

**EXPLANATORY MEMORANDUM TO
THE ALTERNATIVE FINANCE ARRANGEMENTS (COMMUNITY INVESTMENT
TAX RELIEF) ORDER 2008**

2008 No. 1821

1. This explanatory memorandum has been prepared by HM Revenue and Customs and is laid before the House of Commons by Command of Her Majesty.

2. Description

The Community Investment Tax Relief (“CITR”) scheme encourages investment in disadvantaged communities by giving tax relief to investors who back businesses and social enterprises in less advantaged areas by investing, either by loan or equity, in accredited Community Development Finance Institutions (“CDFIs”). This Order widens the range of permitted investments in, and by, CDFIs that raise funds under the CITR scheme by providing that various Sharia’ a-compliant financial products that in substance, but not in form, are equivalent to interest-bearing loans will be treated as loans for the purposes of the scheme.

3. Matters of special interest to the Select Committee on Statutory Instruments

None

4. Legislative Background

Schedule 16 to the Finance Act 2002 (FA2002) (Community Investment Tax Relief) and Part 7 of the Income Tax Act 2007 (ITA2007)(Community Investment Tax Relief) limit the type of investment in a Community Development Finance Institution (CDFI) that can be a qualifying investment under CITR scheme to loans to, and shares or securities in, the CDFI. Similarly, the Community Investment Tax Relief (Accreditation of Community Development Finance Institutions) Regulations 2003 (S.I. 2003/96) define the type onward investment by the CDFI that can be a relevant investment under the scheme to loans to, or shares or securities in, an investee enterprise.

Chapter 5 of Part 2 to Finance Act 2005 (FA2005)(Alternative Finance Arrangements) provides that the tax treatment of certain financial arrangements that in substance, but not in form, amount to interest-bearing loans should follow that of a conventional interest-bearing loan.

Section 98 of the Finance Act 2006 (FA2006) provides for Chapter 5 of Part 2 FA2005 to be amended by Treasury Order.

This is the first Order to be made under Section 98 FA2006. It provides that for certain arrangements falling within Chapter 5 of Part 2 FA2005 the arrangement should be regarded as a loan for the purposes of Schedule 16 to FA2002, S.I. 2003/96 and Part 7 to ITA2007.

5. Territorial Extent and Application

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

Angela Eagle MP has made the following statement regarding Human Rights:

In my view the provisions of the Alternative Finance Arrangements (Community Investment Tax Relief) Order 2008 are compatible with the Convention rights.

7. Policy background

The tax relief is available to individuals and companies and is worth up to 25% of the value of the investment in the CDFI. The relief is spread at 5% over each of five tax years or accounting periods, starting with the year or period in which the investment is made.

Relief under the scheme is available in relation to investments into CDFIs that take the form of loans, securities or shares. The form of onward investment by CDFIs is similarly restricted if it is to count towards the CDFIs' onward investment obligations. This means that CITR may not be available if investors and CDFIs engage in financial arrangements that in substance amount to loans but which, in order to comply with the principles of Sharia'a (Islamic law), take another legal form.

Recent Finance Acts have included a number of measures that seek to tax Sharia'a-compliant financial products in a similar way to their conventionally-structured counterparts. Chapter 5 of Part 2 of FA 2005 describes a number of Alternative Finance Arrangements (AFAs) that are effectively treated as interest-bearing loans for specified tax purposes.

This Order provides that certain types of AFA within FA05 which are similar in substance to a conventional arrangement that would be a qualifying investment (in a CDFI) or relevant investment (by a CDFI) under the CITR scheme, will be treated in the same way as a conventional arrangement for the purposes of the scheme.

The effect of the Order will be that existing CDFIs will be able to offer a greater range of financial products under the CITR scheme to the investors from whom they raise funds and the enterprises to whom they provide funds. And some CDFIs that may not otherwise have been able to offer CITR to investors may seek accreditation under the scheme.

8. Impact

A Regulatory Impact Assessment has not been prepared for this Order as it has no impact on business, charities or voluntary bodies,

9. Contact

Richard Kent at HM Revenue & Customs (tel: 020 7147 2635 or e-mail: richard.kent@hmrc.gsi.gov.uk) can answer any queries regarding the Order.