

**EXPLANATORY MEMORANDUM TO  
THE INCOME TAX (BUILDING SOCIETIES) (DIVIDENDS AND INTEREST)  
(AMENDMENT) REGULATIONS 2005**

**2005 No. 3474**

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

**2. Description**

These regulations extend the rules which require deduction of tax at source on certain payments of interest made by Building Societies to amounts which are equivalent to interest and are paid under certain Alternative Finance Arrangements.

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

There are no matters of special interest relating to these regulations.

**4. Legislative Background**

4.1 Part 2 Chapter 5 of the Finance Act 2005 made provision for the taxation of certain arrangements ("Alternative Finance Arrangements") which are equivalent to interest bearing deposits and loans. Alternative finance return and profit share return paid under such arrangements is taxed as if they were interest.

4.2 Paragraph 5 of Schedule 2 to the Finance Act 2005 applied Section 477A ICTA 1988 (building societies: regulations for deduction of tax) to alternative finance return and profit share return as if they were interest paid or credited in respect of a deposit or loan.

4.3 Section 477A ICTA 1988 provides the power for the Commissioners for Her Majesty's Revenue and Customs to make regulations requiring any building society to deduct income tax from interest paid or credited in respect of any shares in, or deposits with or loans to the society.

**5. Extent**

5.1 The instrument applies to all of the United Kingdom.

**6. European Convention on Human Rights**

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

## **7. Policy background**

- 7.1 Conventional financing or investment involves the payment or receipt of interest. Some people who wish to comply with Shari'a law are prevented from paying or receiving interest, and alternative ways to replicate the effect of interest bearing loans and deposits have been developed. The Finance Act 2005 included provisions to provide certainty of tax treatment for such arrangements ("alternative finance arrangements"), and to tax them in a way equivalent way to conventional loans and deposits.
- 7.2 Where interest on a deposit with a building society is paid, income tax has to be deducted at source by the society in certain circumstances. These are set out in detail in regulations (The Income Tax (Building Societies)(Dividends and interest) Regulations 1990). In order to provide a level playing field, the requirement to deduct income tax in exactly the same circumstances is being extended to payments equivalent to interest which are made in respect of alternative finance arrangements.

## **8. Impact**

- 8.1 A Regulatory Impact Assessment has not been prepared for this instrument as it has no impact on business, charities or voluntary bodies.
- 8.2 The impact on the public sector is nil.

## **9. Contact**

Chris Kerr at Her Majesty's Revenue & Customs, telephone 020 7147 2619 or e-mail [chris.kerr@hmrc.gsi.gov.uk](mailto:chris.kerr@hmrc.gsi.gov.uk) can answer any queries regarding the instrument.