

## **Schedule 1: Alternative finance arrangements**

### **Overview**

1. This Schedule rewrites the income tax and capital gains tax provisions dealing with alternative finance products. The source legislation is in Chapter 5 of Part 2 of FA 2005. These provisions tax and relieve alternative finance return under certain types of financial arrangement in the same way as interest. This includes financial arrangements that comply with Shari'a law, which prohibits transactions that involve interest. The rules are not limited to Shari'a compliant products but also apply to any finance arrangement that falls within their terms.

2. The overall approach is in line with that used for the corresponding corporation tax provisions in CTA 2009. As far as possible the provisions have been kept together so that users can see the overall scheme of the legislation. Signposts have been inserted into appropriate places in other parts of the tax code that are affected by these provisions.

3. The regulatory power in section 98 of FA 2006, rewritten for corporation tax in section 521 of CTA 2009, has proved difficult to rewrite separately in a way that ensures that it continues to operate satisfactorily and in an unchanged way. This draft therefore rewrites the regulatory power as a single clause in Bill 7 and repeals section 521 of CTA 2009.

<p><b>Q1. We would welcome comments on the overall approach to the rewrite of this material</b></p>
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4. Part 1 of the Schedule inserts a new Part 10A into ITA 2007 to deal with the income tax aspects of the legislation. Part 2 of the Schedule inserts a new Chapter 4 into Part 3 of TCGA 1992 to deal with the capital gains tax aspects.

5. Part 3 of the Schedule makes a number of amendments to other enactments.

6. The prospective amendments to section 48B(2) and (3) of FA 2005 in Schedule 61 to the Finance Bill 2009 have been incorporated into the draft clauses.

7. The corresponding rules for corporation tax are in Chapter 6 of Part 6 of CTA 2009.

8. The draft provisions rewriting section 54A of FA 2005 (alternative finance return – community investment tax relief) will be issued separately.

### **Clause 1: Alternative finance arrangements**

9. This clause introduces Schedule 1, which inserts new sections into ITA and TCGA.

**Clause 2: Power to extend alternative finance provisions to further arrangements**

10. This clause provides a regulatory power to enable the legislation about alternative finance arrangements to be extended to cover other forms of alternative finance that may be developed in the future. It is based on section 98 of FA 2006 and sections 521 and 1310 of CTA 2009.

11. The clause provides a regulatory power for income tax, corporation tax and capital gains tax. The single power is clearer in its scope than would be the case with separate powers. Section 521 of CTA 2009 is repealed and the specific procedural rules relevant to this power, currently in section 1310(5) of CTA 2009, are brought into this clause.

**Part 1 of Schedule 1: Amendments of ITA 2007**

12. Part 1 inserts new Part 10A into ITA 2007 containing sections 564A to section 564Y.

**New section 564A of ITA: Introduction**

13. This section sets out what is included in the Chapter and provides signposts to the location of certain definitions. It is based on sections 46(1) and 57 of FA 2005.

**New section 564B of ITA: Meaning of “financial institution”**

14. This section provides the meaning of “financial institution” for the purposes of the alternative finance rules. It is based on section 46(2) and (3) of FA 2005.

15. It is a requirement that at least one party to the arrangements must be a financial institution.

**New section 564C of ITA: Purchase and resale arrangements**

16. This section deals with an arrangement whereby an asset is purchased by a financial institution and then sold to another person with the payment by that second person left on credit. It is based on section 47(1) to (3) of FA 2005. The corresponding rule for corporation tax is section 503 of CTA 2009.

17. The price paid by that second person exceeds the price paid by the financial institution. The difference between the two prices equates to the return from an investment at interest and is treated as alternative finance return (see new section 564I of ITA).

**New section 564D of ITA: Diminishing shared ownership arrangements**

18. This section deals with a second type of alternative finance arrangement. It is based on section 47A(1) to (4) of FA 2005. The corresponding rule for corporation tax is section 504 of CTA 2009.

19. Two persons, at least one of them a financial institution, acquire an interest in an asset. The financial institution receives payments from the other party for that party's use of the financial institution's share as well as (usually leasing) payments, with the

ownership of the asset passing by degrees to the other party. The other party to the arrangement has full use of the asset being acquired and may grant rights in the asset. Payments made by the other party in excess of the payments for the beneficial interest being acquired are treated as an alternative finance return.

**New section 564E of ITA: Deposit arrangements**

20. This section deals with an arrangement whereby deposits are made with a financial institution and payments are made to the depositor out of profits earned by the use of the money. It is based on section 49(1) of FA 2005. The corresponding rule for corporation tax is section 505 of CTA 2009.

21. The payments must equate to a return from an investment at interest. The return is treated as an alternative finance return.

**New section 564F of ITA: Profit share agency arrangements**

22. This section deals with an arrangement where the investor appoints an agent to whom a sum of money is given to be invested at a specified return. It is based on section 49A(1) of FA 2005. The corresponding rule for corporation tax is section 506 of CTA 2009.

23. Any additional sum above the specified return is retained by the agent as an incentive fee.

**New section 564G of ITA: Investment bond arrangements**

24. This section sets out the conditions that must be present for arrangements to be treated as an investment bond arrangement. It is based on section 48A(1) and (2) of FA 2005. The corresponding rule for corporation tax is section 507 of CTA 2009.

25. An investment bond arrangement exists where the bond-issuer uses the subscription proceeds to acquire assets, which are specified in the arrangement, and are held for the benefit of the bond-holder. Income generated from the assets is distributed to the bond-holder and, on maturity of the bond, the assets are sold under pre-existing arrangements and the proceeds returned to the bond-holder.

**New section 564H of ITA: Provision not at arm's length: exclusion of arrangements from sections 564C to 564G**

26. This clause excludes arrangements from sections 564C to 564G where the parties are connected persons within the transfer pricing legislation in Schedule 28AA of ICTA, the arrangements are not at arm's length and the recipient of the alternative finance return is not subject to income or corporation tax or a similar non-United Kingdom tax. It is based on section 52(1) to (3) of FA 2005. The corresponding rule for corporation tax is section 508 of CTA 2009.

27. Schedule 28AA to ICTA is rewritten in this Bill (see Part 4).

**New section 564I of ITA: Purchase and resale arrangements**

28. This section explains the meaning of “alternative finance return” in relation to the purchase and resale arrangements in section 564C. It is based on section 47(4), (6), (7) and (8) of FA 2005. The corresponding rule for corporation tax is section 511 of CTA 2009.

29. It provides for circumstances where the second purchase price is paid either immediately or in instalments.

**New section 564J of ITA: Purchase and resale arrangements where return in foreign currency**

30. This section sets out how to deal with purchase and resale arrangements in currencies other than sterling. It is based on section 48(1) of ICTA 2009. There is no explicit equivalent for corporation tax as currency matters are dealt with as an integral element of Parts 5 and 6 of CTA 2009.

**New section 564K of ITA: Diminishing shared ownership arrangements**

31. This section explains the meaning of “alternative finance return” in relation to the diminishing shared ownership arrangements set out in section 573E. It is based on section 47A(5) of FA 2005. The corresponding rule for corporation tax is section 512 of CTA 2009.

32. The phrase “costs and expenses” in section 47A(5) of ICTA has been reduced to “expenses” in *subsection (3)* as the additional words appear to be unnecessary.

**New section 564L of ITA: Other arrangements**

33. This section explains the meaning of “alternative finance return” in relation to deposit arrangements, profit share agency arrangements and investment bond arrangements. It is based on sections 48B(1), 49(2), 49A(2) and 51A(1) and (2) of FA 2005. The corresponding rule for corporation tax is section 513 of CTA 2009.

**New section 564M of ITA: Treatment of alternative finance return as interest for ITTOIA 2005**

34. This section directs that for all purposes of ITTOIA, alternative finance return is to be taxed and relieved in the same way as interest. It is based on section 51(1) of and paragraph 10 to Schedule 2 to FA 2005.

**New section 564N of ITA: Alternative finance return under arrangements for trade or property business purposes**

35. This section directs that, where a person is party to an alternative finance arrangement for the purposes of a trade or property business then any alternative finance return is treated as an expense of that trade or business. It is based on section 51(3) to (5) of FA 2005.

36. Specific provision is made to permit the deductibility of the incidental costs of raising loan finance via alternative finance arrangements under section 58 of ITTOIA.

**New section 564O of ITA: Relief for some alternative finance return under Chapter 1 of Part 8 etc**

37. This section ensures that alternative finance return can be relieved in the same way as interest under provisions in ITA and ICTA. It is based on section 51(2) of FA 2005.

**New section 564P of ITA: Tax relief schemes and arrangements**

38. This section ensures that relief for alternative finance return is subject to possible restriction under section 809ZE of ITA (which rewrites section 787 of ICTA). It is based on paragraph 8 of Schedule 2 to FA 2005.

**New section 564Q of ITA: Deduction of income tax at source under Part 15**

39. This section ensures that the provisions requiring the deduction of income tax at source from payments of interest also apply to payments of alternative finance return in equivalent circumstances. It is based on paragraphs 11, 12 and 13 of Schedule 2 to FA 2005.

**New section 564R of ITA: Treatment of discount**

40. This section ensures that where part of the return equates in substance to a discount, then that part is dealt with in accordance with the rules for discounts in section 381 of ITTOIA, but not where the arrangements equate to a deeply discounted security. It is based on section 51A(1) and (3) of FA 2005.

41. *Subsection (3)* ensures that where any part of the return equates to the return on a deeply discounted security, then that part of the return is dealt with under the rules in ITTOIA that deal with deeply discounted securities.

**New section 564S of ITA: Treatment of bond-holder and bond-issuer**

42. This section sets out a number of consequences for bond-holders and bond issuers under investment bond arrangements. It is based on section 48B(2) and (6) of FA 2005. The corresponding rule for corporation tax is section 517 of CTA 2009.

43. The draft incorporates the prospective amendment to section 48B(2) of FA 2005 in Schedule 61 to the Finance Bill 2009.

**New section 564T of ITA: Treatment as securities**

44. This section ensures that investment bond arrangements are treated as securities for income tax purposes. It is based on section 48B(3) of FA 2005. The corresponding rule for corporation tax is section 518 of CTA 2009.

45. The draft incorporates the prospective amendment to section 48B(3) of FA 2005 in Schedule 61 to the Finance Bill 2009.

**New section 564U of ITA: Arrangements not unit trust scheme or offshore fund**

46. This section ensures that investment bond arrangements are not treated as a unit trust scheme or an offshore fund for income tax purposes. It is based on section 48B(5) of FA 2005.

**New section 564V of ITA: Exclusion of alternative finance return from consideration for sale of assets**

47. This section ensures that where assets are sold under certain types of alternative finance arrangement the alternative finance return is excluded from the consideration for the sale and purchase. It is based on section 53 of FA 2005.

48. The corresponding provision for corporation tax is in section 514 of CTA 2009, and the corresponding rule for capital gains tax is inserted as section 151T of TCGA by this schedule.

**New section 564W of ITA: Diminishing shared ownership arrangements not partnerships**

49. This section provides that diminishing shared ownership arrangements are not treated as a partnership for income tax or capital gains tax purposes. It is based on section 47A(6) of FA 2005. The corresponding rule for corporation tax is section 515 of CTA 2009.

**New section 564X of ITA: Treatment of principal under profit sharing agency arrangements**

50. This section ensures that in the case of profit sharing arrangements the deposit-taker is taxable in respect of all of the profit resulting from the use of the money – both the depositor’s share of profit made under the arrangements and also the amount that the deposit-taker can retain. It is based on section 49A(3) of FA 2005. The corresponding rule for corporation tax is section 516 of CTA 2009.

51. The deposit-taker is entitled to relief for the depositor’s share of profit.

**New section 573Y of ITA: Provision not at arm’s length: relevant return**

52. This section prevents any deduction in calculating profits for income tax purposes as a result of alternative finance arrangements where the rules about arrangements not at arm’s length in section 573I applies. It is based on sections 46(1), 48A(3), and 52(4) and (5), and 57 of FA 2005. The corresponding rule for corporation tax is section 520 of CTA 2009.

**Part 2 of Schedule 1: Amendments of TCGA 1992**

53. This Part of the Schedule inserts the necessary rules for capital gains tax as Chapter 4 of part 4 of TCGA.

**New sections 151H to 151S of TCGA**

54. The inserted sections 151H to 151S of TCGA, containing the definitions of alternative finance arrangements and alternative finance return, perform the same function for capital gains tax as the inserted sections 564A to 564L of ITA.

**New section 151T of TCGA: Investment bond arrangements are qualifying corporate bonds**

55. This section ensures that investment bond arrangements are treated as qualifying corporate bonds for the purposes of TCGA. It is based on section 48B(4) of FA 2005.

56. CTA 2009 inserted a reference in section 117(6D) of TCGA to add a reference to section 507 of CTA 2009 alongside the reference to section 48A of FA 2005. Paragraph 6 of Schedule 1 rewrites section 117(6D) of TCGA to conform to the new structure.

**New sections 151U to 151Y of TCGA**

57. The inserted sections 151U to 151Y of TCGA set out a number of consequences for capital gains tax, equivalent to the inserted sections 564S to 564Y of ITA (except section 564X of ITA, for which no equivalent is needed for capital gains tax).

**Part 3: Amendments of other enactments**

58. This Part inserts new section 367A into ICTA and new 173A into ITEPA.

**New section 367A of ICTA: Alternative finance arrangements**

59. This section brings alternative finance arrangements within the scope of sections 353 and 367 of ICTA, which provide for relief for interest payment in certain limited circumstances. It is based on section 51(2) of FA 2005.

60. The section has been inserted here because the legislation only affects a defined group of people and will eventually be spent when there are no longer any eligible claimants.

**New section 173A of ITEPA: Alternative finance arrangements**

61. This section brings the effect of the alternative finance provisions into the rules for the taxation of employee benefits. It is based on section 97 of FA 2006.