for Government commitment to community renewable energy. This is vital and timely support for the growing community energy sector. Community based renewable energy has the potential to make a substantial contribution to tackling the social and economic challenges faced by communities (especially rural communities) in the UK.

The organisations responding to this consultation are a mixture of community based renewable energy enterprises as well as organisations supporting these community energy enterprises.

**We have highlighted that there needs to be further clarification that these community energy enterprises (as defined in the draft legislation) will also be exempt from the proposed test set out in section 4.12 of the consultation document.** We fully support the principle of the test which is designed to prevent exploitation of the scheme, and disqualify companies set up solely for the purpose of benefiting from tax relief. However, the findings of our research shows that the proposed test will unfortunately disqualify most community energy enterprises. Co-operatives and community interest companies achieve the purpose of the tests through their own restrictions and regulation as explained below.

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## The importance of EIS and VCT incentives to community energy enterprises

EIS and VCT incentives are vital to ensure the success of the large number of fledgling community based energy organisations that have been inspired by the few landmark enterprises delivered to date. Community energy projects can require large pre-planning risk

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<sup>10</sup> <http://www.uk.coop/organisation/low-carbon-ladock-limited>

<sup>11</sup> <http://www.veyvalleysolar.co.uk/>

<sup>12</sup> <http://www.cew.coop/>

investment and construction equity investment which can be difficult to access without support. Yet once these community energy enterprises are generating energy they generate substantial economic, social and environmental returns. Therefore EIS and VCT eligibility represents a good use of tax support, for example it:

- Stimulates the emergence of tax-based investors with offers matching the investment needs of community renewable energy projects;
- Supports local community investment through community share offers;
- Bridges the gap between the return that can be offered by a community renewable energy project and the return required by investors;

There is currently no alternative source of capital with the capacity to significantly scale-up investment in community renewable energy. Without the ability to attract EIS/VCT investment community renewable energy initiatives will either have to compete with each other for limited sources of social investment and grants or focus on larger scale projects, which are limited by the availability of good sites and are disconnected from the needs and aspirations of smaller communities. This means very few projects will be delivered and most of the projects already underway will have to be shelved.

### **How social enterprise structures protect government and community interests, whilst enabling investors to make a sufficient return**

Community Interest Companies (CIC) bring together the interests of communities and investors through a company structure that enables investors to earn a return commensurate with their risk, but ensuring any surplus profit is channelled to the community rather than investors. The CIC asset lock, stated company purposes, investor return caps and regulation by the CIC regulator ensure that community energy projects set up as CICs will be set up and operated to maximise community benefit.

Industrial and Provident Societies, in both the co-operative and community benefit versions, embody the principle of 'one member one vote', regardless of how many shares the member holds, which prevent control falling into the hands of large investors. Industrial and Provident Societies have a cap on total investment by any individual through the purchase of withdrawable shares, currently £20,000 but due to be raised<sup>13</sup>, and the interest payable on shares must be limited to what is "necessary to obtain and retain enough capital to run the business". In addition societies for the benefit of the community can install an asset lock.

An exemption for community renewable energy projects with social enterprise legal forms would safeguard and encourage investment in the UK's budding community energy industry, whilst preventing the subsidy of 'surplus' profits for investors. The details of the exemption

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<sup>13</sup> There's no limit on transferable share capital, or on one IPS investing in another IPS.

(such as investor return caps) could be controlled and adjusted if necessary through guidance notes appended to the governing documents of qualifying companies.

Examples of community renewable energy initiatives that would struggle without this EIS/VCT support are:

- Hamm Hydro, on the River Thames, in Teddington: This is a community interest company (CIC) that is developing a hydropower installation in order to generate clean energy, contribute to reducing carbon emissions and use the income generated to develop further low-carbon solutions locally.
- Low Carbon Ladock, Cornwall: this is an inspiring community cooperative with plans to become the UK's first zero carbon parish. It has developed and installed a community wind turbine and roof-top solar PV. The profits made go to a local community fund (a co-operative) and are re-invested in further community energy initiatives and other community initiatives that address local social, environmental and economic concerns. Low Carbon Ladock has been developed with broad community involvement and support.

**We have responded to some of the specific questions below.**

***Question 38: Are there any other sorts of community based company that ought to be included?***

We agree with the range of community based legal forms that have been included in this Condition. It is important that a range of different types of community based legal forms are included in this Condition due to the varying needs and requirements of each community enterprise. Community Interest Companies, Industrial and Provident and NI Industrial and Provident Societies all aim to maximise the community benefit from renewable energy projects and limit profits to investors. We feel it is important to allow for this diversity since they all share this objective.

***Question 39: Will the definitions included in paragraph (9) of new clause 198A in the draft legislation give the right result in practice?***

We agree that the simplest, least costly and most transparent way to ensure that this tax relief is creating the maximum social, environmental and economic benefits to the UK has been set out in the draft legislation – using the legal form of a business claiming this support. Each of the models has its own controls to ensure in practice the results are driven by generating the maximum community benefit. For example, with IPS models there is democratic governance and a limit on individual shareholdings and a Community Interest Company has an asset lock and a range of other controls on investor returns and profit distribution.

The legal forms set out in the draft legislation each have their own regulator and trade bodies:

- Community Interest Companies are regulated by the Community interest Company Regulator;
- Industrial and Provident Societies are regulated by the Financial Services Authority;
- NI Industrial and Provident Societies are regulated by the Northern Ireland Department of Enterprise, Trade and Investment.

If further regulation is needed in addition to the regulation already in place, this can be amended through guidance notes.

In practice, it is likely that the new clause will lead to a range of different organisational types, based on existing legal forms. This is to be welcomed as it will reflect an approach where communities choose the legal form that best meets their needs. Encouraging good demonstrator projects will be the best way to establish best practice in community energy organisations.

**Questions 29 - 33: Test to disqualify companies established for the main purpose of benefiting from tax relief (extract copied below)**

*4.12 Alternatively, the tests might stand on their own, with companies being disqualified if they displayed, 3 or more of the characteristics in the list. Suggested characteristics might be along the following lines:*

- *50% or more of the activities required to fulfill obligations to customers will be carried out by persons not employed by the company;*
- *50% or more of company's costs during the relevant period will be subcontract payments;*
- *50% or more of the monies raised by the relevant share issue will be used to acquire intangible assets intended for resale;*
- *the company employs less than one full time unit of staff or part time equivalent, including directors, during the relevant period;*
- *50% or less of the ordinary share capital is held by directors throughout the relevant period;*
- *the company employs at any time during the relevant period staff or directors who are also employees or directors of a party with whom it has contractual trading arrangements (or who have been seconded from that party);*
- *the company has only one customer;*
- *the company has only one supplier;*
- *the contractual arrangements entered into by the company viewed realistically, preclude the possibility of the company making a commercial loss.*

We fully support the principle of the tests which are designed to prevent exploitation of the scheme, and disqualify companies set up solely for the purpose of benefiting from tax relief. Unfortunately the proposed tests are likely to disqualify most social enterprise community energy companies, and so counter-act the proposed exemption. All but the last test may well apply to start up stage community interest companies or cooperatives. Co-operatives and community interest companies achieve the purpose of the tests through their own restrictions and regulation as explained above. It is vital that the legislation makes it clear that the tests proposed in section 4.12 (if adopted) do not apply to the social enterprise community energy companies as defined in paragraph (9) of new clause 198A in the draft legislation.

Examples of how the tests will lead to the exclusion of community energy social enterprises:

<b>Test Characteristic</b> <b>(As proposed in the consultation)</b>	<b>Effect on energy co-operatives</b> <b>(Provided in response to consultation by Co-operatives UK)</b>
<p><i>50% or more of the activities required to fulfil obligations to customers will be carried out by persons not employed by the company;</i></p>	<p>Simon Gilhooly, Green Energy Nayland: <i>“we are not employing anyone.”</i></p> <p>Annette Heslop, Energy4All: <i>“My understanding of the first condition is it relates to trading activities. The fact that the trade is electricity generated by wind turbines and no intervention from employees would mean any wind energy co-op would fall foul of this condition.”</i></p> <p>Andrew King, Energy4All: <i>“As the electrical and engineering maintenance of the site is obviously contracted out by the co-op, then our projects would probably fall foul of this.”</i></p> <p>Danni Craker, Brighton Energy Co-op: <i>“At this moment we would pass this test. However, these employees are not taking salaries and hence not sure of the impact on the test?”</i></p> <p>Wey Valley Solar Schools – <i>“probably yes if ‘fulfil obligations to customers’ is taken to include the installation of the solar panels as scaffolders/solar contractors perform this task”</i></p> <p>Stephen Frankel, WREN: <i>“WREN would fall foul of this test as the majority of activity at this stage is carried out through partnerships, and when WREN raises investment to fund its own projects they will be delivered through sub-contracting.”</i></p>

<b>Test Characteristic</b> <b>(As proposed in the consultation)</b>	<b>Effect on energy co-operatives</b> <b>(Provided in response to consultation by Co-operatives UK)</b>
<p><i>50% or more of company's costs during the relevant period will be subcontract payments;</i></p>	<p>Simon Gilhooly, Green Energy Nayland: <i>"We would fail this test (although depends on exactly what is meant by subcontract payments)."</i></p> <p>Andrew King, Energy4All: <i>"As it stands this is very vague. Does it include business rates, land rentals, finance costs, insurances etc. etc? If not, it is almost inevitable that an energy co-op's costs will be largely to technical specialist companies contracted to maintain the site."</i></p> <p>Danni Craker, Brighton Energy Co-op: <i>"We will be using subcontractors to install our assets. For accounting purposes this doesn't hit the P&amp;L as it is part of the asset cost on balance sheet. But if the test is from a cash flow perspective then we would fail this test. "</i></p> <p>Wey Valley Solar Schools – <i>"yes, assuming the relevant period is the start up period then the bulk of payments are undoubtedly paid to subcontractors."</i></p> <p>Jake Burnyeat, CfR: <i>"CfR will employ a range of specialist subcontractors that are needed to develop a wind project, which is the most efficient business model and therefore will deliver the most community benefit. We would fall foul of this test."</i></p>
<p><i>The company employs less than one full time unit of staff or part time equivalent, including directors, during the relevant period;</i></p>	<p>Simon Gilhooly, Green Energy Nayland: <i>This is true for our organisation."</i></p> <p>Andrew King, Energy4All: <i>"Very difficult to measure as the directors are volunteers who may or may not take expenses and a small honorarium. Apart from that, the co-op may employ only someone to monitor the turbines on a daily basis, so there is a likelihood that a typical community energy co-op would fall foul of this condition as well."</i></p> <p>Danni Craker, Brighton Energy Co-op: <i>"We would fail this test."</i></p> <p>Wey Valley Solar Schools – <i>"possibly, we have one full time member of staff during the launch period but that is only for 4 months."</i></p> <p>Jake Burnyeat, CfR: <i>"As a professional not-for-profit community energy company, CfR will employ more than 1 staff. However, the community energy projects we develop will sit in special purpose companies (which will be co-ops and CIC's structured to maximise community benefit) and so will not employ full time staff. These project companies will fall foul of this test."</i></p>

<b>Test Characteristic</b> <b>(As proposed in the consultation)</b>	<b>Effect on energy co-operatives</b> <b>(Provided in response to consultation by Co-operatives UK)</b>
<p><i>50% or less of the ordinary share capital is held by directors throughout the relevant period;</i></p>	<p>Simon Gilhooly, Green Energy Nayland: <i>“True - although our Directors hold about 40% this is probably not typical.”</i></p> <p>Andrew King, Energy4All: <i>“As with any co-op, our directors are drawn from the membership so, by definition, they will hold only a small % of the co-op’s shares.”</i></p> <p>Danni Craker, Brighton Energy Co-op: <i>“We would fail this test.”</i></p> <p>Wey Valley Solar Schools – <i>“Yes we would fall foul of this. We are still in our launch period but we anticipate the directors will probably end up holding roughly 8% of the total share.”</i></p>
<p><i>Other responses:</i></p>	<p>Hilary Sudbury, BRAVE (Co-operative Development Advisor): <i>“for the energy projects I am working with (Bath Community Energy, Bristol community Energy and Low Carbon Gordano) these bullet points at the end would all apply to these organisations and they are planning to apply for the EIS scheme. Basically the installations will be done by contract with local installers and not by employed people and this is the majority of the work involved!”</i></p> <p>Steve Welsh, h2ope: <i>“I can confirm that the 4 IPS share offers for community hydro that we've done (New Mills, Settle, Bainbridge, Stockport) would all fall foul of four bullet points in the test.”</i></p> <p>Simon Tilley, Sustainable Hockerton: <i>“We would have fallen foul of four test questions. So they would have been a problem for us.”</i></p> <p><i>Referring to the test: the company has only one supplier;</i></p> <p>Wey Valley Solar Schools, <i>“I would say effectively yes - the solar contractors.”</i></p>

The signatories to this response are working with a range of community based energy organisations and other stakeholders and so would be willing to discuss these issues with HMT as part of the consultation. We can provide further evidence and input into revising the test as required.

**Main point of contact for further questions:**

Merlin Hyman (Regen SW/ Communities for Renewables)

Email: [mhyman@regensw.co.uk](mailto:mhyman@regensw.co.uk)

Tel: 01392 494399

Yours Sincerely,

Regen SW  
Green Trust CIC  
Co-operatives UK  
UKSIF  
Climate Change Matters  
Carbon Leapfrog  
Transition North Cornwall  
Wey Valley Solar Schools  
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