Shariah compliant refinancing and capital gains tax

OMB Personal tax Property Tax



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Following our earlier proactive submission, the CIOT responded to the government's Tax Simplification for Alternative Finance consultation that aims to ensure equal tax treatment between alternative (Shariah compliant) finance and conventional finance for refinancing property.

In 2018, the CIOT made a proactive submission to HMRC about the capital gains tax (CGT) trap on refinancing property using alternative (Shariah compliant) finance (see Mohammed Amin's article in *Tax Adviser* in 2019 'The Shariah compliant refinancing trap' tinyurl.com/3m8yrewc).

Alternative finance is structured to ensure that there is no payment or receipt of interest, which 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 tax and corporation tax purposes, current tax legislation ensures that the tax treatment equates to a conventional mortgage in accordance with the government's policy intent. However, for CGT purposes the transfer of the interest to the finance provider is a part disposal. If the property is the owner's principal private residence, the part disposal will not give rise to any CGT liability. Otherwise, for example on the refinancing of a buy to let portfolio, the disposal may trigger a capital gain.

The consultation proposes exempting the transfer to the provider from CGT. However, there is no consideration of the position for taxpayers who have already incurred a CGT 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.

The current treatment is an anomaly in the legislation in need of correction and successive governments have supported and legislated for a level playing field between conventional finance and Islamic finance. Anecdotally, we understand that there are concerns HMRC may not have adopted a consistent approach to cases involving refinancing through Shariah compliant finance.

We also pointed out that, 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. This also seems inconsistent with government policy and in need of correction.

The full CIOT submission can be found here: www.tax.org.uk/ref1287

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