30 Monck Street
London SW1P 2AP
T: +44 (0)20 7340 0550
E: technical@ciot.org.uk

Tax Simplification for Alternative Finance consultation

Response by the Chartered Institute of Taxation

1 Introduction

1.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the UK for advisers dealing with all aspects of taxation. We are a charity and our primary purpose is to promote education in taxation with a key aim of achieving a more efficient and less complex tax system for all. We draw on the experience of our 20,000 members, and extensive volunteer network, in providing our response.

1.2 The government's aim is to ensure that there is equality of tax treatment between alternative finance and conventional finance for economically equivalent transactions. However, that is not the case currently. The refinancing of a residential or commercial property using alternative (Shariah compliant) finance triggers a potential capital gains tax liability on any inherent gain. No potential capital gains tax liability arises when a conventional mortgage is used.

1.3 Alternative finance is structured to ensure there is no payment or receipt of interest that is forbidden under Islamic law. A common structure is diminishing shared ownership. Broadly this involves the owner selling part of the building to the finance provider while retaining occupation of the whole. The owner pays rent to the finance provider for the provider's share of the property. The purchaser gradually buys out the provider's share of the property. For Stamp Duty Land Tax (SDLT) and income/corporation tax purposes, current tax legislation ensures that the tax treatment equates to a conventional mortgage in accordance with the government's policy intent[1]. However for capital gains tax (CGT) purposes the transfer of the interest to the finance provider is a part disposal for CGT purposes, subject to reliefs[2]. The disposal may also trigger a capital

[1] However, in relation to SDLT, there are anomalies in the availability of certain reliefs where a property is acquired using alternative finance arrangements. In many cases, the Finance Act 2003 looks through the alternative finance provider to the underlying buyer when determining whether relief is available but there remain some reliefs (such as charity relief and group relief) where this is not the case.

[2] A refinancing of a residential property that is a taxpayer's main home is unaffected as the capital gains tax relief: Private Residence Relief would usually apply.

allowances balancing charge where eligible plant and machinery/structures and building allowances have been claimed.

1.4 The CIOT's proactive submission in 2018 (https://www.tax.org.uk/ref459) raised the lack of parity of tax treatment for a refinancing property and proposed a way of achieving equal treatment drawing upon precedent in existing tax law. Subsequently the CIOT discussed the submission with HMRC. We received the following response:

'The government recognises the need for greater stability in the tax system and as such, recognises the importance of an evidence based approach to policy changes. To date, evidence of the scale of the issue has been limited making justification of a change in legislation challenging. All tax policy is kept under review and any new evidence as to the extent to which the existing legislation is affecting market outcomes will be considered carefully as part of that process.'

1.5 The consultation document does not indicate whether this consultation is a stage one or stage two consultation in the government's tax policy making process. However, given the consultation sets out specific proposals it appears to be a stage two consultation (Determining the best option and developing a framework for implementation including detailed policy design).

1.6 Our stated objectives for the tax system that are relevant to this consultation include:

- A legislative process that translates policy intentions into statute accurately and effectively, without unintended consequences.
- Greater simplicity and clarity, so people can understand how much tax they should be paying and why.
- Greater certainty, so businesses and individuals can plan ahead with confidence.
- A fair balance between the powers of tax collectors and the rights of taxpayers (both represented and unrepresented).
- Responsive and competent tax administration, with a minimum of bureaucracy.

2 Effective consultation on the proposed changes

2.1 We are pleased the government is now consulting on potential changes to level the playing field by exempting the transfer to the provider from capital gains tax. We recognise the importance of ensuring that the proposed changes do not lead to avoidance or disproportionate administrative burdens.

2.2 We have not responded to the specific questions in the consultation as these are matters for specialists in alternative finance structure. We are grateful to Mohammed Amin for proving insight into this area and for sharing his response with us in draft.

2.3 As this is a specialist area that mainly affects a particular sector we suggest the process of evidence gathering to inform the impact assessment will need to extend beyond the representative tax bodies to reach representatives in the Islamic finance community.

2.4 We respond on one aspect only, that is, to raise the need to consider the position of taxpayers that have incurred a CGT liability prior to implementation of the proposed solution in the consultation.

3 CGT liabilities incurred on alternative finance transactions before implementation.

3.1 The consultation makes no reference to the position for taxpayers who have already incurred a capital gains tax liability using an alternative finance structure. We suggest that consideration should be given to exempting taxpayers from a CGT liability on inherent gains realised on alternative finance transactions that concluded at a time before any new legislation is announced on the basis that:

- the current treatment appears to be an anomaly in the legislation in need of correction,
- anomalies create complexities in the tax system contrary to the government's simplification objectives[3],
- successive governments have supported and legislated for a level playing field between conventional finance and Islamic finance, such that Islamic finance transactions are taxed no more heavily (and no more lightly) than conventional finance transactions.,
- the policy objective to level the playing field can only be fully realised if it applies retrospectively,
- taxpayers adversely affected are likely to include people with a protected characteristic (religion or belief) under the Equality Act 2010, and
- anecdotally we understand that there are concerns HMRC may not have adopted a consistent approach to cases involving refinancing through Shariah compliant finance[4].

3.2 The CIOT's position is that any use of retrospection needs to be fully justified as retrospection typically undermines the principles of certainty and stability. However, we suggest the use of retrospective changes to taxation in circumstances where there is an anomaly in the legislation that is both inconsistent with government policy during the time the anomaly exists and adversely affects taxpayers, particularly those with protected characteristics, should be considered and evaluated as part of the impact assessment and equalities assessment of the proposed measures.

3.3 We observe that the case for retrospection is unlikely to be made if correction of the anomaly would benefit one group but adversely affect a different group of taxpayers. We consider the case for retrospection in relation to capital allowances may fall into this category. Changing the entitlement to capital allowances from one group of taxpayers (finance providers) to the another (persons refinancing) is contrary to the principles of certainty and stability.

4 Acknowledgement of submission

4.1 We would be grateful if you could acknowledge safe receipt of this submission, and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the consultation is published.

[3] HMRC/HMT four simplification objectives published at Box4B Autumn Statement 2023.
[4] https://www.mohammedamin.com/Islamic_finance/Shariah-compliant-refinancing-treated-unfairly.htm

The Chartered Institute of Taxation

The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries.

Our members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

5 April 2024