



Stamp duty land tax: Commercial sukuk

**Consultation Document
26 June 2008**

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1. Introduction

- 1.1 It was announced at Budget 2008 that the Government would be seeking comments on the form of a relief to be provided to offset any stamp duty land tax (SDLT) consequences arising on the issuance of a commercial sukuk.
- 1.2 This document provides an overview of the particular difficulties faced by the alternative finance industry and details the measures the Government has introduced in order to provide a level playing field to alternative finance products.
- 1.3 It also sets out the proposed legislative framework under which commercial sukuk issuance could be introduced in the UK.
- 1.4 HM Revenue & Customs (HMRC) would be interested in views on the specific questions raised in this consultation document, in particular:
 - whether the relief meets the requirements of industry;
 - what additional costs, if any, may arise as a result of complying with the requirements of the relief; and,
 - whether the proposed relief is sufficiently flexible for future development of the market.
- 1.5 HMRC would also welcome any comments on the impact assessment attached at Annex B to this document.

2. The Consultation Process

2.1 How to Respond

A summary of all the questions posed as part of this consultation is included at Chapter 8.

Responses should be sent by 18 September 2008 by e-mail if possible to yasmin.ali@hmrc.gsi.gov.uk or by post to:

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HM Revenue and Customs
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London
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Or by fax to 020 7147 2748

Telephone enquiries 020 7147 2804

Paper copies of this document or copies in alternative languages and formats may be obtained free of charge from the above address. This document can also be accessed from the HMRC Internet site at <http://www.hmrc.gov.uk/consult>. All responses will be acknowledged, but it will not be possible to give substantive replies to individual representations.

When responding please say if you are a business, individual or representative body. In the case of representative bodies please provide information on the number and nature of people you represent.

2.2 Confidentiality

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided

as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Revenue and Customs (HMRC).

HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

2.3 Code of Practice

This consultation is being conducted in accordance with Department for Business Enterprise & Regulatory Reform Code of Practice. A copy of the Code of Practice criteria and a contact for any comments on the consultation process can be found in Annex A.

3. Background

- 3.1 As part of the Government's policy on City competitiveness to facilitate innovation in the financial services sector, Islamic finance has been identified as an important, high-growth area. The Government's objective for Islamic finance is two-fold:
- to establish London as a global gateway for Islamic finance; and
 - to ensure that all British citizens, regardless of their faith, have access to competitive financial services.
- 3.2 Since 2003, the Government has worked steadily towards its aim to ensure a 'level playing field' for both retail and wholesale Islamic finance products against existing financial products. The Government is continuing to deliver changes to facilitate growth in this area.
- 3.3 In Budget 2007, the Government announced a package of measures reflecting market developments over the past 12 months, including a new special tax regime for listed sukuk.
- 3.4 A sukuk is an Islamic financial certificate, equivalent to a bond that complies with the requirements of Sharia'a Islamic law.
- 3.5 The Government measures enable sukuk to be held, issued and traded in the same way as corporate bonds.
- 3.6 A summary of changes to taxation and regulatory policy on Islamic finance since 2003 is detailed below.
- 3.7 Building on legislation in Finance Act 2007 regarding sukuk and in light of discussions with industry, the Government announced at Budget 2008, that it would consult on removing the Stamp Duty Land Tax (SDLT) barrier to sukuk with the aim of legislating in Finance Act 2009.
- 3.8 In addition in April 2007, the then Economic Secretary announced that the HM Treasury and the UK Debt Management Office (DMO) would assess the feasibility of issuing sovereign sukuk and a consultation on this issue concluded on 21 February 2008 with the response being published on the 2nd June 2008.
- 3.9 This consultation document builds upon the views sought in respect of the sovereign issuance and seeks to develop a mechanism for relief by which the barriers to the issuance of a commercial sukuk can be removed.

3.10 Informal discussions have been held with interested parties within the alternative finance industry and where appropriate their comments have been incorporated into this document.

Changes to taxation and regulatory policy on Islamic finance since 2003

Changes in 2003

- The first tax legislation catering specifically for Islamic finance arrangements came in Finance Act 2003, in the area of stamp duty land tax (SDLT). This removed a major obstacle to the marketing of Sharia'a compliant mortgages by introducing reliefs to prevent multiple payments of SDLT for these transactions.
- The FSA consulted on whether to regulate Islamic home financing using Ijara (lease to own), home purchase products in order to give consumers broadly the same protection as consumers of conventional mortgages.

Changes in 2005

- In 2005 Government created a 'level playing field' for tax purposes for Mudaraba and Murabaha products that are equivalent to deposits and loan financing.
- The Government also introduced further changes to SDLT legislation to extend relief from multiple stamp duty to a newly available shared ownership product known as diminishing Musharaka and to ensure that the existing Ijara wa Iqtina (lease based mortgage) relief was effective in Scotland.
- The Government passed regulations to enable providers to offer Sharia'a-compliant Child Trust Funds (CTFs).

Changes in 2006

- HMRC enabled the use of diminishing Musharaka (reducing partnership share based) products in place of standard loans.
- As part of leasing reform, legislation was introduced enabling the use of Ijara wa Iqtina for asset finance.
- SDLT reliefs for Islamic products were extended to companies.
- Secondary legislation bringing Home Purchase Plans (HPPs) into regulation by the FSA was enacted.

Changes in 2007

- Introduction of legislation to clarify the taxation of sukuk. Regulations were introduced detailing stock exchanges recognised for the purposes of sukuk.
- Regulations introduced to extend the Community Investment Tax Relief scheme to include Islamic financial products
- Guidance on treatment of diminishing Musharaka for Capital Gains and Capital Allowance and clarification of tax treatment of Takaful (Islamic insurance), Real Estate Investment Trusts (REITs) and Private Finance Initiative (PFI).
- The Financial Services Authority (FSA) commenced regulation of Islamic home financing.
- HM Treasury and DMO announce a study into the feasibility of Government sukuk issuance.
- National Savings & Investment announce decision to look at the feasibility of Government issuing retail Islamic products as part of implementation of new 5-year strategy.
- FSA publish: "Islamic Finance in the UK: Regulation and Challenges".

Announcements in 2008

Government announced at Budget 2008 its intention to:

- Introduce legislation in Finance Bill 2009 to provide relief from stamp duty land tax (SDLT) for alternative finance investment bonds, following a formal consultation.
- Amend legislation to classify alternative finance investment bonds as loan capital for the purposes of stamp duty and stamp duty reserve tax (SDRT).
- Introduction of legislation to allow existing corporation tax and income tax rules on alternative finance arrangements to be amended by regulation if and when required.

Financial Services Authority announced its intention to clarify the regulatory treatment of sukuk, consulting with stakeholders where appropriate.

4. Alternative Finance and Islamic Finance

4.1 The term alternative finance is synonymous with Islamic finance, though it actually encapsulates any form of financing which does not conform to western banking models. Islamic finance is based on the Sharia'a rulings on commercial and financial transactions. The modern Islamic financial framework is based on the following principles.

The emphasis on fairness

4.2 On a micro level everybody participating in a financial transaction must be adequately informed and not cheated or misled. On a macro level, social justice and economic prosperity for the whole community must be sought.

The belief in personal economic well-being

4.3 Islam encourages individuals to pursue their own economic enrichment within the parameters of what is considered to be socially responsible behaviour. This means that financial transactions involving socially detrimental activities such as gambling, pornography, alcohol, and armaments are forbidden.

The importance of profit and loss sharing

4.4 Unlike conventional finance where income can accrue from capital alone, Islamic finance requires the investor and investee to share the risk of all financial transactions.

The strict prohibition of the payment or receipt of interest

4.5 Islamic finance considers money to have no intrinsic value in itself – it is merely a store of wealth and medium of exchange. Modern Islamic banking has developed mechanisms that allow interest income to be replaced by payments flowing from productive sources, for example, returns from trading in assets and rental income.

4.6 In order to comply with the requirements of Sharia'a law, a sophisticated Islamic financial system has developed which seeks to reward investors for the actual risks undertaken. Investors are deemed to acquire a share of the underlying business from which profits are generated. Sukuk (a plural noun in Arabic – the singular is sakk or saak) literally means “certificates”: it refers to an arrangement under which holders acquire a beneficial interest in assets in proportion to the value of certificates that they hold.

4.7 A company wishing to raise finance through sukuk will, typically, issue certificates to investors for cash, and identify assets that are then ring-fenced in some way – normally, but not necessarily, the company will make a declaration that it holds these assets on trust for the certificate holders.

4.8 The assets are used to generate income, which is periodically distributed to the certificate holders. These periodic distributions are frequently benchmarked to a rate of interest, so that – for example – investors may

receive quarterly distributions equal to London Inter-Bank Offered Rate (LIBOR) plus a margin, calculated on the capital they have subscribed.

- 4.9 Most sukuk will be issued by companies (or governments) wishing to raise finance in capital markets, either for specific projects, or as general working capital. The issuing company will therefore frequently want the certificates to be listed on a stock exchange, and rated by credit rating agencies. An example of a typical Ijara sukuk structure is provided at Annex C.
- 4.10 Sukuk do not fit within the current tax rules as the acquisition of an interest in underlying assets has specific taxation consequences. At present UK taxation requirements are acting as a barrier to the development of the alternative finance industry.
- 4.11 Some of the taxation issues arising have already been addressed by earlier legislation. In Budget 2007 it was announced that a regime would be introduced that would treat sukuk listed on recognised exchanges as if they were corporate securitisations.
- 4.12 These adjustments were made in Finance Act 2007 under 'alternative finance investment bonds' and gave tax certainty to income and corporation taxes, capital gains, capital allowances and inheritance tax. However, they did not cover stamp duty land tax.
- 4.13 Stamp duty land tax is a transaction tax, payable by the buyer, on the purchase of land or property, or any considerations for the acquisition of an interest in land or property. It is administered and collected by the Stamp Taxes business stream within HM Revenue and Customs (HMRC).
- 4.14 This consultation document seeks to address the stamp duty land tax consequences arising as a result of a commercial sukuk issuance.

5. Commercial Sukuk

- 5.1 Sukuk are economically similar to Eurobonds and structured in a way similar to a securitisation transaction, a form of corporate finance in which assets are transferred to a special purpose vehicle (SPV) , which then issues bonds to third party investors in capital markets, secured on those assets. The sukuk evidences a share in the beneficial ownership of an underlying asset.
- 5.2 A typical ijara (lease) sukuk structure is set out at Annex C.
- 5.3 Sukuk may often be backed by interests in land or property as the underlying asset. In a normal securitisation transaction where bonds are issued the investor does not have a direct ownership share in the underlying asset but merely an interest bearing certificate, whereas in a sukuk the investors own part of the underlying asset.
- 5.4 Stamp duty land tax (SDLT) is a charge on the acquisition of a chargeable interest whether or not evidenced in writing. Issuing a conventional bond secured on a building does not cause any SDLT to arise.
- 5.5 However, in a sukuk structure the originator in order to be Sharia'a compliant must transfer an asset to a SPV so that the investors can own part of the underlying asset. SDLT will therefore be charged if a chargeable asset such as a building is transferred to an SPV that issues a sukuk, and is charged again when the originator buys back the building. (SDLT is generally not chargeable on the rent payable by the sponsor to the SPV, as "sale and leaseback relief" should be available).
- 5.6 It has been Government policy to date to ensure that where practical, Sharia'a compliant financial products should be taxed on an equivalent basis with conventional products. At present a SDLT charge on sukuk places an additional barrier to issuance compared with a conventional equivalent and inhibits UK Government's two fold aims on Islamic finance: first to boost London's position as an international financial hub; and, secondly to encourage greater social and financial inclusion among its two million Muslims.
- 5.7 Working under a plain vanilla Ijara sukuk and in applying current legislation to any sukuk issuance, there is the potential for the sukuk to be subject to SDLT charges at the following points if the property is UK land or property qualifying as a chargeable asset.

SDLT charge 1

5.8 SPV purchasing asset from originator. SDLT will be payable by the purchaser (the SPV) on the acquisition of a chargeable interest in land at a rate of four per cent (assuming that the asset is valued at more than £500,000).

SDLT charge 2

5.9 Originator, purchasing asset from SPV. On the winding up of the sukuk, the originator will purchase the asset back from the SPV. SDLT will be payable by the purchaser (this time the originator) on the acquisition of a chargeable interest in land at a rate of four per cent (assuming again that the asset is valued at more than £500,000).

SDLT charge 3

5.10 There is also some uncertainty as to whether sukuk certificate buyers would be liable to SDLT as the certificate will evidence their interest in an underlying chargeable asset.

5.11 These extra SDLT charges put a sukuk structure at a considerable disadvantage compared to their conventional equivalent.

5.12 It is therefore considered desirable that SDLT should not be charged when land is sold to the issuer of a sukuk, and that no SDLT is charged on the saleback of the building to the originator. The sale of sukuk bonds should also not attract any SDLT.

Q1. Do you support the principle of allowing a relief for sukuk issuance?

5.13 There are significant tax avoidance risks associated with addressing these issues. The use of SPV's, in particular, is currently one of the most common ways of avoiding SDLT. The proposed relief set out in this consultation document contains certain requirements which seek to counter these risks.

6. Structure of UK Commercial Sukuk

- 6.1 Preliminary discussions with representatives of the alternative finance industry have provided a useful insight into how a commercial sukuk would operate in practice.
- 6.2 There are a number of different types of sukuk structure available within the Islamic world; however, it has been suggested that the most suitable model to be adopted in the UK would be the Ijara sukuk.

Q2. Would the restriction of the relief to only Ijara sukuk be sufficient for the industry?

- 6.3 To ensure that any commercial sukuk is viable the value of the underlying assets would be in the region of £100M+.

Q3. What are the likely costs of sukuk issuance compared to conventional bonds?

Q4. Do respondents have a view on the likely eventual size of the UK corporate sukuk market in terms of (i) value; and (ii) number of issuances per year?

- 6.4 The underlying asset is likely to be high value commercial property such as shopping centres or hotels. Such assets provide the potential for different classes of bonds being issued, related to the rental stream from particular outlets.
- 6.5 There was a strong preference expressed by industry representatives for asset substitution within the sukuk.

Q5. How important is the need for asset substitution in a sukuk structure?

- 6.6 The sukuk issuers are likely to be financial institutions (FI). However, it is recognised that organisations not falling currently falling within the FI definition may also wish to issue sukuks.

Q6. Who will be the likely issuers of UK sukuks?

- 6.7 In a normal securitisation assets tend to be held in orphan SPV's, typically established offshore. It is envisaged that similar models will be adopted for commercial sukuk.
- 6.8 The target market for such products would be high net worth individuals primarily within the Islamic world as well as corporate investors. There may also be interest from sovereign wealth funds and western investors wishing to include a relatively secure investment product within their portfolios, a typical example being UK pension funds.

7. Proposed Legislative Framework

Summary of proposed SDLT relief on alternative finance investment bond transactions

- A. The relief will be self-certified.
- B. In order to obtain the relief the sukuk must fall within requirements of s48A of FA 2005 (alternative finance investment bonds).
- C. The following transactions will be exempt:
 - i) The transfer from originator to the SPV.
 - ii) The transfer back from the SPV to the originator.
 - iii) The issue and resale of sukuk bonds.
- D. Legislation to be introduced in Finance Bill 2009 to provide specific relief.

Relief available on transfer to Special Purpose Vehicle

The transfer of the property from the originator to the SPV will be exempt providing that the following conditions are satisfied:

- The asset must be defined and returned to the originator within the same period as the bond issuance.
- The sukuk issuer would need to identify a UK agent who would become liable for SDLT should the asset not return to the originator.

Q7. Would the requirement for a UK agent cause any practical difficulties?

Q8. Are there any alternatives to using a UK agent?

- A charge would be held on the asset by HMRC for the period it is held by the SPV.
- To provide for asset substitution, no relief will be granted on a substituted asset until the original underlying asset had been returned to the originator.

Relief available on transfer to back to originator

The transfer of the asset back to the originator will be exempt.

- If the defined asset is not returned to the originator then an SDLT charge will arise on the SPV- or any company within the SPV group. This requirement would be extended to the new group if the SPV is sold.
- If it is not possible to recover SDLT from the SPV or any company within the SPV group, then the UK agent will become liable for any SDLT.

Relief on sukuk issuance and sale on secondary market

The initial issue and subsequent resale on secondary markets of the bonds would be exempt.

- Sukuk issuer must issue bonds up to the value of at least 95 per cent of asset.
- To address avoidance risks we would like to encourage wide ownership of bonds. For example, if one person acquired 10 per cent or more of the total sukuk then any income generated above that level would be restricted.

Q9. Would a wide ownership requirement create any commercial difficulties?

Q10. Is the 10 per cent ownership threshold too low? If so, what level is considered reasonable?

- The SPV would be responsible for ensuring that an income restriction is put into place for persons holding 10% or more of the issued bonds. If the SPV fails to restrict the income for parties holding 10% or more of the sukuk on three occasions, then, on the third offence, the SPV would become liable to 4% SDLT on the market value of the asset.

Q11. In general, do you feel that the proposed relief meets industry requirements? If not, why not?

8. Summary of Consultation Questions

- 8.1 Do you support the principle of allowing a relief for sukuk issuance?
- 8.2 Would the restriction of the relief to only Ijara sukuk be sufficient for the industry?
- 8.3 What are the likely costs of sukuk issuance compared to conventional bonds?
- 8.4 Do respondents have a view on the likely eventual size of the UK corporate sukuk market in terms of (i) value; and (ii) number of issuances per year?
- 8.5 How important is the need for asset substitution in a sukuk structure?
- 8.6 Who will be the likely issuers of UK sukuks?
- 8.7 Would the requirement for a UK agent cause any practical difficulties?
- 8.8 Are there any alternatives to using a UK agent?
- 8.9 Would a wide ownership requirement create any commercial difficulties?
- 8.10 Is the 10% ownership threshold too low? If so, what level is considered reasonable?
- 8.11 In general, do you feel that the proposed relief meets industry requirements? If not, why not?

A Code of Practice Criteria

ABOUT THE CONSULTATION PROCESS

This consultation has been conducted in accordance with the consultation criteria in the Department for Business Enterprise & Regulatory Reform Code of Practice. If you wish to access the full version of the Code, you can obtain it at

<http://bre.berr.gov.uk/regulation/consultation/code/>

THE CONSULTATION CRITERIA

1. Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy.
2. Be clear about who may be affected, what questions are being asked, and the timescale for responses.
3. Ensure that your consultation is clear, concise and widely accessible.
4. Give feedback regarding the responses received and how the consultation process influenced the policy.
5. Monitor your department's effectiveness at consultation, including through the use of a designated consultation co-ordinator.
6. Ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

If you feel that the consultation does not satisfy these criteria, or if you have any complaints about the process, please contact –

Richard Bowyer
Better Regulation Unit
020 7147 0062 or Richard.bowyer@hmrc.gsi.gov.uk

B

Impact Assessment

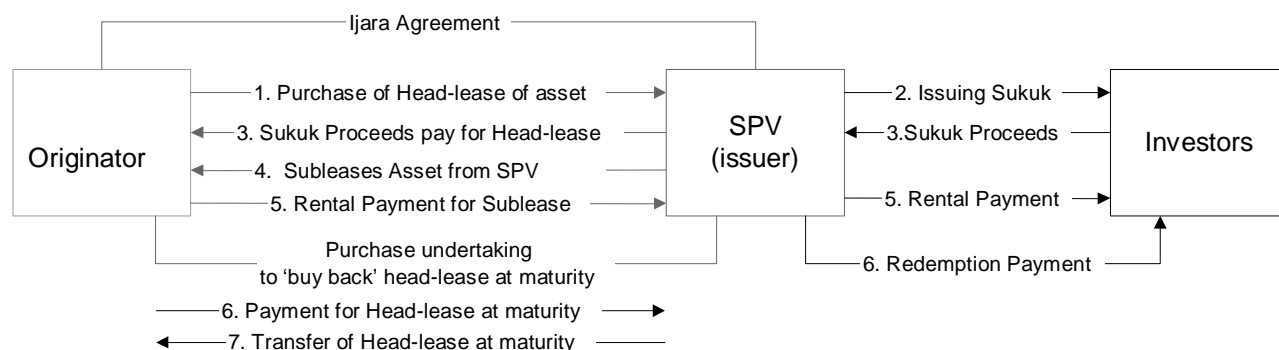
C Ijara (lease) Sukuk Structure

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 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 (e.g. 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.

D Relevant Government Legislation

Overview of existing alternative finance legislation

Alternative finance arrangements were brought into the loan relationship legislation by FA 2005. FA 2005 identified two types of alternative finance arrangements that were in substance used for the lending of money although in form involved the purchase and sale of an asset or a profit sharing contract.

The scope of the FA 2005 legislation was extended by FA 2006. This introduced two additional alternative finance arrangements, which in substance replicate the effect of either an interest-bearing deposit or that of a mortgage. FA 2007 introduced a further extension to cater for alternative finance investment bonds (sukuk), which are economically equivalent to a marketable security issued by a company.

These arrangements are described as giving rise to either an:

Alternative finance return

- under a purchase and resale arrangement or
- diminishing shared ownership arrangement; or
- arising on alternative finance investment bonds, or to

Profit share return

- under a deposit arrangement or
- profit share agency arrangement.

The distinction in terminology between “alternative finance return” and “profit share return” does not mean that they are treated differently for Corporation Tax (CT) purposes – both terms describe amounts paid or received that are economically equivalent to interest.

A purchase and resale arrangement and diminishing shared ownership arrangement can be used, for example, as an alternative to a conventional loan or mortgage, or provide a return to a customer placing money with a bank.

The deposit arrangement and profit share agency arrangement are similar to a conventional interest return on a bank deposit.

Alternative finance investment bonds may be issued by banks, trading groups or governments to raise finance, and held by financial institutions, pension funds or other corporate or non- corporate investors. Unlike the

other alternative finance arrangements to which the legislation applies, they are intended to be traded in recognised markets.

Statutory conditions for alternative finance investment bonds

Sukuk arrangements are capable of taking a wide variety of forms. Those which fall within the alternative finance legislation are those which function economically as debt securities.

FA2005/S48A (1) lays down a number of conditions that alternative finance investment bonds must satisfy, and FA2005/S48A (2) provides a further gloss on the conditions. These conditions are set out below:

- The arrangements provide for one person, described in the legislation as the bond- holder, to pay a sum of money (“the capital”) to another person, described as the bond-issuer.
- The arrangements must identify assets, or a class of assets (“the **bond assets**”) In many cases, this “identification” will take the form of the issuer making a Declaration of Trust in respect of the assets. Particularly where the arrangements are not governed by English law, however, the sukuk holders’ interest in the assets may take some different legal form: this does not prevent the arrangements from coming within section 48A.
- The bond-issuer must acquire the bond assets in order to generate income or gains. The requirement for the issuer to acquire assets means that arrangements under which an issuing company pledges existing assets as collateral for borrowing, or where a charge is created over particular assets of the issuer, do not come within the legislation.
- The arrangements must have a fixed term or maturity date. This distinguishes alternative finance investment bonds from, for example, collective investment schemes, where the investor’s interest in the scheme may subsist indefinitely. But arrangements are not disqualified because investors (usually by majority vote in a general meeting) may have the right to require the trust to be dissolved early in certain circumstances.
- Under the arrangements, the bond-holders must be entitled to two sorts of payment. At the end of the bond term, the bond-issuer must dispose of the remaining bond assets, and make a payment to the bond-holder – described as the **redemption payment** – to repay the capital subscribed. The bond-holder must also receive **additional payments**, either during the term of the bond or at maturity, or both.
- The amount of the additional payments must not exceed a **reasonable commercial return**.

- The arrangements must allow the bond-issuer to **manage the assets** so as to generate sufficient income to make the redemption payments and the additional payment.
- The alternative finance bonds must be **listed on a recognised stock exchange**. They must also be transferable – although listed securities will always fulfil this condition.
- The arrangements must be wholly or partly treated in accordance with international accounting standards as a **financial liability**.

Tax treatment of alternative finance investment bonds

Where sukuk meet the conditions in FA2005/S48A to be alternative finance investment bonds additional payments made or received under the bonds are alternative finance return. This is subject to the provisions about discount.

For corporation tax purposes, FA2005/S50 treats alternative finance investment bonds as loan relationships.

For income tax purposes, FA2005/S51 applies to alternative finance return received or paid on such bonds. There are further statutory provisions for alternative finance investment bonds, which are relevant only to non-corporate holders.

Where an alternative finance investment bond is treated as a loan relationship, FA1996/S80(5) ensures that profits or losses from the bond cannot be taxed or relieved in any other way. But because many, if not most, sukuk arrangements

- involve the creation of a trust, and
- fall to be treated as collective investment schemes under Financial Services and Markets Act 2000,
- the legislation provides that tax provisions relevant to trusts or to collective investment schemes do not apply.

Specifically, FA2005/S48B (5) ensures that alternative finance investment bonds are not treated as a unit trust scheme either for the purposes of ICTA1988/S469 or ITA2007/S1007 (dealing with the taxation of unauthorised unit trusts) or for capital gains purposes; not treated as an offshore fund; and, for a company, are not a “relevant holding” in a unit trust or offshore fund for loan relationships purposes.