

## Summary: Intervention & Options

<b>Department /Agency:</b> <b>HMRC</b>	<b>Title:</b> <b>Impact Assessment for Stamp Duty Land Tax, Capital Gains Tax &amp; Capital Allowance tax reliefs for Alternative Finance Investment Bonds</b>	
<b>Stage:</b> Implementation	<b>Version:</b> 2	<b>Date:</b> 22 April 2009
<b>Related Publications:</b> 1. Consultation document: Stamp duty land tax Commercial sukuk (June 2008); 2. Impact Assessment (June 2008); 3. Consultation responses (February 2009)		

**Available to view or download at:**

<http://www.hmrc.gov.uk/consultations/index.htm>

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**What is the problem under consideration? Why is government intervention necessary?**

The Government is keen to promote the growth of the Islamic Finance market in the UK. In order to achieve this, it is necessary to deal with certain tax barriers preventing the development of the industry. The tax treatment of Alternative Finance Investment Bonds (called sukuk, a Sharia'ah compliant bond) is in some areas uncertain and in others produces anomalous results. These anomalies can put providers of such bonds at a commercial disadvantage. This legislation addresses the Stamp Duty Land Tax (SDLT), Capital Gains Tax (CGT) and Capital Allowances (CA) anomalies.

**What are the policy objectives and the intended effects?**

There are two policy objectives for Islamic Finance. For business we wish to maintain London's position as a European leader for international Islamic Finance. For individuals, we wish to ensure that everybody, irrespective of their beliefs, has access to competitively priced financial products and that there is equal taxation of these products. These measures on Alternative Finance Investment Bonds can help achieve both of these objectives.

**What policy options have been considered? Please justify any preferred option.**

Two options were considered.

1. Do nothing. 2. Provide a framework to enable a market for Alternative Finance Investment Bonds to develop in the UK.

Choosing the first would mean missing opportunities to develop Islamic Finance in the UK. Doing nothing would fail to address tax barriers to business and would allow tax inequality of Alternative Finance Investment Bonds to continue. The second option is preferred. The equalisation of these particular tax rules will encourage the development of the Islamic Finance industry. A competitive market in these products could substantially benefit London as a global financial centre.

**When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?** HMRC will conduct a post-implementation review within 1-3 years of introduction.

**Ministerial Sign-off** For final proposal/implementation stage Impact Assessments:

*I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.*

Signed by the responsible Minister:

Ian Pearson MP



.....Date:

22 April 2009

## Summary: Analysis & Evidence

<b>Policy Option: 2</b>	<b>Description: Provide a framework to enable a market in Alternative Finance Investment Bonds to develop in the UK</b>
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<b>COSTS</b>	<b>ANNUAL COSTS</b>	Description and scale of <b>key monetised costs</b> by 'main affected groups'  The average annual cost reflects administrative burdens on companies for registering charges and completing the SDLT return. The one-off cost is for companies familiarising themselves with the new legislation. These should only impact on companies that wish to take up the opportunity to develop Alternative Finance Investment Bonds products.
	<b>One-off</b> (Transition) <b>Yrs</b>	
	<b>£ 12,000</b>	
	<b>Average Annual Cost</b> (excluding one-off)	
<b>£ 20,000</b>	5	<b>Total Cost (PV)    £ 90,000</b>
Other <b>key non-monetised costs</b> by 'main affected groups'		

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>	Description and scale of <b>key monetised benefits</b> by 'main affected groups'
	<b>One-off</b> <b>Yrs</b>	
	<b>£ Not quantifiable</b>	
	<b>Average Annual Benefit</b> (excluding one-off)	
<b>£ Not quantifiable</b>	<b>Total Benefit (PV)    £ Not quantifiable</b>	
Other <b>key non-monetised benefits</b> by 'main affected groups' Removing existing inequalities will promote fairness and choice for those wanting to access Alternative Finance Investment Bonds, and support the growth of the Islamic Finance market in the UK. This will maintain London's position as a European leader for Islamic Finance, generating further investment, jobs and indirect tax revenues in the UK economy.		

**Key Assumptions/Sensitivities/Risks** A key assumption underlying these estimates is the expected growth of the Islamic Finance market in the UK and thus the number of companies and transactions assumed to be affected. The average scale and complexity of transactions is also unknown, though potentially very large, and has been assumed. This option is expected to have a negligible direct impact on tax revenues.

Price Base Year 2009	Time Period Years 5	<b>Net Benefit Range (NPV)</b> £	<b>NET BENEFIT (NPV Best estimate)</b> £ 90,000 cost
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What is the geographic coverage of the policy/option?	UK				
On what date will the policy be implemented?	Royal Assent, FB09				
Which organisation(s) will enforce the policy?	HMRC				
What is the total annual cost of enforcement for these organisations?	£ negligible				
Does enforcement comply with Hampton principles?	Yes				
Will implementation go beyond minimum EU requirements?	N/A				
What is the value of the proposed offsetting measure per year?	£ N/A				
What is the value of changes in greenhouse gas emissions?	£ N/A				
Will the proposal have a significant impact on competition?	No				
Annual cost (£-£) per organisation (excluding one-off)	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%; text-align: center;">Micro neg</td> <td style="width: 25%; text-align: center;">Small neg</td> <td style="width: 25%; text-align: center;">Medium neg</td> <td style="width: 25%; text-align: center;">Large neg</td> </tr> </table>	Micro neg	Small neg	Medium neg	Large neg
Micro neg	Small neg	Medium neg	Large neg		
Are any of these organisations exempt?	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%; text-align: center;">No</td> <td style="width: 25%; text-align: center;">No</td> <td style="width: 25%; text-align: center;">No</td> <td style="width: 25%; text-align: center;">No</td> </tr> </table>	No	No	No	No
No	No	No	No		

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)		(Increase - Decrease)
Increase of    £ 8,000	Decrease of    £ 0	<b>Net Impact    £ 8,000 increase</b>

Key:      Annual costs and benefits: Constant Prices    (Net) Present Value

## Evidence Base (for summary sheets)

### Background

Islamic Finance has to be compliant with Sharia'ah law. In Sharia'ah law certain transactions are prohibited, principally those involving riba (interest).

Existing UK tax legislation does not in general provide for alternative methods of finance structured in a way that does not involve interest. As a result the tax treatment of some alternative finance products is inconsistent or uncertain when compared to conventional finance products.

The market for alternative finance products has the potential to be very large, but current providers of some alternative finance products are rendered uncompetitive compared with other financial institutions due to the tax treatment of these products. Since 2003 legislation has been introduced to ensure that the tax treatment of alternative methods of finance is made certain and, as far as possible, creates a level playing field for equivalent financial products. This gives those wishing to utilise alternative finance products the opportunity to do so without being disadvantaged because of tax.

The Government has already introduced legislation enabling the provision of alternative methods for an individual or business to finance a property purchase, deposit money in a bank and borrow money from a financial institution. The focus has now moved to the issue of Alternative Finance Investment Bonds (sukuk), structured to comply with Sharia'ah law.

This Impact Assessment examines the benefits and costs of implementing a package of changes which will remove the SDLT, CG and CA barriers to the issuance of Alternative Finance Investment Bonds in the UK. It builds on the [Regulatory Impact Assessment for Alternative Finance Products](#) issued at Budget 2007 and the [Regulatory Impact Assessment for Sukuk \(Islamic Bonds\)](#) issued in June 2008. It provides an update to the June 2008 Impact Assessment following [responses](#) received to the [Consultation document - Stamp duty land tax: Commercial sukuk](#) published in June 2008.

### The issue / situation

With a conventional bond, the investor does not have a direct ownership share in the underlying asset but merely an interest bearing certificate. In an Alternative Finance Investment Bond, however, the investors own part of the underlying asset and interests in UK land and property are often used as that asset. The necessary changes in ownership of the underlying asset, involved in an Alternative Finance Investment Bond structure, may involve SDLT, CGT (including companies' liability to corporation tax on chargeable gains) and CA issues.

#### *Taxation of conventional bonds*

SDLT is a charge on the acquisition of a chargeable interest in land or property situated in the UK. Issuing a conventional bond secured on a building does not cause any SDLT to arise.

CGT is a charge on capital gains arising on disposal of assets. Giving an asset as a security does not count as a disposal for CGT purposes. So equally, issuing a conventional bond secured on a building does not incur any liability to CGT.

CAs are a relief on qualifying expenditure. A body issuing a conventional bond secured on a building would continue to be able to claim any CAs during the life of the bond.

#### *Taxation of Alternative Finance Investment Bond (sukuk)*

An example of a typical Ijara sukuk structure is at Annex A.

Based on the Ijara structure, under current legislation any Alternative Finance Investment Bond will be subject to SDLT charges at the following points.

- **SDLT charge 1** –SPV (special purpose vehicle) purchasing asset from originator. At this point the purchaser (the SPV) will be liable for SDLT on the chargeable consideration for the transaction at a rate of four per cent (assuming the asset is valued at more than £500,000).
- **SDLT charge 2** – Originator purchasing asset from SPV. At the end of the bond term, the originator will purchase the asset back from the SPV. At this point the purchaser (this time the originator) will be liable for SDLT on the chargeable consideration for the transaction at a rate of four per cent (assuming the asset is valued at more than £500,000).
- **SDLT charge 3** – There is also some uncertainty as to whether holders of Alternative Finance Investment Bonds would be liable to SDLT as the certificate will evidence their interest in an underlying chargeable asset.

In addition a charge to CGT can arise on the originator at the time of SDLT charge 1, and on the SPV at the time of SDLT charge 2, because they make disposals of the property at those times.

The originator may also lose the entitlement to CAs during the term of the bond.

At present these issues place additional barriers to issuance of Alternative Finance Investment Bonds, putting this structure at a considerable disadvantage relative to equivalent conventional securitisations.

### **Policy objectives and intended effects**

To provide similar tax outcomes for Alternative Finance Investment Bonds to their equivalent conventional financial products:

- For SDLT, no tax will be charged when the land is sold to the issuer of Alternative Finance Investment Bonds nor on the sale back of the land to the originator at the end of the bond term and no SDLT will arise on the issue, transfer or redemption of the Alternative Finance Investment Bonds.
- For CGT, the acquisitions and disposals made by the originator and the SPV will be disregarded, with the consequence that gains will not arise on the transactions.
- For CAs, the originator will retain the right to claim CAs.

This will help the UK Government to maintain London's position as a European leader for the Islamic Finance market, while removing existing inequalities, promoting fairness and choice.

### **Costs and benefits**

#### ***Option 1: do nothing***

There are no appreciable benefits to this option. This option will do nothing to address the underlying tax problems and will therefore be of no benefit to the financial institutions who offer alternative financial products to customers and individuals and businesses that require them.

There would be a continued economic cost from this option. Doing nothing could prevent financial institutions offering Alternative Finance Investment Bonds, reducing the choice to customers.

#### ***Option 2: introducing the necessary legislative framework***

##### *Businesses affected*

This legislation will only affect companies that wish to take up the opportunity to develop Alternative Finance Investment Bonds. Accurate information is not available on the current size of this market in the UK but few if any such issuances involving a property transaction currently take place. Therefore, it is assumed that there will be up to 20 issuances in the first year following the introduction of the legislation, rising to up to 50 a year in the short-term. This assumption is particularly uncertain in the current economic climate, which also makes predictions beyond the short-term impractical. It is also assumed that up to around 50 entities

have specific interests in Alternative Finance Investment Bonds (such as Islamic banks, law firms and accountancy firms) and will need to familiarise themselves with the legislation.

### *Expected benefits*

By removing existing inequalities the UK Government has the potential to encourage development of Islamic Finance within the UK. The emergence of a thriving and competitive market in Islamic Finance products could substantially benefit London as a global financial centre, generating further investment, jobs and indirect tax revenues in the UK economy.

By removing existing inequalities the UK Government will enable the industry to offer genuine choice to consumers wishing to take up these products. While the Exchequer effect in the short term is expected to be negligible, this may grow in the long-term as more institutions offer such products, enabling financial institutions to provide further funding for their customer base.

Comments received in [response](#) to the consultation document on SDLT have suggested that there is a significant demand for such alternative finance products in the UK and that these developments would bring into the regulated environment financial transactions that may currently be taking place without any significant regulation or consumer protection.

### *Administrative burdens*

The new legislation will only affect those companies choosing to offer Alternative Finance Investment Bonds and so doesn't impose any additional burden on the wider business population. Companies are free to choose whether to offer Alternative Finance Investment Bonds based on a commercial decision weighing up transaction costs (legal fees etc) against the likely returns.

HMRC is subject to quantified targets to reduce the admin burden on business of disclosing information to HMRC or to third parties. This burden is assessed through the 'Standard Cost Model', which estimates the cost of these activities, including agent fees and software costs.

Companies choosing to access this relief will incur the standard administrative burden associated with submitting a SDLT return (£130 on average in the Standard Cost Model at 2005 prices) plus a small burden to notify HMRC that a charge has been registered with the Land Registry and then applying for the charge to be removed at the end of the arrangement. An average burden of around £150 per transaction is therefore assumed. Given the assumed number of issuances, this produces a total increase in administrative burdens of around £3,000 in the first year and £8,000 a year thereafter at 2005 prices. These estimates remain unchanged when converted to current prices. These estimates are highly dependent on the actual growth in the Alternative Finance Investment Bond market and thus should be seen as largely indicative.

### *Wider compliance costs*

The main wider compliance cost is likely to come from the resources involved in the affected entities ensuring they are aware of and understand the legislation and its impact on their work, systems and processes.

If each entity needs to spend an average of 10 hours familiarising themselves with the new legislation, based on an assumed average hourly wage of £25, the total one-off familiarisation cost will be around £12,000. Companies will also face the additional cost of registering a charge with the Land Registry and Companies House, which would incur fees of around £200 and £30 respectively. These fees are outside the control of HMRC. Based on the assumed number of issuances, this represents an ongoing annual cost of around £5,000 in the first year and £12,000 a year thereafter.

### *Costs relating to CGT and CA*

Anyone entering into arrangements that meet the conditions for SDLT reliefs will, on the vast majority of occasions, also meet the conditions for CGT reliefs. It is believed that the cost of setting up Alternative Finance Investment Bonds is likely to subsume any capital gains compliance cost. Therefore, the additional cost specific to CGT is expected to be negligible.

Similarly, the legislation is not expected to change the way capital allowances are claimed by the businesses concerned and so the additional cost specific to CA is also expected to be negligible.

#### *HMRC operational costs*

The additional costs to HMRC from removing the SDLT and CGT charges from the structuring of Alternative Finance Investment Bonds will be negligible.

#### *Total costs*

Overall, therefore, the new legislation is estimated to involve a one-off familiarisation cost of around £12,000, plus ongoing costs of up to around £8,000 in the first year and £20,000 a year thereafter at current prices. Over a five year period, therefore, the total estimated cost is £100,000, converting to £90,000 in net present value terms assuming a 3.5% discount rate.

There is considerably uncertainty over these estimates, particularly relating to the potential rate of growth in the Alternative Finance Investment Bond market. The average costs assumed are likely to vary between different types of Alternative Finance Investment Bond issuances and different entities affected. The available information is not sufficient, however, to estimate the possible differences in average costs.

### **Enforcement, sanction and monitoring**

These are positive measures for affected parties that allow consistent tax treatment. Avoidance disclosures will be monitored to identify any attempt to use Alternative Finance Investment Bonds for avoidance purposes and HMRC will use the SDLT enquiry regime to investigate these.

### **Post-implementation review**

HMRC will conduct a post-implementation review with reference to the operational impacts of this new process. It is currently anticipated that this will be between one and three years from the date of implementation. The review will cover development of the alternative finance industry and the anticipated positive impact on the UK economy. It will also endeavour to see what impact these changes have upon tax avoidance.

HMRC continues to work with all the key stakeholders interested in SDLT. Through industry/HMRC groups, stakeholders continually assess the performance of the SDLT regime, suggest ideas for improvements and evaluate changes that have already been made. This is a vital tool for gauging the effectiveness of any changes in the stamp duty system and will provide a useful forum for ensuring that the relief works as it was intended to.

### **Impact Tests**

#### *Competition Assessment*

The Office of Fair Trading outlines four criteria for a Competition Assessment, asking whether the measure would:

1. Directly limit the number or range of suppliers?
2. Indirectly limit the number or range of suppliers?
3. Limit the ability of suppliers to compete?
4. Reduce suppliers' incentives to compete vigorously?

The answer to all four questions is no for these changes, which instead are likely to enhance competition within the UK by assisting in the development of the alternative finance market and ensuring that alternative finance products are not disadvantaged by UK taxation requirements. This will increase both the number and range of suppliers.

### *Small Firms Impact Test*

This policy will have no negative impact on small firms because issuance of Alternative Finance Investment Bonds is voluntary and the option won't be taken up for small firms where the benefits do not outweigh the costs. Creating a level playing field for Alternative Finance Investment Bonds may also have some positive impacts in terms of increasing some small firms' access to finance if they are able to find investors via Alternative Finance Investment Bonds that may not have invested in conventional bonds.

### *Legal Aid Impact Test*

There will be no need for a new criminal sanction or civil penalty.

### *Equality Impact Test (Disability/Gender/Race)*

An initial equality assessment has revealed that these changes have no negative impacts on any sector of the community, as everyone is able to access the reliefs provided by them.

These are positive measures which will promote equality by enabling everyone to participate in financial activity on equal terms, allowing everyone and UK Muslims in particular access to a Sharia'ah compliant investment product that has, to date, not been available in the UK.

Respondents to the consultation, who included both Muslim and non-Muslim organisations representing individuals and businesses, raised no concerns on these issues.

This product will be accessible to any person regardless of gender, race, religion or disability.

### *Environmental/ Social/ Sustainable Development Impact Tests*

HMRC has considered all the remaining impact tests and concluded that none of them is likely to be affected by these changes. No concerns were raised with regards to these issues in the responses to the consultation. This assessment will be kept under review and updated in the light of consultation if appropriate.

## Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

**Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.**

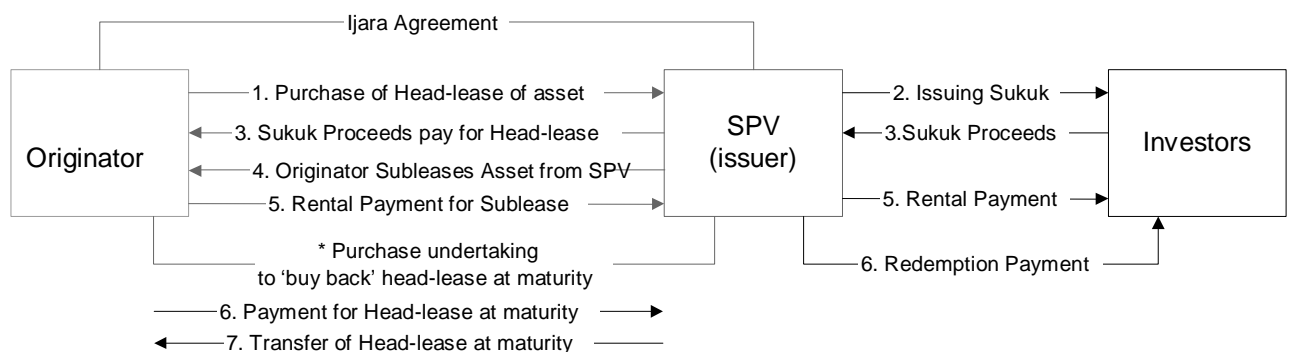
Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes	No
Sustainable Development	Yes	No
Carbon Assessment	Yes	No
Other Environment	Yes	No
Health Impact Assessment	Yes	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes	No
Rural Proofing	Yes	No

## SUKUK AL-IJARA

An Ijara contract allows the transfer of usufruct (usage) of an asset in return for rental payment; as such it is similar to a conventional lease contract. An Ijara sukuk uses this leasing contract as the basis for the returns paid to investors, who are part owners (either actual or beneficial) of the underlying asset and as such benefit from the lease rentals as well as sharing in the risk.

The diagram below illustrates the relevant parties and how the funds might flow in a Sukuk al-Ijara.

### Sukuk al-Ijara structure



**After the establishment of a special purpose vehicle (SPV), the following steps take place.**

#### Purchase of head-lease of asset

1. The SPV purchases the head-lease to the underlying asset for a nominal value from the original owner of the asset (the originator)

#### Issuing sukuk

2. To finance this purchase of usufruct, the SPV sells Sukuk al-Ijara to investors, these sukuk are quite similar to bonds, but are based on the underlying asset that the SPV has acquired rather than being debt securities.

#### Sukuk proceeds

3. The proceeds from investors are used by the SPV to pay for the grant of the head-lease by originator.

#### Purchase undertaking

- \* After the purchase of the head-lease, originator would separately give a purchase undertaking (a one-sided promise or Wa'd which is not conditional on any other contract) to "buy-back" the head-lease from the SPV in the future.

#### Originator subleases asset from SPV

4. The SPV then sub-leases the asset back to the originator.

**Rental payment for sublease**

5. This sub-lease generates a stream of rental payments that are paid to the SPV. These rental payments form the periodic return to the investors who own a share in the underlying asset.

**Payment for head-lease/beneficial title at maturity**

6. At the end of the sublease period, originator exercises the purchase undertaking and “buys back” the head-lease. This allows the sukuk certificates to be redeemed and for the investors to get their capital back.

**Transfer of head-lease/beneficial title at maturity**

7. The beneficial title or head-lease to the assets transfers back to the originator.