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Islamic Finance

Tax Considerations Around the World

September 2012

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Contents

Foreword

At the turn of the 21st century, Islamic finance was largely an infant industry. At that time, the growth of Islamic finance was organic and largely concentrated in countries with significant Muslim populations.

Today, Islamic finance is amongst the fastest growing financial segments in the international financial system, with a presence in both Muslim and non-Muslim dominated communities. Additionally, global financial sectors such as London, and Singapore have all begun to offer Islamic financial products and services.

Despite the growth of the global Islamic finance market, taxation systems have not necessarily caught up with the many innovations of a rapidly expanding market.

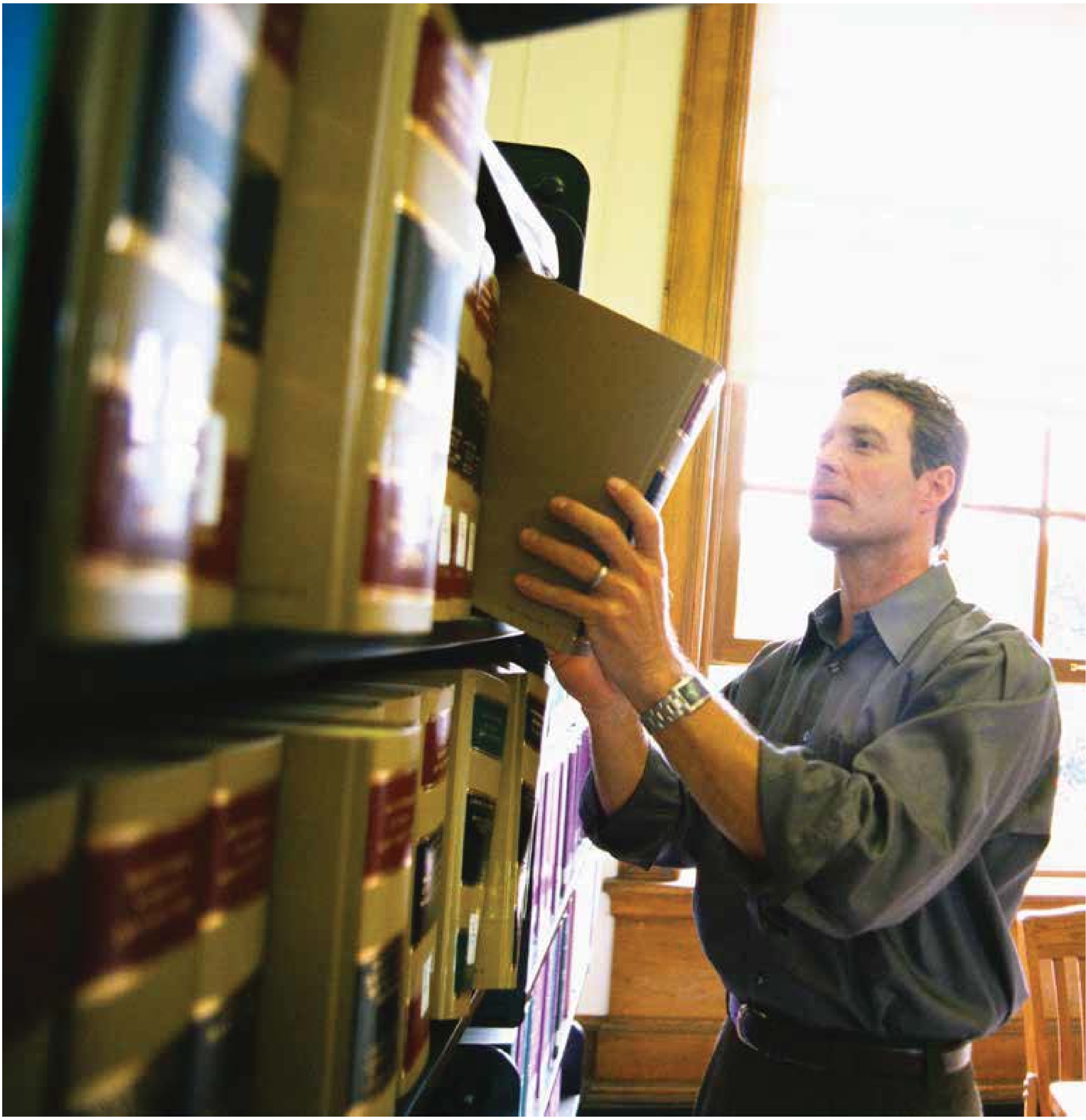
PricewaterhouseCoopers has a global team of tax professionals who have conceived this booklet as part of our thought leadership initiative.

We hope you find this publication insightful in the area of taxation of Islamic finance.

Jennifer Chang

Islamic Finance Tax Leader for Southeast Asia and Australasia
September 2012

Australia



Corporate Tax

Companies that are resident in Australia are subject to Australian income tax on their worldwide income. Generally, non-residents are subject to Australian income tax on Australian-sourced income only.

Companies are subject to federal tax on their income at a flat rate of 30%. There are no state or municipal taxes on income.

Withholding Tax

Withholding tax rates (WHT) for non-treaty countries are nil for Franked Dividends (broadly, dividends paid out of taxed profits), 30% for Unfranked Dividends (i.e. paid out of untaxed profits), 10% for Interests and 30% for Royalties.

Dividends paid to non-residents are exempt from dividend withholding tax to the extent that the dividends are franked (i.e. paid from taxed profits where credit for the tax paid is attached to the dividends) or are declared by the company to be conduit foreign income (CFI). Broadly, CFI is certain foreign income that is ultimately received by a non-resident through one or more interposed Australian corporate tax entities.

Interest WHT exemption is available for certain publicly offered debentures and syndicated debt arrangements subject to certain conditions being satisfied or under exemptions for interest paid to financial institutions under certain treaties.

The withholding tax rates on Dividends, Interest and Royalties for treaty countries depend on the relevant tax treaties with Australia.

Stamp Duty

Stamp duty is a transaction based tax imposed by the various States and Territories of Australia and typically applies to transfers of dutiable property (such as real estate, goodwill, shares in unlisted companies).

Goods and Services Tax

The federal government levies Goods and Services Tax (GST) at a rate of 10%. The GST is a value added tax applied to the supply or importation of taxable goods or services, based on their value.

Most financial supplies are input taxed rather than taxable under the GST regime. Input taxation means that entities making financial supplies are not liable to GST on the financial supply and cannot claim input tax credits for the GST paid on related financial acquisitions. Certain asset financing arrangements are treated as taxable supplies (and not financial supplies) for instance hire purchase and leasing.

Other taxes

Australia imposes certain other taxes such as import duties, excise duties (e.g. on alcohol and tobacco) and various other State based taxes such as payroll tax and land tax.

Islamic Finance - Tax Implications

General Overview on the Islamic financing industry / market overview

There is a growing awareness in Australia of the potential of Islamic finance.

Currently, Australia has a Muslim population of about 476,000, that is, 2.2% of the total population[1]. Australia's geographical position, especially its proximity to the large Muslim populations of the Asia Pacific and its attractiveness as a financial centre present an important base to service the fast growing Islamic financing sector within the global financial services market. Therefore, Australia is well placed to take advantage of the Islamic finance opportunities.

The growing attention to Islamic finance products has the potential to contribute to the finance sector by:

- Providing Australian financial institutions with a much needed alternative source of funding.
- Encouraging foreign Islamic banks to establish offices or operations in Australia.
- Allowing Australian financial institutions to target foreign investors by offering Shariah-compliant investment and financial products in global markets. All the major Australian banks now

[1] *2011 Census – Australian Bureau of Statistics*

- provide Islamic-style banking products for investors[2].
- Attracting investment in Australian assets by international Shariah investors.
- Allowing Australian institutions to export their services into Islamic economies, particularly in Asia and the Gulf region. (This and the previous point are of particular relevance to Australian fund managers).

Major issues faced within industry - tax and regulatory-wise

Due to the Australian tax, legal and regulatory regimes historically catering for conventional western finance, some Islamic finance products do not currently enjoy parity of treatment with conventional western products. However, the need for reform has been recognised by the Australian Government through various initiatives including:

- Stamp duty reforms in Victoria in 2004.
- The Johnson Report in November 2009 "Australia as a Financial Centre – Building on our Strengths" included recommendations to remove impediments to Islamic Finance.
- The release by the Australian Government of a comprehensive publication on Islamic Finance in February 2010. The booklet provided a detailed explanation of the opportunities that booming Shariah-compliant investment and banking could offer Australia's financial services sector.
- The Board of Taxation's Discussion Paper "Review of the Taxation Treatment of Islamic Finance" released in October 2010. This paper was the result of a request by the Australian Treasury for the Australian Board of Taxation to review the tax treatment of Islamic finance products and to make recommendations and findings that will ensure, where possible, that Islamic finance products have parity of tax treatment with conventional finance products.

The major tax issues facing the Islamic financing sector as identified in the Australian Board of Taxation's Discussion Paper include:

- The return is not typically characterised as interest for tax purposes. The return is more typically characterised as lease income, profits on disposals of assets and profit share.
- Differing withholding tax outcomes depending on the classification of the Islamic finance product as debt/equity.
- Differing goods and services tax ("GST") outcomes.
- The timing of assessability and deductibility.
- Potential for double stamp duty (in the case of dutiable property).

General tax principles / treatment for Islamic products, including any special tax incentives

Currently, there are no Australian tax principles/treatment legislated specifically for Islamic finance products.

In determining the tax principles/treatment applicable for Islamic products, reference is drawn to general income tax provisions which currently apply to conventional products having regard to the substance of Islamic products (refer below).

There are generally no special tax incentives available in Australia for Islamic finance activities/products.

Overview of the key Australian tax principles applicable to conventional financing products

General assessability and deductibility provisions

Ordinarily, income is assessable when it is derived for tax purposes and expenses incurred in deriving assessable income are deductible, provided they are not of a private, domestic or capital nature.

Taxation of Financial Arrangement (TOFA) provisions

The TOFA rules which relevantly include debt/equity rules and tax timing rules were introduced to promote a substance over form approach as compared to the general income and deduction rules.

Debt/equity rules[3]

Broadly, the debt/equity rules are important as they govern if the return on the finance instrument may be deductible to the issuer. The return is

[2] *The Age, Westpac to Offer Islamic Banking, 12 February 2010*
[3] *Division 974 of the Income Tax Assessment Act 1997*

deductible in the case of debt interest and non-deductible in the case of equity interest. The outcome can have further implications under the thin capitalisation and withholding tax rules (refer below).

Broadly, an instrument will be a debt interest where the issuer has an effectively non-contingent obligation to return at least the issue price of the instrument to the holder. Equity interests include ordinary shares and other instruments that provide an element of contingency on the issuer's obligation to return funds to the holder. For example, an instrument may be an equity interest if it carries a right to a return which is in substance or effect contingent on the economic performance of the company.

Tax timing rules

Broadly, the TOFA tax timing rules apply to all financial arrangements that an entity entered into from 1 July 2010, unless the entity satisfies the applicable exemptions[4]. Financial arrangements are broadly defined as cash settleable rights or obligations to receive or provide financial benefits.

Under the TOFA rules, the gains or losses on financial arrangements are brought to account under a accruals basis, where gains/losses are "sufficiently certain", or, in the absence of "sufficiently certain" gains/losses, on a realisation basis. Alternatively, some taxpayers may be eligible to adopt one of four timing elective methods (i.e. financial reports, fair value, foreign exchange retranslation or hedging methods[5]) .

Equity interests may be excluded from the TOFA timing rules in certain cases.

Thin capitalisation rules

The thin capitalisation rules apply to all debt of inbound entities (e.g. foreign controlled Australian entities and foreign entities with Australian investments) and outbound entities (e.g. Australian entities with foreign subsidiaries/branches). These rules provide that an entity's debt deductions (e.g. interest expense) will be limited to the extent the entity's debt level exceeds certain limits prescribed by the thin capitalisation provisions.

Leases

The characterisation of a lease arrangement as an "operating lease" or "finance lease/hire purchase arrangement" for Australian tax purposes is critical to determining the tax outcomes applicable. This may or may not mirror the classification under the accounting rules.

For Australian tax purposes, payments made by a lessee under an operating lease is generally deductible and the lessor is required to include the full amount of the payment received as part of its assessable income. Depending on the type of lease asset under the arrangement, the lessor may also be entitled to claim tax depreciation on the leased assets.

For a finance lease or hire purchase arrangement, the tax rules re-characterise the arrangements as a notional sale and loan, where the lessee has a right or obligation to acquire the asset and the amounts payable for the use and acquisition of the asset exceed the price of the asset[6]. Where these rules apply, periodic payments are divided into principal and finance charge components. In this case, the portion of lease payments that is deductible for the lessee is the finance charge component. Conversely, the lessor is required to include the finance charge as part of its assessable income. Further, the lessee may be entitled to claim tax depreciation on certain leased assets depending on the terms of the agreement.

Withholding tax

Generally, interest (or other amounts in the nature of interest) paid to a non-Australian tax resident is subject to 10% interest withholding tax. Further, interest withholding tax exemption is available for certain publicly offered debentures and syndicated debt arrangements subject to certain conditions being satisfied[7], or under treaty exemptions for interest paid to financial institutions.

Returns paid on an equity interest (e.g. dividends) to a non-Australian tax resident are not subject to dividend withholding tax to the extent that the return is franked (i.e. paid out of profits which have been taxed in Australia). If the return is unfranked, the dividend is subject to dividend withholding tax (usually at either 15% or 30% depending on the application of any applicable tax treaty).

Goods and services tax (GST)

The GST regime applies to the value added on most goods and services consumed in Australia. It generally

[4] *Division 230 of the Income Tax Assessment Act 1997*
[5] *This paper is intended to provide a very high level overview of Australian tax law, we have not discussed the TOFA tax timing methods in any greater detail as these rules are extremely complex*

[6] *Division 240 of the Income Tax Assessment Act 1997*
[7] *Section 128F of the Income Tax Assessment Act 1936*

applies at a uniform rate of 10 percent to the supply or importation of taxable goods and services, based on their value. However most financial supplies are input taxed rather than taxable under the GST regime. Input taxation means that entities making financial supplies are not liable to GST on the financial supply and cannot claim input tax credits for the GST paid on related financial acquisitions. Certain asset financing arrangements are treated as taxable supplies (and not financial supplies) for instance hire purchase and leasing.

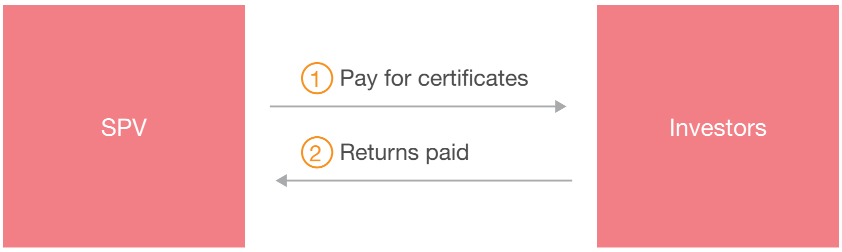
Stamp duty

Stamp duty is a transactions based tax imposed by the various States and Territories of Australia and typically applies to transfers of dutiable property (such as real estate, goodwill, shares in unlisted companies).

General comment on the tax treatment of common Islamic financing products / principles:

- *Sukuk*

Under Australian tax principles, Sukuk may be regarded as an Islamic finance equivalent of conventional tradable notes or bonds.



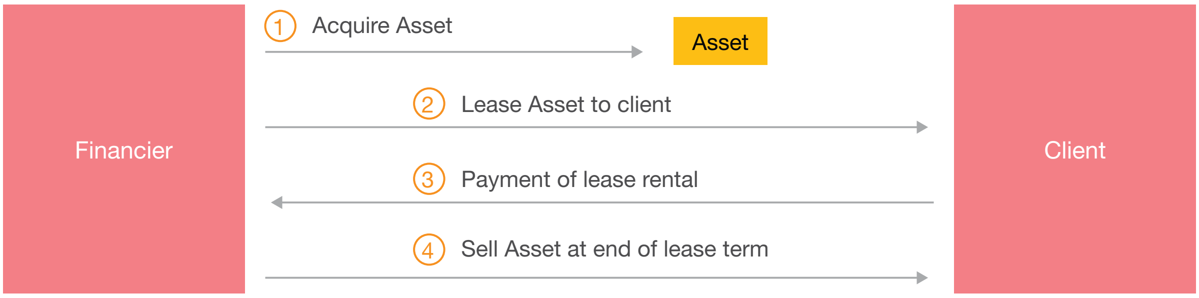
A tax deduction should be available in respect of the return paid on Sukuk to the extent the certificates are considered debt interest for tax purposes. The classification of Sukuk would depend on whether the value of the financial benefits provided by the Sukuk issuer is at least equal to the value of the financial benefits it receives. Where the return on the Sukuk is contingent on any event, condition or situation (e.g. distribution of profits), then Sukuk would fail the debt test and may be considered as an equity interest.

Where the Sukuk is considered an equity interest for tax purposes, no deduction should be available on the returns paid.

Withholding tax would arise where the return on the certificates is paid to a non-resident depending on the classification of the certificates as debt or equity interests. It is unlikely that the interest withholding tax concessions would be available where the Sukuk certificates are not “debentures” or “syndicated loan facilities”.

- ***Ijarah Muntahiah Bin Tamlik (finance leasing)***

Although the Ijarah is in substance equivalent to a conventional secured loan, its form is similar to a conventional finance lease or hire purchase arrangement.



In essence, an Ijarah would be taxed as a lease and where relevant under the finance lease or hire purchase rules (refer above). Where an Ijarah is over an asset already owned by the Client, in which case, the transaction is essentially a sale and lease back with a right or obligation to acquire the asset back at the end of the term. There is possibly capital gains tax on disposal where the asset is already owned by the Client.

Most Ijarahs would be regarded as financial arrangements for the purposes of the debt/equity rules and therefore capable of being regarded as "debt" for tax purposes.

As discussed above, the finance lease or hire purchase rules will re-characterise the arrangement as a notional sale and loan such that periodic payments are divided into principal and finance charge components. The finance charge component is deductible for the Client whereas the Financier is required to include the finance charge as part of its assessable income. The Client may be entitled to claim tax depreciation on certain lease assets depending on the terms of the agreement.

Payments to a non-resident financier under an Ijarah would likely be deemed to be interest under Australian withholding tax provisions which broadly applies to lease arrangements where the lessee has the right to acquire the leased assets[8]. Complexities exist in relation to the application of interest withholding tax for an Ijarah, including the likely non-availability of withholding tax concessions or treaty exemptions for interest paid to financial institutions.

Under an Ijarah arrangement, stamp duty (if dutiable property) would apply on the initial purchase by the Financier as well as the final disposal by the Client.

- ***Takaful***

Under Takaful, the contract parties invest in a pooled investment vehicle which, together with the investment earnings from Shariah compliant investments, is used to cover payouts to the members when a specified event occurs. Unlike conventional Western insurance, the members have the right to receive surplus profits but may be liable to make additional contributions if there is a deficiency of funds to meet claims.

The ordinary tax principles applicable for insurance entities will be relevant for Takaful which may potentially operate to treat the contributions by the members as assessable insurance premiums[9]. The usual insurance company provisions may also be relevant if the Takaful vehicle is a company[10].

8 *Section 128AC of the Income Tax Assessment Act 1936*
9 *Section 121 of the Income Tax Assessment Act 1936*
10 *Division 320 and 321 of the Income Tax Assessment Act 1997*

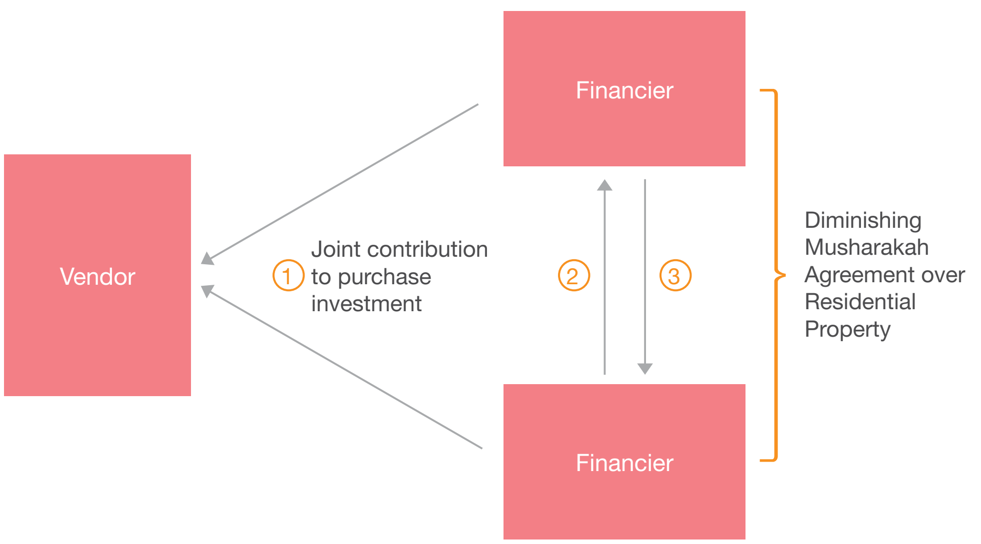
- ***Mudaraba (profit sharing)***

A Mudaraba is a type of joint undertaking where an investor provides capital and another party provides expertise and effort. Profits from the undertaking are shared on a pre-agreed basis. However losses are only borne by the capital investor.

The Mudaraba arrangement may be characterised as an agency, trust, partnership or other equity interest arrangement depending on the detailed structure. The tax treatment will depend on this legal form. For example, if the arrangement is characterised as a trust, the arrangement may be treated as a "flow through" vehicle for Australian tax purposes. That is, the investors should be taxable on the net income of the trust on a flow through basis.

The return derived by the investor would be ordinary assessable income (akin to a commission) and taxed when due and receivable in contrast to the tax treatment of interest spread (which would normally be on an accrual basis).

- ***Musyarakah (partnership)***



A Musyarakah is akin to a partnership or joint venture for a specific business (or income producing asset), whereby the distribution of profits will be apportioned according to an agreed ratio. In the event of losses, both parties will share the losses on the basis of their equity participation.

Depending on the terms of the arrangement, a Musyarakah could be considered a partnership under Australian tax law (i.e. where there is joint receipt of income[11]). In this instance, the partners of a Musyarakah should be subject to tax on their share of net income and losses of the partnership.

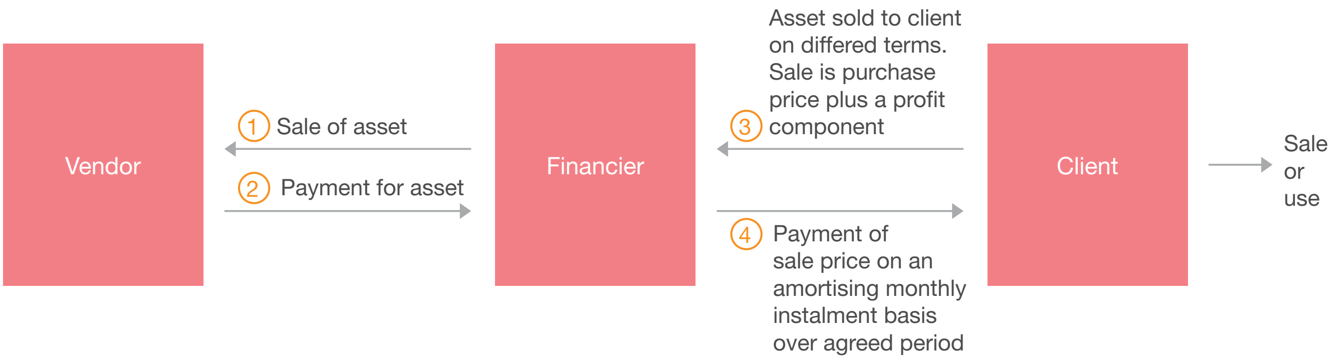
In addition, if the financing partner is a non-resident, they may need to lodge an Australian tax return and account for all of their Australian sourced income arising from the partnership. This may result in a higher tax rate applicable than if the return on their capital was characterised as interest subject only to interest withholding tax.

[11] *Definition of partnership in section 995-1 of the Income Tax Assessment Act 1997*

The payment for the acquisition of part of the equity held by the Financier may give rise to tax consequences (i.e. disposal of part of the Financier's asset). Where there is a change in the composition of the equity participation (e.g. through diminishing profit sharing partnership), a dissolution and reconstitution of the partnership could arise and also result in tax consequences.

Stamp duty would be payable on the initial purchase by the partners, then on the incremental purchases by the partner and then on the incremental buy out by the final owners.

- ***Murabaha (cost plus)***



Whilst Murabaha is similar to a conventional mortgage, the Australian tax implications of the arrangement are less clear. The profit component in a Murabaha structure is akin to a financing charge. However, given that the payment which gives rise to the profit component is for the purchase of a capital asset, a deduction may not be available under ordinary tax principles.

However, the payment may be deductible if the Murabaha is considered a debt interest[12]. It is possible that a Murabaha should be able to satisfy the debt test. In circumstances where TOFA applies to the Client, these provisions may also operate to allow a deduction for the profit component. This is on the basis that the deferred payment arrangement under Murabaha is capable of constituting a financing arrangement.

If the profit component is not deductible, it may form part of the cost base of the asset such that the deductibility of the payment is deferred until the disposal of the asset.

For the Financier, the profit component would typically constitute assessable income under ordinary principles, TOFA or even the trading stock provisions.

Where the Financier is a non-resident, there is some uncertainty as to whether the profit component would fall within the definition of interest for withholding tax purposes. If not considered "interest" then the profit component:

- would not be subject to withholding tax;
- would not qualify for interest withholding tax concessions;
- would likely be Australian sourced assessable income for the non-resident Financier, subject to any treaty relief under the "business profits article".

Even if considered "interest" and subject to withholding tax, it is not clear if the arrangement would qualify for interest withholding tax concessions available for debentures, or a syndicated loan or treaty exemptions for interest paid to financial institutions[13].

[12] *Section 25-85 of the Income Tax Assessment Act 1997*

Australia

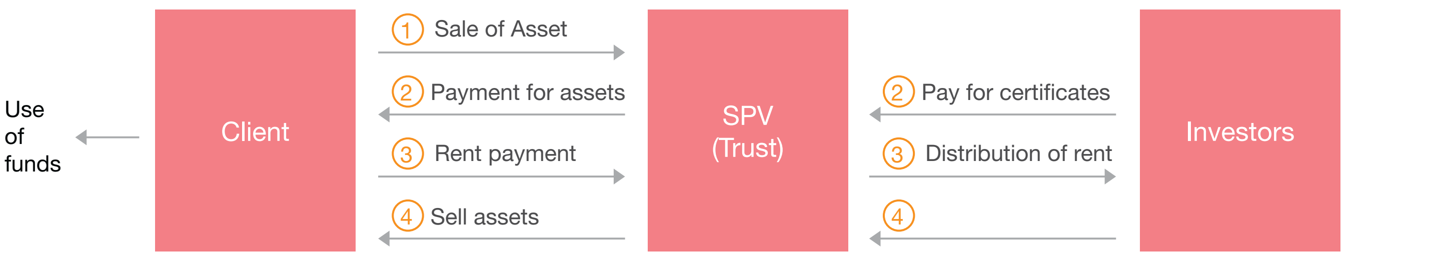
For stamp duty purposes, unlike conventional mortgage arrangements, in a Murabaha there are two separate purchases of property (the first purchase by the Financier and the second subsequent purchase by the Client). Therefore, where the property is dutiable property, stamp duty may be payable twice on what is in substance one transaction[14].

Analysis of 2 structures and comments on the tax issues / treatment for Sukuk Ijarah AND Commodity Murabaha. Typical structures as follows:

Sukuk Ijarah

Our analysis below is based on the following Sukuk Ijarah structure:

The following example refers to a Sukuk (i.e. a financial certificate held by the Investors) that is backed by an underlying asset finance transaction such as Ijarah in respect of an asset already owned by the Client.



A typical Sukuk Ijarah constitutes a trust arrangement, with the Sukuk Investors having a beneficial interest in the underlying trust property, which is in turn being leased to the Client under Ijarah. The tax analysis of the Sukuk Ijarah therefore requires it to be broken down into two separate arrangements:

- the Ijarah between the Client and the SPV – essentially a lease or hire purchase arrangement; and
- the Sukuk itself, representing the arrangement between the SPV and the Sukuk Investors – essentially a trust relationship.

The discussion on the tax treatment of Ijarah in Section 2.4 above will be equally relevant to the Ijarah leg. The following discussions should therefore focus on the Sukuk leg.

Assuming that the SPV is an Australian resident trust, the income of the SPV will be dealt with under the trust provisions[15] . For example, where the underlying lease is over land, then "flow through" tax treatment will apply and the investors should be taxable on the net income of the trust on a flow through basis (i.e. income retains its character).

In calculating the net income or taxable income of the SPV trust, the relevant leasing provisions will become relevant[16].

Complexities arise as to the tax treatment of the distributions made by the SPV trust to non-resident Investors. For example, some or all of the distribution may be subject to interest withholding tax[17]. In particular, as discussed above, relevant interest withholding tax concessions may not necessarily apply.

In certain instances, the SPV trust may be taxed as if it were a company, for example, where the relevant lease is not over land[18]. Where this is the case, the distributions made to the Sukuk Investors will be broadly taxed in the same way as company dividends and distributions.

The discussion of the other general tax treatment of Sukuk in Section 2.4 above will be equally relevant to the Sukuk leg.

[13] *Many pure Islamic Financiers may not meet the definition of "financial institution" for the purposes of these exemptions (see for example Article 11(3)(b) of the US/ Australia DTA which defines financial institution as a "bank or other enterprise substantially deriving its profit by raising debt finance… or by taking deposits at interest… and using those funds in carrying on a business of providing finance.")*

[14] *Some exceptions to double duty may apply in Victoria following amendments in 2004*

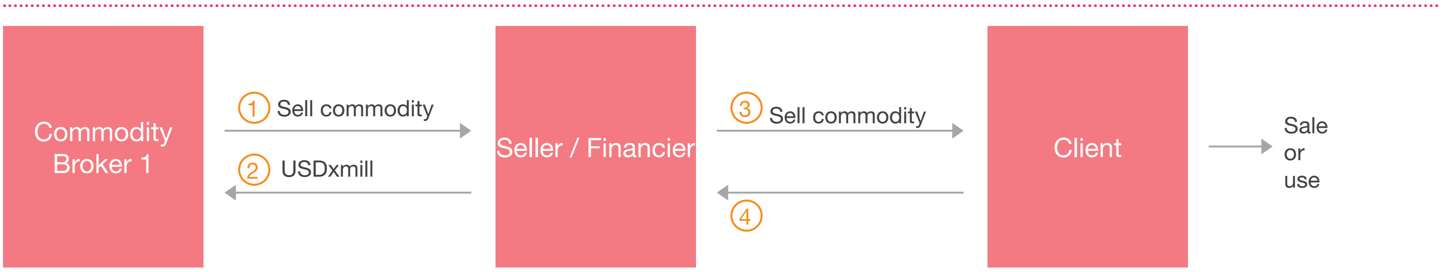
[15] *Division 6 or Division 6C of the Income Tax Assessment Act 1936*

[16] *Division 240 and Division 250 of the Income Tax Assessment Act 1997*

[17] *Section 128AC of the Income Tax Assessment Act 1936*

[18] *The definition of "eligible investment business" in Section 102M of the Income Tax Assessment Act 1936*

Commodity Murabaha



The discussion on the tax treatment of Murabaha in Section 2.4 above will be equally relevant to the Commodities Murabaha.

Brief summary of cross border transactions and the impact of dealing with Islamic securities by entities in Australia and other countries (e.g. Malaysia).

The applicability of DTAs with respect to such Islamic financing.

Refer above for comments in relation to the:

- classification of returns on Islamic finance products for interest withholding tax purposes; and
- applicability of DTAs with respect to Islamic financing in particular the uncertainty of interest withholding tax treaty exemptions for payments to financial institutions.

Any other major tax matters relevant to Islamic finance

Offshore banking unit (OBU)

The Australian OBU regime enables entities declared as OBUs to receive certain tax concessional treatment for income (other than capital gains) derived from certain offshore banking and investment activities. Under this regime, income derived from these activities is effectively subject to a concessional tax rate of 10% rather than the standard Australian corporate tax rate of 30%. Further, OBUs are exempt from interest withholding tax in relation to certain offshore borrowings.

In order to access the concessional tax treatment, an OBU must satisfy certain legislative requirements. Broadly, these requirements include:

a. The activities undertaken by the OBU fall within the eight defined types of activities, including borrowing or borrowing, advisory, investment, trading, eligible contract, guarantee, hedging or any other activity declared in regulations (none have been declared to date); and
b. The other party of the transaction is an “offshore person”.

The OBU rules are complex and Islamic finance structures are not specifically included within the definition of eligible OB activities and the OBU withholding tax exemptions.

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Bahrain, Saudi Arabia and UAE

Bahrain

Corporate Tax

There are no taxes in Bahrain on income, sales, capital gains, or estates, with the exception, in limited circumstances, to businesses (local and foreign) that operate in the oil and gas sector or derive profits from the extraction or refinement of fossil fuels (defined as hydrocarbons) in Bahrain. For such companies, a tax rate of 46% is levied on net profits for each tax accounting period irrespective of the residence of the taxpayer.

In the absence of taxation in Bahrain, the taxability of corporate profits of subsidiaries or branches of foreign banks operating in Bahrain would depend on whether there are bilateral treaties for the avoidance of double taxation with the country in which the branch's head office state is incorporated.

In all other Gulf Corporation Council (GCC) countries, there is some form of taxation on business profits (personal income taxes are still very rare). The taxability of the profits of a Bahrain bank derived from any of the other GCC countries would depend on whether the underlying banking activity was 'offshore' or 'onshore' in relation to this country. As a general rule offshore activity is exempt from tax, whereas onshore activity is taxable.

Withholding Tax

There are no withholding taxes (WHTs) on the payment of dividends, interest, or royalties in Bahrain.

Stamp Duty

Stamp duty is levied on property transfers on the basis of the property value as follows: 1.5% up to BHD 70,000; 2% from BHD 70,001 to BHD 120,000; and 3% for amounts exceeding BHD 120,001.

Indirect Tax

Companies are subject to social insurance in respect of their employees, stamp duties, customs duties, as well as a series of corporate registration fees, licence fees, and certain municipal taxes (e.g. taxes on leases of property and registration of land title). There are currently no VAT or excise duties in Bahrain.

Generally, a customs duty of 5% is imposed on the cost, insurance, freight (CIF) value of imports. Other rates may apply to certain goods, such as alcohol and tobacco, and certain exemptions may also be available.

Saudi Arabia

Corporate Tax

The rate of income tax is 20% of the net adjusted profits. Zakat, an Islamic assessment, is charged on the company's Zakat base at 2.5%. Zakat base represents the net worth of the entity or adjusted net income as calculated for Zakat purposes, whichever is the higher amount.

Only non-Saudi investors are liable for income tax in Saudi Arabia. In most cases, Saudi citizen investors (and citizens of the Gulf Cooperation Council [GCC] countries, who are considered to be Saudi citizens for Saudi tax purposes) are liable for Zakat. Where a company is owned by both Saudi and non-Saudi interests, the portion of taxable income attributable to the non-Saudi interest is subject to income tax, and the Saudi share goes into the basis on which Zakat is assessed.

According to the income tax law, the following persons are subject to income tax:

- A resident capital company to the extent of its non-Saudi shareholding.
- A resident non-Saudi natural person who carries on activities in Saudi Arabia.
- A non-resident person who carries out activities in Saudi Arabia through a permanent establishment (PE).
- A non-resident person who has other income subject to tax from sources within Saudi Arabia.
- A person engaged in natural gas investment fields.
- A person engaged in oil and other hydrocarbon production.

It should be noted that although the income tax rate is 20%, income from select few activities attract different rates.

Withholding Tax

Payments made from a resident party or a PE to a non-resident party for services performed are subject to WHT. The rates vary between 5%, 15%, and 20% based on the type of service and whether the beneficiary is a related party.

The domestic rate for WHT is 5% on dividends, 15% on royalties, and 5% on interest.

Stamp Duty

There is no form of stamp duty, transfer, excise, sales, turnover, production, real estate, or property taxation except in so far as they may fall within the scope of Zakat, which is applicable only to Saudi nationals.

Indirect Tax

Generally, a customs duty of 5% is imposed on the cost, insurance, freight (CIF) value of imports. Other rates may apply to certain goods, such as alcohol and tobacco, and certain exemptions may also be available.

UAE

Corporate Tax

The United Arab Emirates is a federation of seven emirates: Abu Dhabi, Dubai, Sharjah, Ajman, Umm Al-Qaiwain, Ras Al-Khaimah, and Fujairah. Currently, the UAE federation does not impose a federal corporate income tax (CIT) in the emirates. However, most of the emirates introduced income tax decrees in the late 1960s, and taxation is therefore determined on an emirate-by-emirate basis.

Under the emirate-based tax decrees, CIT may be imposed on all companies (including branches and permanent establishments [PEs]) at rates of up to 55%. However, in practice, CIT is currently imposed only on branches of foreign banks and companies that produce, trade in, or trade in rights over oil, gas, or other hydrocarbon products (i.e. oil & gas companies) having operations in the emirate.

In addition, some of the emirates have introduced their own specific banking tax decrees, which impose tax on branches of foreign banks at the rate of 20%.

Withholding Tax

There are currently no withholding taxes (WHTs) in the United Arab Emirates.

Taxpayers resident in the United Arab Emirates have access to an extensive tax treaty network. These treaties may not be immediately relevant for UAE WHTs (which are not imposed under the UAE tax decrees); however, they may continue to allow for other beneficial tax provisions.

Stamp Duty

Currently, there are no separate stamp taxes levied in the United Arab Emirates.

Indirect Tax

The United Arab Emirates does not currently operate a VAT regime. However, the United Arab Emirates has made significant progress towards its introduction, and it is known that the introduction of a VAT is expected in the near future.

Generally, a customs duty of 5% is imposed on the cost, insurance, freight (CIF) value of imports. Other rates may apply to certain goods, such as alcohol and tobacco, and certain exemptions may also be available.

Islamic Finance – Tax Implications

General Overview on the Islamic financing industry/market overview

Bahrain: Bahrain has in recent years rapidly become a global leader in Islamic finance, being home to the one of the largest concentration of Islamic financial institutions in the Middle East. The Central Bank of Bahrain has implemented a comprehensive prudential and reporting framework, made specifically for the concepts and needs of Islamic banking and insurance. Bahrain also contains a number of organisations dedicated to the development of Islamic finance, including the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), the Liquidity Management Centre (LMC), the International Islamic Financial Market (IIFM) and the Islamic International Rating Agency (IIRA).

Saudi Arabia: Saudi Arabia is the largest Islamic banking player in the world in terms of fund volume and the world's second largest holder of Islamic funds (Iran being the largest). Yet the kingdom has no dedicated legal framework for Islamic finance, despite Shariah compliant products and services accounting for almost 40% of banking assets.

The Banking Control Law of 1966 gives the central bank, SAMA, extensive supervisory powers to oversee the licensing and regulation of all banks. This law supports a universal banking model which allows banks to provide a wide range of financial services including retail and investment activity, but at the same time insists on strict regulatory control with high liquidity requirements and minimal exposure.

Saudi Arabia has recently passed a mortgage law which will enable mortgages to be sold within Saudi Arabia. This law regulates real estate financing and investment, and will help Saudi Arabian nationals to obtain Shariah-compliant financing to construct and acquire their homes.

The United Arab Emirates: Home to the first fully fledged Islamic bank (the Dubai Islamic Bank) and most of the world's top banks, Dubai is regarded as the regional hub for Islamic finance and the leading financial center in the Middle East. The Dubai International Finance Center (DIFC) was established in 2004 as a legal and financial free-zone with a specific objective of developing Dubai as a global center for Islamic finance. The DIFC is now home to most of the world's top 20 banks, the world's largest asset managers and insurers, as well as the Nasdaq Dubai which as the largest exchange for Sukuk trading facilitates the primary listing and secondary trading of sophisticated Islamic financial instruments.

Major issues faced within the industry – tax and regulatory-wise

Bahrain: None

Saudi Arabia: There are currently no specific laws governing Islamic finance in Saudi Arabia. Saudi Arabian banks are – unlike insurance operators – not subject to formal Shariah compliance, as both conventional and Islamic banks are governed under the same universal regulatory framework. Saudi Arabia has also not yet made the use of the accounting and governance guidelines issued by the AAOIFI mandatory.

The United Arab Emirates: None

General tax principles/treatment for Islamic products, including any special tax incentives

Bahrain: N/A

Saudi Arabia: From an Income Tax perspective, the profit element payable by the borrowing party will receive the same treatment as interest. Generally, interest payments made by a Saudi Arabian company are deductible to the extent that those charges relate to income that is subject to tax and by applying the following formula, whichever results in the lesser amount:

Total income from loan charges, plus 50% of (income subject to tax other than income from loan charges – allowed expenses other than loan charge expenses)

Banks and financial institutions are not subject to this formula.

However, in case of transactions between related parties, the Department of Zakat and Income Tax may seek to reclassify what they may deem to be excessive interest into dividends or a distribution of profits. There would be no impact in respect of the rate of withholding taxes which is 5% on both dividends and interest payments paid to non-resident beneficiaries. However, any such interest that may be reclassified as dividends would not be deductible for Income Tax purposes in Saudi Arabia.

Any received interest will be subject to Income Tax in Saudi Arabia as ordinary income.

From a Zakat perspective, the principal amount of an Islamic finance instrument received by the borrower will be part of its Zakat base. Correspondingly, there are no restrictions on the deduction from the Zakat base of the profit element paid by the borrowing party. As far as the lender is concerned, the principal amount of the Islamic finance instrument will most likely not be deductible from its Zakat base. Furthermore, any profits received by the lender will be part of its Zakat base.

In any case, any profits as part of an Islamic finance instrument paid to non-resident beneficiaries will be subject to 5% Withholding Tax in Saudi Arabia.

The United Arab Emirates: Some emirates have implemented specific banking tax decrees which impose tax on branches of foreign banks at the rate of 20%.

General comment on the tax treatment of common Islamic financing products / principles (if any):

(i) Sukuk (bonds)

Saudi Arabia: Profits distributed to non-resident certificate holders will be subject to 5% WHT. Furthermore, if not structured properly, a Sukuk may lead to an incremental Zakat liability on a consolidated basis as the principal amount of the Sukuk will as a liability be part of the Zakat base but as a receivable not deductible.

(ii) Ijarah (leasing)

Saudi Arabia: Under certain circumstances, Ijarah may be treated as financial lease.

(iii) Takaful

Saudi Arabia: Takaful is subject to separate regulations

(iv) Mudaraba (profit sharing) – N/A

(v) Musyarakah (partnership)

Saudi Arabia: In certain circumstances, a Musyarakah may be required to file an Income Tax return.

(vi) Murabaha (cost plus) – N/A

Analysis of structures

Sukuk Ijarah:

Saudi Arabia: The cash proceeds received by the owner of the asset as seller are taxed as ordinary income at 20% Income Tax, and/or will be part of the owner of the asset as the seller's Zakat base.

Furthermore, in case the lease of the asset to the owner of the asset as lessee is qualified as a financial lease, the rental payments by the owner of the asset as lessee will generally be deductible for Income Tax purposes in respect of the profit element in rental payment (subject to interest-deduction limitation provisions).

The periodic distributions and cash for sukuk redemption received by the Sukuk Holders will be taxed as ordinary income at 20% Income Tax or will be part of their Zakat base as applicable.

Any periodic distributions and cash for sukuk redemption paid to non-resident Sukuk Holders will be subject to 5% WHT.

Commodity Murabaha financing:

Saudi Arabia: From an Income Tax perspective, the profit payable by Purchaser to Seller are generally deductible, subject to interest-deduction limitations (in case Purchaser is a bank or a financial institution, it will not be subject to the formula-based interest-deduction limitation discussed previously). Correspondingly, this profit will be taxed as ordinary income at the level of Purchaser.

From a Zakat perspective, there are no restrictions on the deduction from the Zakat base of the profit element paid by Purchaser and correspondingly any profits received by Seller will be part of Seller Zakat base.

The United Arab Emirates: In case Seller and Purchaser are subject to the banking tax, the profit paid by may be tax deductible at the level of Purchaser and taxed at the level of Seller.

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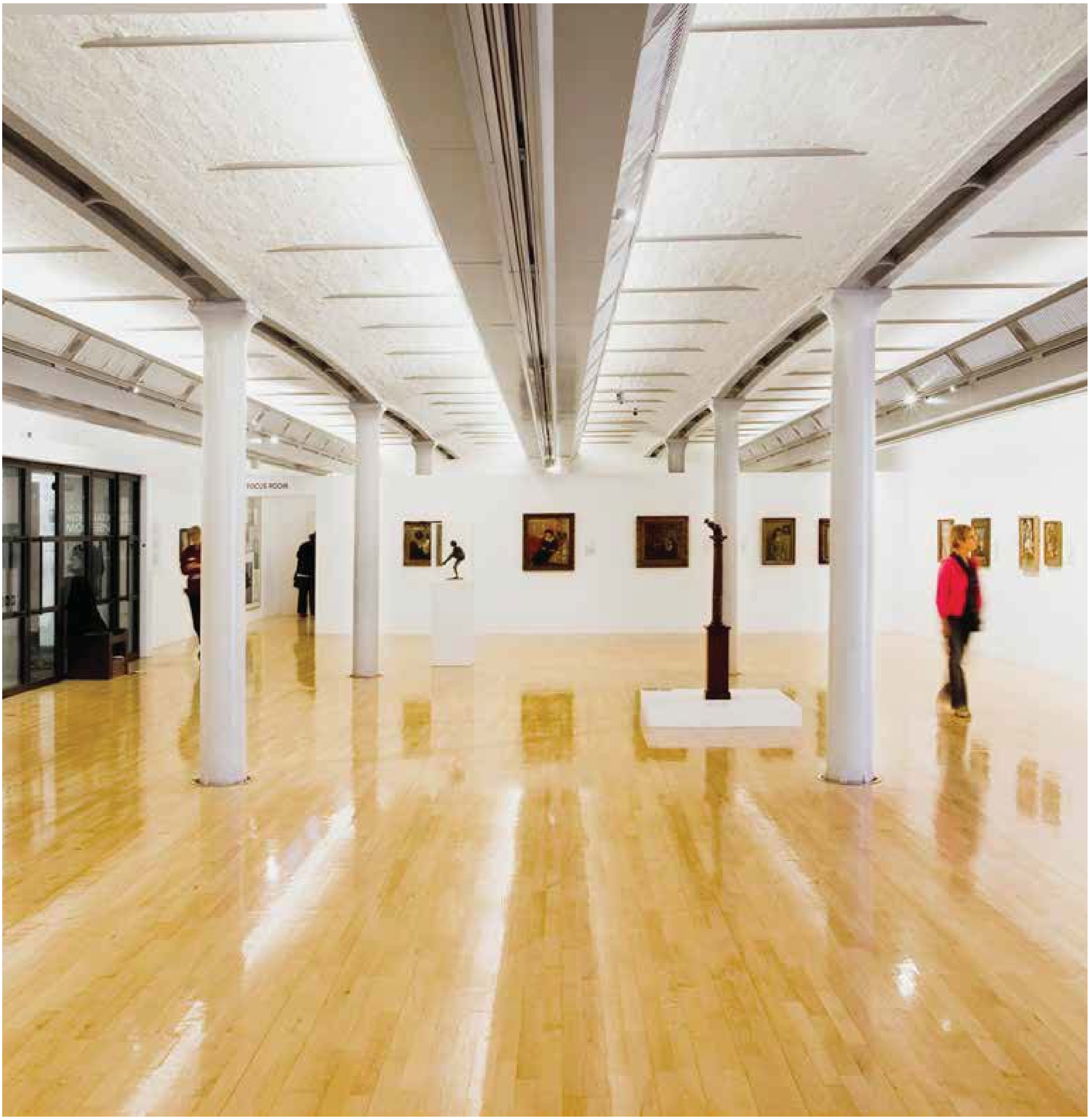
France



Corporate Tax

France levies Corporate Income Tax ("CIT") at a rate of 33.33%. A resident company is subject to CIT in France on its French-source and foreign-source income whose right of taxation is allocated to France by a tax treaty provisions. A non-resident company is subject to CIT in France on income attributable to French business activity or to a French permanent establishment (PE), as well as on income from real estate located in France.

Concerning large size companies, a social contribution tax amounting to 3.3% is assessed on the CIT amount from which a EUR 763,000 allowance is withdrawn.

A CIT surcharge of 5% assessed on the CIT amount is due by companies whose turnover exceeds EUR 250 million. This temporary surcharge is applicable to fiscal years ending on or after 31 December 2011 until 30 December 2013.

Withholding Tax

Withholding tax is only applicable to payments to non-resident corporations and individuals, and is applied to dividends, interest, royalties. The rates for non-treaty countries are as follows:

- Dividends: 30%
- Interest: 0%
- Royalties: 33.33% (50% if the beneficiary is located in a Non Cooperative State or Territory).

However, dividend and interest payments made in a Non Cooperative State or Territory are subject to an increased withholding tax rate (55%) whatever the residence of the beneficiary.

When a non resident company operates business in France through a branch, profits of the latter are deemed to be distributed to non resident investors; branch profits are therefore subject to withholding tax at 30%. However, exemptions are available for non resident companies whose head office in within the EU as well pursuant to tax treaty provisions.

The rates for treaty countries depend on their specific double taxation treaty.

Stamp Duty

In general, France has no significant stamp duties. However, there exists a registration duty which is a form of transfer tax.

Indirect Tax

Various turnover taxes including VAT are assessed on goods sold and services rendered in France. The normal VAT rate is 19.6%.

A specific contribution called CET which is partially assessed on added value is due by entities carrying out business in France . The maximum rate is 1.5%.

Islamic Finance - Tax Implications

General Overview on the Islamic financing industry / market overview and major issues

Structured financing complying with Shariah rules have been used for acquisition of French assets for a very long time. However, until 2007, these Shariah structures were merely based on legal instruments as available under French law and accommodated with the tax environments.

In 2009, the French Government highlighted its ambition for the development of Paris as a platform for Islamic Finance in Europe. Specific working committees which included representatives of the French Ministry of Finances and of the French regulation authority were set up and worked out the possible adaptation of French rules with Islamic finance. The purpose of the French legislator was to build up a corpus of legal, regulatory, accounting and tax rules so as to host Islamic structures and business.

As regards the tax aspects, specific regulations addressing the tax consequences of the various Islamic structures were issued in February 2009 , revised in 2010. These regulations cover the following instruments; Sukuk, Ijara, Istina and Mudharaba with the view to remove the tax discrepancies which would result from a straightforward application of French tax rules and would therefore penalize Islamic financing compared to conventional instruments.

In addition to the tax aspects, French banking authorities have launched a survey on banking and regulatory matters for the purposes of adapting French rules and allowing both the development of Islamic financing and the set up of Islamic banks in France. While discussions with the French regulator have been progressing, the set up of a bank which would comply with Shariah law is not yet feasible under current French law.

Further, a legal analysis has been initiated to make it possible to issue sukuk in France. In practice, very few instruments have been issued under French law and the issuing procedure tend to be lengthy and very burdensome.

General comment on the tax treatment of common Islamic financing products / principles:

i. Sukuk (bonds)

The taxation regime of Sukuk is defined under regulation dated August 24th, 2010; as a main rule, Sukuk are considered as hybrid financial instruments. Under French standard tax rules, this could result in the performance components being treated as a dividend or a gain item.

Subject to conditions, French tax regulation allows for the Sukuk to be treated a pure debt instruments ; as a result, the profit including the expected indexed performance is subject to tax on an accrual basis in the hand of the holder. Symmetrically, the issuer is entitled to deduct the expense on an accrual basis.

Withholding tax exemption available for interest payment also applies on payment made pursuant to a Sukuk.

If the redemption value is based on an index, the investor recognizes a gain or a loss on redemption; this item is subject to the taxation regime of gains on securities.

ii. Ijarah (leasing)

The French tax regime of Ijarah transaction is defined in a specific regulation dated August 24th, 2010. The tax rules depends on whether the agreement can be viewed as a leasing transaction (so called “credit-bail”) or whether it constitutes a renting agreement with a purchase option under French commercial law.

It is subject to various conditions one of them being that the lessor must qualify as a financial institution.

Provided the conditions are met, the Ijarah transaction is subject to the same tax rules as a French leasing transaction; this involves a specific amortization regime for the lessor and the lessee as well as specific rules with regards to registration tax on the transfer of assets.

iii. Mudaraba (profit sharing)

No specific guidance has been published in relation to the French tax regime applicable to Mudaraba. In a draft regulation prepared in 2010, the French tax authorities indicated that tax treatment would depend on whether the Mudaraba agreement relates to an underlying fund or to an investment account.

Although the regulation was not published, the distinction remains valid; a mudaraba with an underlying fund should be treated as investment in an investment fund, while income from a mudaraba based on investment account should be taxed in the same way as interest income. Analysis on a case by case basis is required

iv. Takaful

There are no tax rules relating to Takaful under French law; Takaful agreements need to be analyzed on a case by case basis and will be subject to French taxation according to standard rules.

v. Musyarakah (partnership)

There are no tax rules relating to Musyarakah under French law. These agreements must be analyzed on a case by case basis and will be subject to French taxation according to standard rules.

vi. Murabaha transactions

The regulation applies to Murabaha with a purchase order : for French tax purposes, it is analyzed as a financing transaction whereby a client explicitly requests from a counterparty that the latter finances the purchase of an assets or a portfolio of assets in consideration for a remuneration

The financing mechanism is achieved through a double transfer of ownership with the purchase price on the 2nd transfer including a fee and a revenue for the financing party.

Under French standard rules, a Murabaha transaction could trigger the following specific tax issues:

- both transfer of assets could be subject to registration tax which would involve a double taxation compared o a conventional financing;
- the profit realized by the financing party could be taxed entirely as a capital gain.

In order to eliminate such consequences the regulation states that a specific allowance is granted under which a Murabaha transaction is considered as involving only one transfer of assets. The allowance is granted both for Murabaha transactions on properties and for shares in real estate companies. As a result, the transaction is considered as involving only one property sale; hence the registration tax apply only once as it would be the case under a conventional financing scheme; where the Murabaha transaction relates to shares in a real estate entity, again registration tax will apply only one time.

The profit recognized by the financing party is treated as interest income for the purposes of French corporate income tax (ie. it is taxed over the duration of the contract).

The profit is not considered subject to VAT , similar to an interest payment

Withholding tax exemption applies on the profit if paid to a foreign financing counterparty.

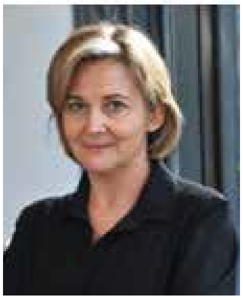
It must be noted that the allowance can only be granted if the financing counterparty qualifies as a financial institution. In addition, the above tax regime is subject to the transaction meeting specific conditions; in particular, the documentation stating expressly the various amounts of the transaction (purchase price / resale price of the assets, commission and profits for the financing counterparty) shall be disclosed distinctively. The documentation shall refer to the French tax regulation.

The applicability of Double Tax Agreements with respect to such Islamic financing.

Cross border transactions fall in the scope of the tax regulations as described above. Provided the conditions are met, the transactions will be qualified as detailed in the regulations and crossborder flows will be taxed accordingly pursuant to the French tax rules for such income/gain.

In this respect, it is worth noting that payments made to a Non Cooperative State or Territory, regardless whether they qualify as dividend, interest or fee payment for French tax purposes may be liable to an increased withholding tax(50 /55%). For payments treated as interest or dividend, this is regardless of the location of the beneficiary.

Double Tax treaties signed by France are applicable to Islamic financing in the same way as for conventional agreements.



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Germany

Corporate Tax

Germany taxes its corporate residents on their worldwide income.

Corporation tax is levied at a uniform rate of 15% and is then subject to a surcharge of 5.5% (solidarity levy).

There is also a trade tax which varies by location from a minimum effective rate of 7% to the Munich rate of 17.1%. The local rates in most cities range between 14% and 16%, whilst those in small towns can be as low as 12%.

If the basis for the two taxes is identical (unlikely in practice), the overall burden on corporate profits earned in Munich would be 33%. In Frankfurt, the burden would be 31.9%. In Berlin, the burden would be 30.2%.

Withholding Tax

WHT is applicable for dividends, interest, royalties and movable asset rentals. The WHT rates are as follows:

Recipient of German-source income	WHT (%)		
	Dividends	Interest	Royalties
Resident corporations and individuals	25	25	0
Non-resident corporations and individuals:			
EU corporations	0	0	0
Non-treaty corporations	25	25	15
Non-treaty individuals	25	25	15

It should be further noted that there is also a solidarity levy of 5.5% on the tax due.

Stamp Duty

The only significant German stamp tax is the real estate transfer tax of, in most parts of the country, 3.5% of the consideration on conveyances of German property. In some federal states, though, the rate is as high as 5%.

This tax is also levied on indirect transfers from the acquisition of at least 95% of the shares in property owning companies. This applies to shares in the shareholder throughout the corporate chain.

Indirect Tax

Proceeds of sales and services effected in Germany are subject to VAT under the common system of the EU at the standard rate of 19% (7% on certain items, such as food and books). Entrepreneurs are generally entitled to deduct the VAT charged on inputs to the extent they provide VATable services or supplies or engage in other privileged transactions.

Customs duties are levied under a common system on imports into the European Union. The rate is set at zero on most imports from EU candidate countries and on many imports from countries with which the European Union has an association agreement.

Islamic Finance in Germany

General Overview of the Islamic Financing Industry in Germany

The Islamic Finance industry is rather undeveloped compared to other European countries such as the UK and France. Apart from one Sukuk which was issued by a federal state and several large investments in real properties, Islamic Finance has bypassed Germany until now.

Despite a population of more than 4 million, the Muslim community has not developed a significant appetite for Shari'ah compliant products. One of the reasons for this lack of interest in Islamic Finance may be the Ponzi scheme which was specifically addressed to practicing Muslims about a decade ago. Countless Turkish families invested in this scheme and lost the largest part of their savings in 2002. Hence, the Islamic Finance industry has had a bad reputation amongst many practicing Muslims.

Furthermore, many Muslims are guest workers who transfer significant parts of their income to their families in their home country leaving little or nothing to invest in financial instruments.

All these factors have prevented the Islamic Finance industry to reach a critical mass in Germany. Nonetheless, some conventional German banks have developed cost efficient and sophisticated Shari'ah compliant financing solutions, in particular, for real estate investments.

Islamic Finance – Tax Implications

Major issues from a tax and regulatory perspective

Shari'ah compliant investments into Germany are exposed to a number of tax risks. Making Islamic investment products as tax efficient as their conventional counterparts may result in very complex structures. Over the past decade, though, the Islamic Finance industry and its service providers have developed quite sophisticated strategies to balance Shari'ah compliance, tax exposure and cost efficiency. Some of these strategies have already been successfully tested in tax audits.

Real Estate Transfer Tax

A number of Islamic investments require a two-step (or more) acquisition of assets; first by a financial institution and then by the investor. Other investments rely on a separation of legal and beneficial ownership.

Both approaches may trigger transfer tax two or more times over, whereas conventional investments would only be burdened with transfer tax once.

Tax deductibility of payments

Depending on the risk-return profile of a transaction and associated control rights, payments to lenders, asset managers and trustees may qualify as profit shares and, thus, might be disallowed for tax purposes.

Interest capping rules

German interest capping rules apply to the difference between a tax payer's interest expense and interest income. Since the income of Islamic lenders may not qualify as interest income, but their financing costs may well be regarded as interest expense, the amount of disallowed interest expense may be significant. Conventional banks would typically not be exposed to such risk.

Add back of financing costs for trade tax purposes

According to German trade tax regulations, parts of certain financing costs should be added back to the trade tax base. Since some financing costs under Shari'ah compliant instruments should not fall into the scope of the add backs whereas their conventional counterparts would, borrowers may enjoy advantages for trade tax purposes if they chose Islamic instruments.

Treaty relief - lender's liability to local taxation

A non-resident lender who grants a conventional loan to a real estate investor would enjoy relief from German income tax under most double tax treaties. Hence, conventional lenders should only be subject to taxation in the jurisdiction where they are based, but not where the property is situated.

Since Shari'ah requires an Islamic financial institution to participate in the business risk, though, a Shari'ah compliant "lender" might be deemed to own a share in the underlying asset. In this event, the lender would not be viewed as receiving interest income, but rental or trading income which would be subject to German income tax and, as the case may be, trade tax.

Withholding tax on profit participating loans

Interest payments to a non-resident lender on loans with a fixed interest coupon should not be subject to German income tax unless the loan would be secured by German real property or similar assets. Many investors use this rule for tax mitigation through related party loans.

Given the Riba-limitations, Islamic investors often find it difficult to use this strategy to reduce their German tax burden. Since profit participating debt and equity instruments attract withholding tax or create a deemed permanent establishment, Shari'ah compliant investments may be exposed to withholding tax or resident taxation, unless they can claim treaty relief. Given the structure of most German double tax treaties, though, tax mitigation often calls for complicated investment structures.

VAT

Conventional loans and most other financial services should enjoy an exemption from VAT. Financial instruments which are Shari'ah compliant as well as related services, though, may attract German VAT at 19%.

No specific tax incentives for Islamic Finance

German tax law does not provide for any particular tax incentives for investments in accordance with Shari'ah.

Regulatory environment

Various Shari'ah compliant financial instruments are not subject to the German Banking Act and consequently, do not require a banking license. For instance, Murabahah, Tawarruq and Istisnaa arrangements should not call for a banking license. Depending on the terms and conditions of an Ijarah or Mudarabah, however, a banking license may be required.

The Takaful concept is similar to German cooperative insurances and should call for an insurance license.

Tax treatment of common Islamic Finance products

Sukuk

Basically, Sukuks should be viewed as debt instruments like conventional bonds. Consequently, investors should recognize interest income and the issuing entity/special purpose vehicle should be entitled to deduct interest expense within the limits of German interest capping rules and transfer pricing regulations. Interest payments to non-resident investors would attract German withholding tax, if the Sukuk would be viewed as a profit participating rather than a fixed interest bearing loan.

Interest payments should be exempt from VAT with an option for the investor to opt for VAT provided the issuing entity qualifies as entrepreneur for VAT purposes.

Ijarah

In the context of real estate investments, Ijarah agreements would trigger real estate transfer tax at least twice (i.e. upon acquisition of the asset by the lessor and upon transfer of the legal title to the lessee). Therefore, Ijarah agreements are commonly not being used to finance real estate investments in Germany.

The income tax treatment of an Ijarah agreement depends on its terms and conditions. If the agreement would be viewed as an operating lease, all payments to the lessor should be treated as lease payments. The lessor should be able to claim depreciation allowances but may then encounter difficulties under the interest capping rules. The lessee, on the other hand, should be able to deduct all lease payments without limitations under the interest capping rules. The lease of moveable property should be subject to VAT. Hence, operating leases increase the costs for private individuals and VAT exempt corporate customers. The lease of real estate should, basically, be exempt from VAT, but the lessor can opt for VAT provided certain requirements are met.

In case the Ijarah would qualify as a finance lease, payments to the lessor should be split into interest and down payments. The interest portion may be beneficial for the lessor and disadvantageous for the lessee. Since the lessee should qualify as beneficial owner of the underlying asset, the lessee should be able to claim depreciation allowances. Ijarah agreements which qualify as finance lease should be exempt from VAT like their conventional counterparts.

Takaful

Small cooperatives which engage in Takaful may be exempt from corporate income tax and trade tax provided certain requirements are met. Entities which would not enjoy the exemption would be subject to rather light income taxation if they are engaged in life or medical insurance. Such entities, Shari'ah compliant and conventional, should namely be entitled to deduct provisions for premium refunds and other future expenses.

Property insurers, though, would have to subject their profits to corporate income tax and trade tax just like their conventional peers.

Mudarabah and Musharakah

Ordinary Mudarabah and Musharakah should experience the same treatment as conventional partnerships/joint ventures. Hence, all partners would be deemed to maintain a permanent establishment in Germany if the joint venture has a presence in Germany. Furthermore, profit shares of the partners should not be allowed as deductible expense.

Given the above tax consequences, joint ventures should either be formed offshore and operate in Germany through subsidiaries or the partners should strive to make the agreements qualify as ordinary service contracts.

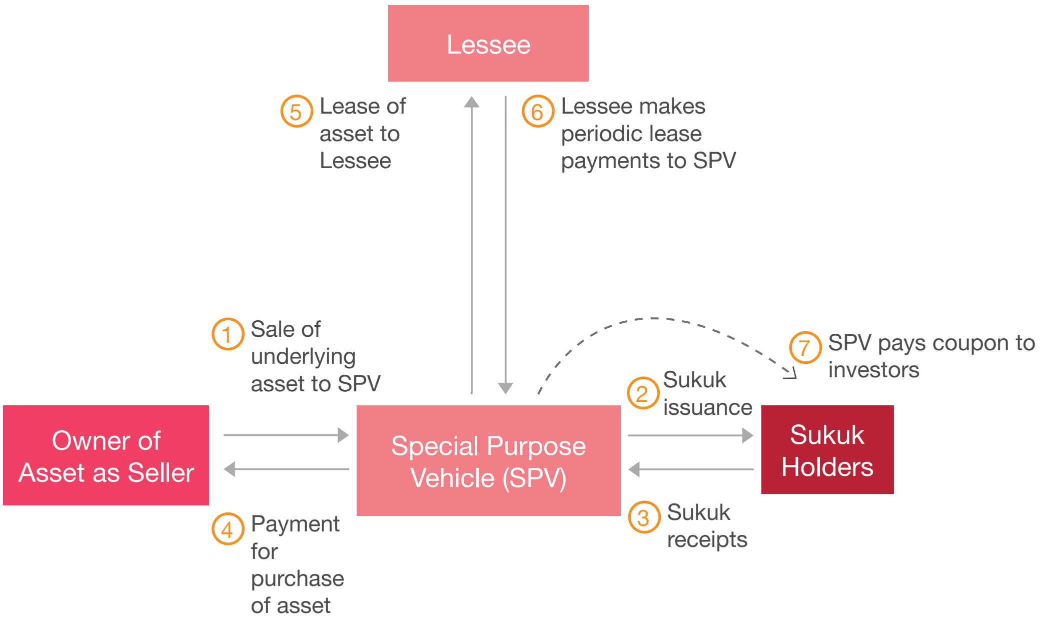
The margin between purchase costs and sales proceeds may not qualify as interest income/expenses. Consequently, the bank may encounter issues under the German interest capping rules due to the lower amount of interest income.

The customer, on the other hand, may be spared from add backs of expenses under the interest capping rules and for trade tax purposes.

The purchase and sale of goods by the financial institution should be subject to VAT. At the level of the financial institution the VAT treatment should be neutral or even advantageous. If the customer is a private individual or an entrepreneur who is not allowed to deduct input VAT, though, the VAT treatment should result in a significant tax burden for the customer.

Conventional loans should be exempt from VAT. Therefore, conventional consumer loans and similar arrangements should have a significant advantage over their Islamic counterparts.

Analysis of Sukuk Ijarah



Transaction Flow

(1) SPV purchases asset from owner

(2)(3) The issuance of sukuk provides the funding for the SPV to purchase assets. This represents beneficial ownership in the asset and lease.

(4) Asset owner receives cash proceeds.

Ijarah (lease) contract

(5) SPV rents property to owner of the asset for a specified period.

(6) SPV receives rental.

Tenure of rental

(7) Rental received by SPV passes to investors in the form of periodic receipts (ie. coupons).

Maturity

SPV sells asset back to its original owner at the pre-agreed price in cash, while simultaneously paying investors cash as sukuk redemption.

Steps 1 and 4 – transfer of title and payment of purchase price to the SPV: If the underlying asset is German real estate, the signing of the purchase agreement should trigger real estate transfer tax. The transfer should be exempt from VAT unless the seller would opt for VAT.

In case the underlying asset would be a moveable property or any other asset which is not subject to real estate transfer tax, the sale should attract VAT. Provided the SPV would qualify as an entrepreneur for VAT purposes and renders VATable services, the SPV should be allowed to deduct the input VAT.

Steps 5 and 6 – entering into lease agreement: In the event the Ijarah agreement would transfer beneficial ownership in real property to the lessee, signing the agreement should trigger real estate transfer tax. In case legal title in the asset would eventually be transferred to the lessee, real estate transfer tax would be triggered a third time. Leasing real property should be exempt from VAT.

The lessor could opt for VAT, provided the lessee is an entrepreneur who renders VATable services or supplies. In case the underlying asset would be a moveable property or any other asset which is not subject to real estate transfer tax, the transaction should trigger VAT.

Steps 2 and 3 – subscription of certificates and collection of capital: Tax neutral

Step 7 – distributions to investors: The payments should attract 25% interest withholding tax unless the recipients would be tax exempt entities, privileged tax payers such as life insurance companies or investors can claim relief under a double tax treaty. German resident corporates would have to pay corporate income tax and trade tax on the interest income, but could claim the withholding tax as a credit against their corporate income tax liability.

Ongoing tax consequences for the SPV during the holding period: If the Ijarah agreement would be viewed as an operating lease, all payments should be treated as lease payments which are subject to corporate income tax and trade tax. If the underlying asset was real estate the SPV may enjoy an exemption from trade tax provided the entity would meet certain requirements. This would bring down the overall income tax burden to less than 16% of the SPV's taxable profits. The SPV should be able to claim depreciation allowances. Within the limits of German interest capping rules, payments to investors should qualify as tax deductible interest expense.

In case the Ijarah would qualify as a finance lease payments to the lessor should be split into interest and down payments. The interest portion should be subject to corporate income tax and trade tax.

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Hong Kong

Corporate Tax

Hong Kong profits tax is chargeable on every person (which includes a corporation, partnership, trustee, whether incorporated or unincorporated, or body of persons) carrying on a trade, profession or business in Hong Kong in respect of profits arising in or derived from Hong Kong from such trade, profession or business (excluding profits arising from the sale of capital assets).

The current profits tax rate for year 2012/13 is 16.5% for corporations and 15% for unincorporated businesses.

The taxable or assessable profits are based on the profits of the business, adjusted in line with specific provisions of the Hong Kong Inland Revenue Ordinance ("IRO"). To arrive at the assessable profits, the taxpayer may deduct expenses which were incurred in the production of taxable income and provided that the applicable tax deduction rules are met. Depreciation expenses are not deductible but the Inland Revenue Ordinance provides for tax deductible depreciation allowances on qualified capital expenditure.

Sums derived from the sale, disposal or redemption of securities may be subject to Hong Kong profits tax where received by or accrued to a person who carries on a trade, profession or business in Hong Kong and the sum has a Hong Kong source and is of trading nature.

A person not carrying on a trade or business in Hong Kong should not be subject to Hong Kong profits tax on its investments in securities in Hong Kong.

Withholding Tax

There is no withholding tax (WHT) on dividends, interest, or royalties. However, the 4.95%/16.5% (for corporations) or 4.5%/15% (for unincorporated businesses) tax on royalties received by non-residents is in effect similar to a WHT.

Stamp Duty

Stamp duty is charged on transfer of Hong Kong stock by way of sale and purchase at 0.2% of the consideration (or the market value if it is higher) per transaction. Hong Kong stock is defined as stock the transfer of which must be registered in Hong Kong.

For conveyance on sale of immovable property in Hong Kong, the stamp duty payable depends on the property consideration and ranges from a flat rate of 100 Hong Kong dollars (HKD) (for property consideration of up to HKD 2 million) to the highest rate of 4.25% of the consideration of the property (for property consideration exceeding HKD 20 million), with marginal relief upon entry into each higher rate band.

For lease of immovable property in Hong Kong, stamp duty is calculated at a specified rate of the annual rental that varies with the term of the lease. Currently, the applicable rate ranges from 0.25% to 1%. Exemption is available to certain transactions.

There is also a Special Stamp Duty (SSD) on resale of residential property within 24 months from the date of acquisition. The SSD is imposed on top of the ad valorem stamp duty payable on conveyance on sale or agreement for sale of residential property, with a few exemptions.

Indirect Tax

Hong Kong does not have a VAT, goods and services tax, or sales tax.

Hong Kong

Islamic Finance - Tax Implications

General Overview on the Islamic financing industry / market overview

It has been the Hong Kong Special Administrative Region ("SAR") Government's policy initiative to develop Islamic finance in Hong Kong with a view to diversifying its financial platform and consolidating it's status as an international financial centre. The policy initiative of developing Islamic finance was first articulated by the Chief Executive of the Hong Kong SAR in his policy address in 2007, which highlighted the potential of introducing Islamic finance and encouraged the development of a sukuk market in the city. As a first step, the focus of Hong Kong SAR Government is to promote the development of a sukuk market in Hong Kong.

Major issues faced within industry - tax and regulatory-wise

The issuance of sukuk often involves more complex structures which may give rise to additional Hong Kong profits tax and stamp duty implications and uncertainties under the existing tax legislation of Hong Kong, thereby putting sukuk at a disadvantage as compared with their conventional counterparts. For example, if the underlying asset involved is Hong Kong immovable property or Hong Kong stocks, additional stamp duty charges will be incurred as a result of the multiple transfers and lease of the underlying asset between the originator and the issuer. In addition, unlike conventional bonds, the coupon payments made by the issuer to sukuk-holders and certain periodic payments from the originator to the issuer may not be tax deductible from the Hong Kong profits tax perspective. Also, the originator of the sukuk may no longer be entitled to tax depreciation allowances associated with the underlying asset since, in legal form, the asset has been transferred to the issuer during the sukuk term.

The Hong Kong SAR Government therefore considers it necessary to align the Hong Kong profits tax and stamp duty treatments of common types of sukuk with those applicable to conventional bonds by making amendments to the Inland Revenue Ordinance ("IRO") and the Stamp Duty Ordinance ("SDO"). In this regard, over the years, the Government has collected the views and ideas from various market players. In March 2012, the Financial Services and the Treasury Bureau ("FSTB") issued a "Consultation Paper" to consult the market on the proposed amendments to the IRO and the SDO with a view to facilitating development of a sukuk market in Hong Kong. The consultation period of the Consultation Paper ended on 28 May 2012. Subject to market feedback, the proposed plan is to introduce the relevant amendment bill in the 2012-13 legislative session. It is uncertain at this stage when and whether or not the proposed amendments would be enacted.

The Consultation Paper proposes to cover four types of sukuk, viz. Ijarah, Musharakah, Mudarabah and Murabahah, which are the relatively more common types of sukuk in the global market. It also proposes to adopt a tripartite structure, comprising an originator, a bond-issuer and bond-holders, as the basis for the framework of the proposed legislative amendments. The Consultation Paper also lists out various essential features and qualifying conditions that must be satisfied in order for the parties involved to enjoy the special Hong Kong profits tax treatment and stamp duty treatment / relief applicable to the sukuk arrangement. In addition, under certain specified circumstances, the special Hong Kong profits tax treatment or stamp duty treatment / relief applied to the arrangement in question may cease to apply or be withdrawn by the Commissioner of Inland Revenue or the Collector of Stamp Revenue which would result in paying back previously exempted tax and duties.

As the above-mentioned proposed amendments to the IRO and to the SDO are still under consultation, it is unclear whether sukuk arrangement would be entitled to any of the Hong Kong profits tax or stamp duty treatment/ relief according to the Consultation Paper. In addition, the Consultation Paper did not mention that the profits tax or stamp duty treatment/ relief can have retrospective effect in relation to sukuk issued before the amendment of the relevant legislation.

Currently, before amendments are made to the IRO and the SDO in relation to sukuk, market players can, under the existing tax framework, make use of the administrative mechanism available under section 87 of IRO and section 52 of SDO to apply for profits tax exemption and stamp duty remission respectively in relation to sukuk issuance. Applications should be submitted to the FSTB and will be considered on a case-by-case basis.

General tax principles / treatment for Islamic products, including any special tax incentives

The general Hong Kong profits tax principles stated in Part 1 would apply to Islamic products. There are no specific tax treatments on Islamic products in Hong Kong under the existing tax legislation.

General comment on the tax treatment of common Islamic financing products /principles (if any):

i. Sukuk (bonds)

The issuer of sukuk needs to assess whether it may be subject to Hong Kong profits tax and whether the payments to the sukuk holders are tax deductible.

ii. Ijarah (leasing)

For Hong Kong profits tax purposes, the expenses of the lessee should be deductible if they are incurred in the production of taxable profits. For the lessor, the taxation of the income should follow the conventional rules.

iii. Takaful

Hong Kong has specific tax rules governing the life and non-life insurance companies. These rules would apply to tax Hong Kong insurance premiums. It is yet to be seen whether and how these rules would be applied to tax takaful.

iv. Mudaraba (profit sharing)

Mudaraba contracts are similar to partnership arrangements in that two or more investors come together to invest in a business venture. From a profits tax perspective, one issue that must be considered is whether or not a "partnership" does in fact exist, specifically because a partnership is a taxable person in Hong Kong. If these arrangements are considered as "partnerships" for Hong Kong profits tax purpose, and the "partnerships" may be subject to Hong Kong profits tax on its profits of trading nature arising in or derived from Hong Kong from the trade or business carried on in Hong Kong. A partnership with corporate partners should be subject to Hong Kong profits tax at 16.5%. The "partners" should be jointly and severely liable to the Hong Kong profits tax of the "partnership".

If these arrangements are not considered as partnerships, the profits tax charging provision should technically be applied and analysed at the level of the investor individually (e.g. whether each particular investor should be considered carrying on a trade or business in Hong Kong through such investment).

The application of the source rules should also be analysed. In particular, if there is a partnership, the source rules should be applied by looking at how the "partnership" derives the profits in question and where the underlying activities took place. If there is no partnership, the source rules may be looked at from the perspective of each investor, e.g. where the investor negotiated and concluded the investment in this venture.

v. Musyarakah (partnership)

The Hong Kong profits tax implications should be similar to Mudaraba. Please refer to the above for details.

vi. Murabaha (cost plus)

Under a conventional deferred sale of goods, interest incurred by a taxpayer would be tax deductible only if the tax deduction rules specific to the interest expense are satisfied. On the other hand, the corresponding interest income derived by the taxpayer provided the financing in Hong Kong should in general be taxable.

For murabaha contracts, the issue is whether the profit mark up is regarded as interest or trading profits and whether the related tax deduction rules and source rules on interest income should be applied. For Hong Kong profits tax purposes, there are uncertainties as to whether one should look through the substance and consider the legal form in order to determine the tax treatment.

Analysis of structures

Sukuk Ijarah

Under a sukuk ijarah, there are uncertainties on the tax treatment of income and payments in relation to the special purpose vehicle ("SPV"). The following tax issues need to be considered:

- Would the full amount of the lease payments be taxable to the SPV, or only the interest component in the lease payments?
- If the gross lease payments are taxable, can the SPV claim tax depreciation on the assets acquired?
- Would the transaction be considered as a sale and leaseback transaction and the SPV be denied depreciation allowances?
- Would the profits distributed to the investors of the sukuk be considered as capital in nature and not tax deductible?
- If the assets involved in a sukuk are immovable properties in Hong Kong, there is also the issue of "double" stamp duty since it would be imposed on the transfer of properties from the owner of assets to the SPV at the inception of the sukuk and again on the transfer from the SPV to the owner at maturity of the sukuk.

As mentioned, before any legislative changes, individual application could be made to FSTB for exemption from Hong Kong profits tax, property tax and /or stamp duty with regard to sukuk if the transaction would give rise to additional tax liabilities under the existing tax regime.

Commodity Murabaha

Commodity murabaha contracts are structured as buying and selling of commodity. In the case of commodity murabaha deposits, the issue is whether the "buy/sell profit" should be taxed for Hong Kong profits tax purposes and how it compares with the tax treatment of conventional deposits for different types of depositors, namely individuals, business (non-financial institutions) and financial institutions.

For individual depositors, interest income from conventional bank deposits is not taxable, but there are uncertainties whether the buy/sell gain from the commodity murabaha deposits would constitute a trade or business carrying on by the individual in Hong Kong and hence the individual would be subject to Hong Kong profits tax.

For business (non-financial institution) depositors, if the buy-and-sell gain is recorded as a disposal gain in the profit and loss account, the locality of the gain will be determined by looking at where the transaction is negotiated and concluded, rather than using the general provision of credit test for interest income. One also needs to consider whether the gain on disposal is capital or revenue in nature. The tax analysis is different from a conventional deposit.

If the depositor is a financial institution, the sourcing rules for disposal gains and interest income are different from individuals and non-financial institutions. In addition, there is also an issue of whether the payment to the customer should be recorded as a trading loss in the profit and loss account (following the legal form) or whether it should be recorded as an interest expense (following the substance). For Hong Kong profits tax purposes, there are uncertainties whether one should look through the substance and consider the legal form in order to determine the tax treatment, given that the tax deduction rules for trading loss and interest expense are different.

The applicability of Double Tax Agreements with respect to such Islamic financing.

The tax treaties entered into by Hong Kong should not have any specific provisions accommodating Islamic finance. However, given that Hong Kong does not impose withholding tax except on royalties, this should not be a significant issue from a withholding tax perspective.

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Indonesia

Corporate Tax

Resident corporations are taxed based on worldwide income.

Taxable business profits are calculated on the basis of normal accounting principles as modified by certain tax adjustments. Generally, a deduction is allowed for all expenditures incurred to obtain, collect, and maintain taxable business profits

Generally, a flat Corporate Income Tax rate of 25% applies to net taxable income. Public companies that satisfy a minimum listing requirement of 40% and certain other conditions are effectively taxed at 20%, while small enterprises are entitled to a 50% tax discount of the standard rate.

In addition, certain types of income are subject to a final income tax at a specified percentage of the gross amount of income, without regard to any attributable expenses. A corporate taxpayer may also be liable for a number of regional taxes and retributions. The rates range from 1.5% to 35% of a wide number of reference values determined by the relevant regional governments.

Withholding Tax

WHT is applied as a final tax on the recipient for payments of royalties, interest, and service fees to foreign non-resident companies. WHT rates are as follows:

Recipient	WHT (%)				
	Dividends		Interest	Royalties	Branch profits
	Portfolio	Substantial holdings			
Resident corporations	15	0	15	15	N/A
Resident individuals	10	10	15	15	N/A
Non-treaty, non-resident corporations and individuals	20	20	20	20	0/20

Stamp Duty

Stamp duty is nominal and payable as a fixed amount of either IDR 6,000 or IDR 3,000 on certain documents.

Indirect Tax

With a few exceptions, VAT is applicable on deliveries (sales) of goods and services within Indonesia at a rate of 10%. VAT on export of goods is zero-rated while the import of goods is subject to VAT at a rate of 10%. Zero-rated VAT is also applicable on exported services, but subject to a MoF limitation. Currently, only certain exported services, including toll manufacturing services, are subject to the 0% VAT rate.

The VAT law allows the government to change the VAT rate within the range of 5% to 15%. However, since the enactment of the VAT law in 1984, the government has never changed the VAT rate.

In addition to VAT, some goods are subject to Luxury-goods Sales Tax (LST) upon import or delivery by the manufacturer to another party at rates currently ranging from 10% to 75%.

Import duty is payable at rates from 0% to 150% on the customs value of imported goods. Customs value is calculated on cost, insurance, and freight level (CIF).

Islamic Finance - Tax Implications

General overview of the Islamic financing industry/market overview

Despite Indonesia having the biggest Muslim population in the world, the growth of the Islamic finance market is relatively slow. We have seen efforts by the central bank to grow Islamic banking, but this is more to push the Islamic windows to become a stand alone entity.

Indonesia has started to tap the potential Shariah market through the issue of Government and corporate Sukuk instruments since 2002. Sukuk instruments are still not widespread within Indonesia's capital markets. In March 2012, they only represented 4% of total securities issued in Indonesia. Currently, there are only two Sukuk structures which can be issued in Indonesia, which are Sukuk under Mudharabah and Ijarah contracts.

Despite the above, there is huge optimism that the Shariah market in general and Sukuk in particular have the potential to develop both in terms of quantity and type of contracts.

Major issues faced within the industry - tax and regulatory-wise

Some major issues faced within this industry include:

- Perceptions from Sukuk Issuers that the process for corporate Sukuk issue is longer than for a conventional bond issue and the cost of funds under a Sukuk issue is higher than the cost of issuing conventional debt securities.
- No Government guarantees on infrastructure
- Foreign Exchange controls – conversion/repatriation of funds/ cash controls

With respect to taxation, the Indonesia Tax Authority ("ITA") has put a lot of effort into providing tax neutrality to conventional financing. However, up to now, there has only been a handful of tax regulations that particularly cover Islamic finance, which are only high level tax regulations. It is expected that the ITA will issue further guidelines and implementing regulations in the near future.

General tax principles/treatment for Islamic products, including any special tax incentives

The tax treatment set out in the available regulation is not product-based, but rather based on the type of tax or type of agreement (akad). In the absence of a specific rule on Islamic products, the existing tax regulation on conventional business should prevail.

Value Added Tax

Valued Added Tax ("VAT") Law, effective as of 1 April 2010, VAT imposition on Shariah transactions will only be applicable on the delivery of goods from the VAT-able entrepreneur to the party demanding the goods. There is no clear guidance for Shariah-based financial institutions in the VAT Law. The guidance under the income tax regulation should then be relied on for the time being.

The example set out in the Law is of a Murabahah transaction whereby a Shariah bank is financing a purchase of a car for a customer. Under the Shariah financing, the bank will have to purchase the car from the car dealer (VAT-able entrepreneur) and later on sell it to the customer. In the new VAT Law, the VAT-able delivery of goods is considered to be directly from the car dealer to the customer. The interpretation would be that no sale and purchase has been conducted by the bank between the car dealer and the customer, and thus no VAT is due on the legal transaction in which the bank purchases the car from the car dealer and sells it to the customer. The VAT-able event would only be on the initial sale from the car dealer (considered directly) to the customer.

However, Islamic finance is not all about Murabahah. There are other underlying transactions which may involve other types of transactions (non-trading) such as rental, which is also a VAT object in nature, and yet not covered under the Islamic finance part of the new VAT Law, although most of the financial services covered in the negative list of VAT are also applicable for Shariah-based activities.

Income Tax

In 2009, the Indonesian Tax Authority ("ITA") issued a high level Government Regulation which governs two main areas covered:

i. Withholding tax

The withholding tax ("WHT") applicable to Sharia-based business activities is similar to conventional WHT. For example, the tax treatment of interest also applies to compensation for use of a third party's funds not included in the category of company capital. This compensation may be in the form of the third party's right to production sharing, margin, or bonus, according to the approach of the Sharia transaction used.

ii. Deductibility

The third party's right to profit sharing, the margin, and the loss from profit sharing shall constitute a deductible expense. The third party's right to profit sharing is not considered to be a dividend, on the basis that dividends are distributed according to capital investment in the business, which shows business ownership, while profit sharing is distributed in exchange for the use of the third party's funds for a certain period of time, which does not necessarily relate to its business ownership. This regulation contributes significantly to the dispute over whether profit sharing can be interpreted as a dividend, and therefore as a non-deductible expense on the part of the debtor.

The implementing MoF regulations were issued in 2011 to provide further guidelines on:

Income tax treatment on Shariah-based Financing Activities

It defines Shariah financing companies as non-bank financial institutions which conduct financing activities based on Sharia principles.

Sharia principles are defined as Islamic law principles based on a Fatwa (edict) that is issued by an institution authorised to issue a Sharia Fatwa. Therefore, taxpayers need to ensure that any structure used under a Sharia transaction is based on a Fatwa.

It also provides definitions of the types of agreement and structures used in Sharia financing activities.

The tax treatment is summarised below:

Type of activity	Type of agreement	Tax Treatment
Lease	Ijarah	Similar to an Operating Lease
	IMBT	Similar to a Financial Lease with Option Rights
Factoring	Wakalah bil Ujrah	Gain or fee is treated as interest
Consumer financing	Murabahah	Gain or profit margin is treated as interest
	Salam	
	Istishna'	
Credit Card	Not specified	Fee or any other income is taxed in accordance with the ITL
Other Sharia-based financing		
Corporate financing	Murabahah	Gain and/or profit sharing derived by financiers (*Shohibul maal*) is treated as interest
	Murabahah Musytarakah	
	Musyarakah	

Income tax treatment on Shariah Banking

In addition to providing definitions of Sharia Banking and Sharia Principles, MoF-136 also places banks' customers into three categories:

- Investor customers –customers who place their funds in a Sharia bank or Sharia business unit in the form of investment.
- Saving customers - customers who place their funds in a Sharia bank in the form of savings. Savings are defined as funds entrusted by the customer to the Sharia bank in the form of a demand deposit (giro), saving account, time deposit, or in some other similar form.
- Facility receiving customers (Debtor) –customers who receive a fund facility or other similar facility.

Defines the tax treatment based on the type of income, and based on the recipient of the income. The tax treatment can be summarised as follows:

Type of Income	Tax Treatment	
	Bank	Investor/Depositor
Bonus, profit sharing, and profit margin:		
- from a debtor transaction	Income is treated as interest	
- from a transaction other than a debtor transaction	Income is treated in accordance with the normal income tax regulations for the relevant transaction	
Bonus, profit sharing, and any other income from funds entrusted or placed, and funds placed offshore through an Indonesian Sharia bank or an Indonesian branch of an offshore Sharia bank		Income is treated as interest
Customer's income other than that covered by the previous point		Income is treated in accordance with the normal income tax regulations

Bonus, profit sharing, and other fees payable by the bank to their Investors and Depositors, and the amount agreed in the Sharia agreement are deductible, except for the depreciation expense in financing activities which use an Ijarah Muntahiyah Bittamlik ("IMBT") agreement. This is similar to the rule for the lessor in finance lease transactions.

General comment on the tax treatment of common Islamic financing products/principles (if any):

i. Sukuk (bonds)

To date, there is no specific prevailing regulation providing clear guidelines regarding tax treatment of Sukuk transactions.

1. Income Taxes

- The prevailing tax regulations only govern the income tax treatment of Shariah transactions carried out by banks and financial institutions. Questions remain as to whether or not other types of companies, such as an offshore intermediary company in a Sukuk transaction (as an Issuer), can rely on the same tax treatment under these regulations.
- For initial sale and sale back transactions, if the underlying asset is land and/or buildings and there is a legal ownership/title transfer, the sale may potentially be subject to 5% final WHT on the seller's side and 5% duty on the transfer of the title to land and buildings.
- The margin payout from the Issuer to the Sukuk investors is likely to be regarded as 'interest' and the Indonesian Issuer must withhold 20% domestic WHT, or a reduced rate based on the relevant tax treaty rate (provided that Sukuk investors can meet all of the relevant tax requirements e.g. providing a valid DGT form).

2. VAT

- There is unclear VAT treatment on Shariah-based transactions other than murabaha transactions, including Sukuk and other structures with underlying transactions other than goods, such as services or rental.
- Due to the lack of complete guidance provided by the VAT Law, if there is a transfer of legal title of the assets under Sukuk, the initial sale and sale back of assets could potentially be subject to 10% VAT. There are several factors that need to be considered on the imposition of the VAT such as legal entity status, tax residency of the Issuer and the Sukuk investor, VAT-able status of the involved parties, the Sukuk structure and the also type of the underlying assets.

ii. Ijarah (leasing)

Type of Activity	Type of Agreement	Tax Treatment
Lease	*Ijarah*	Similar to Operating Lease
	IMBT	Similar to Financial Lease with Option Rights

iii. Takaful

No tax regulation has been issued concerning tax treatment of Shariah Insurance/ Takaful.

iv. Mudaraba (profit sharing)

Type of Activity	Type of Agreement	Tax Treatment
Corporate financing	*Mudharabah*	Gain and/or profit sharing derived by financiers (*Shohibul Maal*) is treated as interest

v. Musyarakah (partnership)

Type of Activity	Type of Agreement	Tax Treatment
Corporate financing	*Musyarakah*	Gain and/or profit sharing derived by financiers (*Shohibul Maal*) is treated as interest

v. Murabaha (cost plus)

Type of Activity	Type of Agreement	Tax Treatment
Consumer financing	*Murabahah*	Gain or profit margin is treated as interest

Analysis of structures

a. Sukuk Ijarah (see above)

b. Commodity Murabaha

VAT

Based on the given structure, there should be no real sales occurred i.e. the purpose of the sales of commodity is merely to fulfil the Shariah principle for financing activity. As governed by the VAT Law, in the case of shariah financing, the VAT should only be imposed by the supplier (i.e.commodity Broker 1) with respect to sale of VAT-able goods to the commodity Broker 2 which needs the taxable goods.

Withholding Tax ("WHT")

Based on mutatis mutandis concept, interest WHT should be imposed on the profit paid by a purchaser/debtor to seller/financier. The withholding tax is exempted if the financier is an Indonesian resident Bank

The applicability of Double Tax Agreements with respect to such Islamic financing.

In general, the general provisions available on the DTA should also be applicable to Islamic Financing.

Any other major tax matters relevant to Islamic finance.

At this stage, the need for an implementation regulation on Sukuk and insurance space are immenent. The tax neutrality against conventional transaction is so far provided limited to withholding tax treatment. Further tax neutrality (e.g. on VAT for other than goods underlying transaction) is expected to be governed in the near future.

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Japan

Corporate Tax

A domestic corporation in Japan is taxed on its worldwide income. A foreign corporation is taxed only on its Japan-source income.

The taxable income of a corporation is the aggregate income from all sources. There is no specific requirement to differentiate between the types of income. In principle, accounting for tax purposes follows generally accepted accounting principles in Japan, and income of a corporation is determined on an accrual basis.

The corporation tax rates are provided in the table below. While they were reduced, based on the December 2011 Tax Reform, for fiscal years beginning 1 April 2012, a temporary surtax of 10% is being charged, by the enactment of the Special Restoration Tax Law, to the taxpayer of corporation tax for 3 years from the first tax year that begins during the period between 1 April 2012 and 31 March 2015.

Company size and income	Corporation tax rate (%)		Corporation surtax
	Fiscal years beginning before 1 April 2012	Fiscal years beginning on or after 1 April 2012	
Paid-in capital of over 100 million Japanese yen (JPY).	*30.0*	*25.5**	*10% of the corporation tax before certain tax credit etc.
Paid-in capital of JPY 100 million or less, except for a company wholly owned by a company which has paid-in capital of JPY 500 million or more:			
First JPY 8 million per annum.	*18.0*	*15.0**	
Over JPY 8 million per annum.	*30.0*	*25.5**	

In addition, there is also the Enterprise Tax and Inhabitant's Tax, which are imposed respectively on a corporation's income and corporation tax allocated to each prefecture.

The total corporate income tax burden (i.e. effective tax rate) is currently in the range of 40.69% to 42.05% (in the case of a corporation located in the Tokyo Metropolitan Area) depending upon the size of a company's paid-in capital. The following is the summary of the effective applicable tax rate on each corporation operating in Tokyo:

Tax year	Effective corporate tax rate (%)	
	SMEs	Large corporations
Beginning on or before 31 March 2012	*42.05*	*40.69*
Beginning between 1 April 2012 and 31 March 2015	*39.43*	*38.01*
Beginning on or after 1 April 2015	*37.12*	*35.64*

Stamp Duty

A stamp duty is levied on certain documents prepared in Japan. The tax amount is generally determined based on the amount stated in the document.

Withholding Tax

WHT rates are as follows:

Recipient	WHT (%)			
	Dividends		Interest	Royalties
	Listed	Unlisted		
Japanese corporations	*7*	*20*	*0/20*	*0*
Resident individuals	*10*	*20*	*0/20*	*0*
Non-treaty, non-resident corporations and individuals without a Permanent Establishment in Japan*:	*7*	*20*	*0/15/20*	20

*There is a possibility that they could claim reduced WHT rates through the relevant tax treaty

In addition, income surtax of 2.1% would be levied on the WHT (only the national WHT) for the period from January 1, 2013 through December 31, 2037.

Indirect Tax

Consumption tax (value-added tax or VAT) is levied when a business enterprise transfers goods, provides services, or imports goods into Japan. The applicable rate is 5%. Exports and certain services to non-residents are taxed at a zero rate. Specified transactions, such as sales or lease of land, sales of securities, and provision of public services, are not subject to taxation.

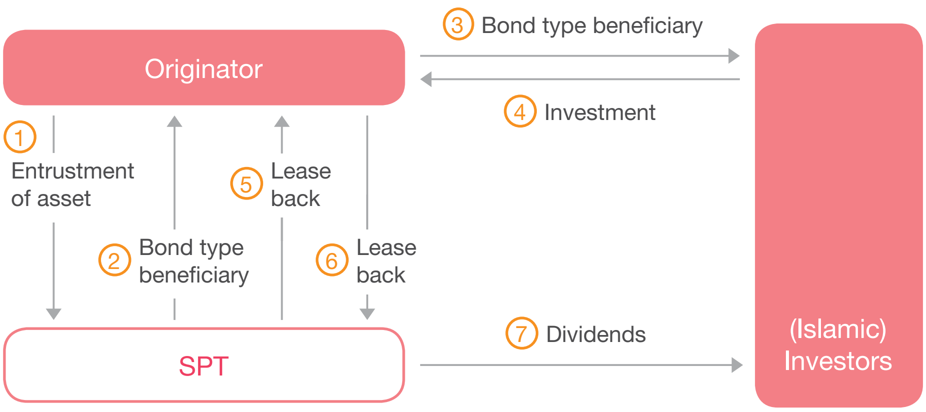
Customs duty is levied on imported goods based on the custom tariff table.

Registration tax and Real estate acquisition tax is levied on transfer of real estate.

General Overview on the Islamic financing industry/market overview

Specific taxation measures for Islamic Finance were introduced in Japan in 2011 in order to attract international investors seeking opportunities to invest in Sharia compliant instruments issued in Japan.

The specific scheme of arrangement proposed by the Japanese Financial Services Agency approximates an Ijarah Sukuk where a bond type beneficiary interest (i.e. a beneficiary where the amount of cash dividends during the trust period is predetermined) being issued by a special purpose trust (SPT). The schematic is depicted as follows:



Japan

Major issues faced within industry – tax and regulatory-wise

The proposed scheme above has not yet been set up in Japan, therefore the potential issues would not come into the open. In practice, the main issue is investor interest given the complexity of a new form of investment when compared to more traditional methods.

General tax principles/treatments for Islamic products, including any special tax incentives

These are the Japanese tax treatment regarding the proposed scheme.

1. Profit distribution and redemption gain derived from book-entry bond type beneficiary interest* received by foreign investors** should be exempt from Japanese withholding and corporate tax in the same manner as book-entry JGBs and corporate bonds;
2. Profit distribution derived from book-entry bond type beneficiary interests* received by designated financial institutions should be exempt from Japanese withholding tax;
3. Capital gain arising from the disposal of bond type beneficiary interests* by foreign investors** should not be subject to non-resident capital gain rules (i.e., generally referred to as the 25/5 rule and real estate holding company rule);
4. Registration tax and real property acquisition tax should be exempt when an originator repurchases the trust assets upon termination of the trust under certain specified conditions; and
5. Dividend from SPT should be deductible under certain specified conditions.

** The qualified is restricted to the beneficiary interest without entitlement to voting rights on ancillary matters*

*** The qualified is restricted to the investors without a PE in Japan*

General comment on the tax treatment of common Islamic financing products/principles (if any):

Currently, only the Ijarah Sukuk scheme has been introduced in Japan.

Analysis of 2 structures and comments on the tax issues/treatment for Sukuk Ijarah AND Commodity Murabaha

Since there is no specific treatment other than the Ijarah Sukuk scheme in existing Japanese tax rules, the Commodity Murabaha scheme must be considered according to general Japanese tax rules and practice. Some of the relevant Japanese tax issues that may arise in the Commodity Murabaha scheme in Japan include:

- The treatment of consumption tax and real estate transfer taxes on the commodity; and
- Whether the payment of consideration which is in economic substance similar to interest should be treated the same as interest.

Brief summary of cross border transactions and the impact of dealing with Islamic securities by entities in Japan and other countries (e.g. Malaysia). The applicability of DTAs with respect to such Islamic financing

As stated the above, any investment income received by foreign investors (without a Permanent Establishment in Japan) on the Ijarah Sukuk scheme would be tax exempt under certain specified conditions.

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Korea, Republic of

Corporate Tax

Resident corporations are taxed on their worldwide income, whereas non-resident corporations with a permanent establishment in Korea are taxed only to the extent of their Korean-sourced income.

The basic Korean CIT rates are 10% on the first KRW 200 million, 20% for the tax base between KRW 200 million and 20 billion, and 22% for the excess. A tax surcharge of 10% on CIT liability for resident companies is assessed each year.

Corporate taxpayers are liable for the minimum tax, which is defined as the greater of 10% (to the tax base of up to KRW 10 billion, 11% on the excess up to KRW 100 billion, 14% on the excess above KRW 100 billion) of the taxable income before various deductions and exemptions pursuant to the Special Tax Treatment Control Law (STTCL) applied to arrive at adjusted taxable income or the actual tax after various deductions and exemptions.

For small and medium enterprises (SMEs), the minimum tax is the greater of 7% of adjusted taxable income or actual tax liability.

Withholding Tax

For dividends, interest, and royalties, the WHT rates are limited as follows:

Recipient	Dividends (%)	Interest (%)	Royalties (%)
Resident corporations	0	14/25	0
Resident individuals	14	14/25/30	0
Non-treaty, non-resident corporations and individuals	20	14/20 (36)	20 (39)

If a foreign company is located in a foreign jurisdiction designated as a tax haven by the Minister of Strategy & Finance, any Korean-source income of such foreign company will be subject to the domestic withholding rate of 20% regardless of whether or not the foreign company is resident of a treaty country.

Stamp Duty

The stamp tax is levied on a person who prepares a document certifying establishment, transfer, or change of rights to property in Korea. The stamp tax ranges from KRW 100 to KRW 350,000, depending on the type of taxable document.

Indirect Tax

VAT is levied at a rate of 10% on sales and transfers of goods and services, except zero-rated goods and services and exempt goods and services.

A securities transaction tax of 0.5% is imposed on the total value of securities at the time of transfer, but the government is authorised to adjust the tax rate in certain circumstances. The flexible tax rate prescribed by the Presidential Decree is 0.3% on transactions in both the Korea Stock Exchange and Korean Securities Dealers Automated Quotations (KOSDAQ).

In addition, there are also customs duties, excise taxes, property taxes and acquisition taxes.

Islamic Finance - Tax Implications

General Overview on the Islamic financing industry / market overview

Notwithstanding the endeavours of the government authority to introduce Islamic finance regime, it has failed to legislate the exemptions on the withholding tax and transaction tax of the Islamic financing due to a religious reason. Under the current Korean tax law, it is still unclear whether the profits should be treated as interest or distribution. And the tax implications of asset transfer and withholding still remain unsolved.

Major issues faced within industry - tax and regulatory-wise

The first issue arising from Islamic financing transaction is how the "profits" should be treated for tax purpose. If the profits are treated as interest, the tax payer can claim a tax deduction; however, if they are treated as distribution, no tax deduction is available for the tax payer. The deductibility of the "profits" may have a significant impact on the feasibility of the Islamic financing transactions.

Also there are tax implications regarding the asset transfer. Transaction taxes such as VAT and acquisition tax are levied whenever there is a change in the ownership of the assets in the absence of specific relief. And capital gains can be crystallized upon change of ownership of the assets. These tax implications may cause a significant impact on the feasibility of the Islamic financing transactions.

Furthermore, there are withholding tax implications of cross border cash flow. If the Islamic financing structure has a onshore SPV, the application of withholding tax will depend on the character of return on Sukuk. In this case, withholding tax exemption is available provided Sukuk is treated as a debt instrument. However, if the Islamic financing structure has a offshore SPV, withholding tax will apply in the absence of specific tax relief depending on the character of underlying cash flow such as rental payment, interest, etc.

General tax principles / treatment for Islamic products, including any special tax incentives

Under the current Korean tax law, the Islamic products are treated without any exceptions or special treatment.

Analysis of structures

i. Sukuk Ijarah

In the absence of special relief for the Islamic Financing under the Korean tax law, general tax implications on the proposed Sukuk Ijarah transaction are as follows.

Withholding tax

The withholding tax implication on the Sukuk Ijarah is discussed above.

Capital gain

Capital gains can be crystallized upon change of ownership of the assets.

Acquisition tax & VAT

The SPV is liable for the acquisition tax of the leasable assets at 4.6% including surtax. Furthermore, the supply of building is a VAT taxable transaction which is subject to 10% VAT.

Also, if the company undertakes to purchase the leased assets upon the expiry of the relevant Ijarah, the acquisition is subject to acquisition tax at 4.6% including surtax. Also the supply of building is subject to 10% VAT.

ii. Commodity Murabahah

Withholding tax

A Profit earned by the Bank may be viewed as business profits and is subject to withholding tax in Korea, subject to treaty relief. On the other hand, the profit may also be considered as an interest income which is subject to final withholding tax, subject to treaty relief.

VAT

If each asset transfer is a taxable transaction, it is subject to 10% VAT. However, if the profit is considered to be an interest income, it is not subject to VAT.

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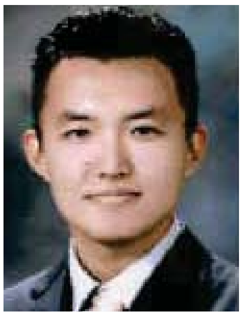

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Kuwait

Corporate Tax

Kuwait does not impose income tax on companies wholly owned by the nationals of Kuwait or other GCC countries, including Bahrain, Oman, Qatar, Saudi Arabia, and the United Arab Emirates. However, GCC companies with foreign ownership are subject to taxation to the extent of the foreign ownership. Income tax is imposed only on the profits and capital gains of foreign 'corporate bodies' conducting business or trade in Kuwait, directly or through an agent.

Income earned from activities in Kuwait shall be considered subject to tax in Kuwait. In cases where a contract involves the performance of work both inside and outside Kuwait, the entire revenue from the contract must be reported for tax in Kuwait, including the work carried out outside Kuwait.

The current tax rate in Kuwait is a flat rate of 15%.

Foreign companies carrying on trade or business in the offshore area of the partitioned neutral zone under the control and administration of Saudi Arabia are subject to tax in Kuwait on 50% of taxable profit under the law.

Zakat is imposed on all publicly traded and closed Kuwaiti shareholding companies at a rate of 1% of the companies' net profits.

Withholding Tax

Apart from the withholding tax (WHT) on dividends arising from trading in the Kuwait Stock Exchange (KSE), there are no other WHTs. However, all government bodies and private entities are required to retain the final payment due to a contractor or subcontractor until presentation of a tax clearance certificate from the Ministry of Finance, confirming that the respective company has settled all of its tax liabilities. The final payment should not be less than 5% of the total contract value.

Stamp Duty

There are no transfer taxes (e.g. stamp duty, real estate) in Kuwait.

Indirect Tax

The Kuwait Tax Law does not currently provide for a VAT. However, we understand that the MOF is considering introducing a VAT in Kuwait by the year 2014.

The GCC states have approved a unified customs tariff of 5% on cost, insurance, and freight (CIF) invoice price, subject to certain exceptions. A higher tariff is imposed on imports of tobacco and its derivatives and other products as notified.

Islamic Finance – Tax Implication

General Overview on the Islamic financing industry / market overview

The Islamic Financing industry in Kuwait dates back to 1977 when Kuwait Finance House was established as the first Islamic Bank in Kuwait. Since then, many banks and financial institutions have followed suit to retain a share in the Islamic Financing market. In the 1990s, several investment and financing companies operating under the principles of Islamic Shari'a were established in Kuwait, and in 2003, the Central Bank of Kuwait issued the Islamic Banking law (Law number 30 of 2003) which brought Kuwait Finance House under the purview of the Central Bank of Kuwait. This opened the door for other Islamic Banks to establish a presence, and in 2005, Boubyan Bank was established as the second Islamic Bank in Kuwait. Subsequently, two conventional Kuwaiti banks (Bank of Kuwait and the Middle East and Kuwait Real Estate Bank) converted from conventional to Islamic to tap into the growing demand for Islamic Finance. In terms of investment and financing companies, the market also witnessed significant growth in the number of investment/financing companies operating under Shari'a principles, and as of May 2012, there were 51 such companies operating in Kuwait, with total financing of KD 464.3 million ($1.3 billion). In terms of Islamic Financing products, Islamic Finance companies in Kuwait provide financing through Murabaha, Ijarah, and Istisna'a contracts. As of the date of this publication, there are no regulations governing the issuance of Sukuk in Kuwait, although some Kuwaiti companies have issued Sukuk in other jurisdictions. The Islamic Finance market has witnessed healthy growth in Kuwait over the last two decades, and the percentage of Islamic Financing to customers as a percentage of total financing by investment and financing companies has increased from 40% in 2007 to 45% in early 2012.

Major issues faced within the industry – tax and regulatory wise

One of the primary issues which has faced Islamic financial institutions is the debt burden ratio (DBR) imposed by the Central Bank of Kuwait on Islamic financing institutions, which currently restricts the amount of monthly instalments a retail consumer can have as a percentage of their total salary. As a reaction to the recent financial crisis, the debt burden ratio was reduced from 50 to 40%, further restricting the retail consumer market's ability to borrow, and in effect, leaving Islamic financing companies with less capacity to lend. Furthermore, the regulator has set a profit rate cap on financing, thus making it increasingly difficult for financing companies to differentiate themselves.

From tax perspective, the Kuwait Tax Law does not include any specific provisions for Islamic financing.

The Kuwait Tax Law is a very brief document and is mainly enforced in accordance with the practices of the Kuwait Tax Authorities. As the Kuwait Tax Authorities have had minimal experience with companies in the Islamic financing industry, certain issues may be expected.

General tax principles/treatment for Islamic products, including any special tax incentives

As mentioned above, the Kuwait Tax Law does not include any specific provisions or special incentives for Islamic financing and the profits of any such companies would be treated as normal business profits.

According to the Kuwait tax law, any body corporate "carrying on trade or business in Kuwait" should submit tax declaration in Kuwait and pay tax on profits earned from such operations. The exception to this rule are companies incorporated within the countries of the Gulf Cooperation Council (GCC) and wholly owned by the citizens of these countries. The Kuwait tax law provides for a flat corporate income tax rate of 15%.

The term "carrying on trade or business in Kuwait" has been defined in the Kuwait tax law to cover the following:

- Lending activities in Kuwait;
- The rendering of services in Kuwait;
- The operating of any office, branch, organization, bureau, administrative centre manufacturing, industrial, or commercial enterprise in Kuwait;
- The purchasing and selling in Kuwait of property, goods, or rights thereto and maintain a permanent office in Kuwait where the contracts of purchase and sales are executed; and
- The letting of any property in Kuwait.

The term "carrying on trade or business in Kuwait" is subject to the widest possible interpretation by the tax authorities to tax all income from Kuwaiti sources. An insignificant presence of employees or short terms visits to Kuwait by the representatives of the company may render the entire revenue from the transactions as taxable in Kuwait. Full value of any agreements signed with Kuwaiti individuals companies or foreign companies operating in Kuwait, including the value of services performed outside Kuwait, would be subject to tax in Kuwait.

Income earned by individuals from carrying on trade or business in Kuwait is not subject to Kuwait tax unless it is proved that such income represents a share to a body corporate.

Analysis of structures

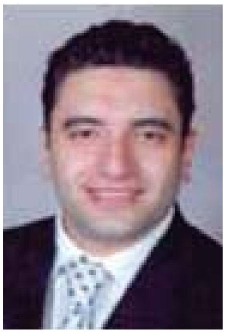
As the Kuwait Tax Law does not provide for any specific provisions for Islamic financing, all profits arising from Kuwait under the above structures and remitted to a company would be considered as taxable in Kuwait at the flat corporate tax rate of 15%.

However, in practice the Kuwait Tax Authorities do not impose corporate income tax on profits received by companies wholly owned by members of the GCC countries. In case of mixed ownership, corporate income tax is imposed to the extent of non-GCC ownership.

The applicability of double tax agreements with respect to such Islamic financing.

The Kuwait tax law does not provide for a particular tax treatment for trading in domestic Islamic securities by foreign companies. Nevertheless, as per the tax law, capital gains realized by foreign companies from speculation activities (sale of shares listed in the Kuwait Stock Exchange ("KSE")) are exempt from tax in Kuwait, however, dividends distributed to foreign companies as a result of their acquisition of securities listed in the KSE are subject to withholding tax at 15%.

DTAs signed between Kuwait and other countries also do not provide for a specific tax treatment for the income related to the Islamic Finance products. However, the DTAs signed by Kuwait follow the OECD Model in its form, thus in most of the cases dividends, which means income from shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights, may be taxed in Kuwait according to the Kuwait tax law (subject to withholding tax at 15%), but if the beneficial owner of the dividends is resident of the other countries the tax is charged at a certain percentage of the gross amount of the dividends (as specified per the dividends article of the DTA).



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Lao PDR

Corporate Tax

All companies (including all forms of legal entities) that are registered under the Lao People's Democratic Republic (PDR) law are subject to Profits Tax (PT) on their worldwide income.

The standard rate of PT for companies in the Lao PDR is 28%. The 28% rate applies to both domestic and foreign investors. Tax holidays are applicable to companies that invest in promoted investment activities and in the promoted zones.

Companies that operate at a loss or have profits below a certain level are subject to Minimum Tax (MT). However, if the company's loss or profit is certified by an independent auditing firm recognised by the government and registered with the Ministry of Finance, MT will not be payable. MT rates are 0.25% of gross receipts for manufacturing companies and 1% of gross receipts for trade and service companies.

For small and medium enterprises (SMEs), the minimum tax is the greater of 7% of adjusted taxable income or actual tax liability.

Withholding Tax

Income Tax (including Personal Income Tax) is regarded as withholding tax. WHT is applied to various types of payments made to domestic and foreign recipients and are as follows:

Payment	WHT rate (%)
Dividends	10
Profit from the sale of shares	10
Interest and guarantee fees	10
Payments for use of trademarks and intellectual property	5

In the case of a foreign recipient, the WHT is considered a final tax.

Personal Income Tax (PIT) rate is 0-28% (progressive rate).

Other Withholding Tax

A WHT on payments to foreign contractors applies where a Lao PDR contracting party contracts with a foreign party that does not have a licensed presence in Lao PDR regardless of whether the services are provided in Lao PDR or outside Lao PDR. The Foreign Contractor Withholding Tax (FCWT) comprises both a PT and VAT element and is intended to be a final tax on the foreign company.

For foreign contractors, PT must be withheld at a deemed percentage of taxable turnover. The deemed rates are determined according to the nature of the contract or activity.

The PT rate would be added to the VAT at 10% to be the total FCWT rate. For example, a Lao company pays LAK 1,000 of service charge to an overseas company (a company registered in a foreign country), the total FCWT rate on the service charge will be 15.6% (5.6% + 10%) and the total FCWT will be LAK 156.

Activity	Deemed profit margin (% of business revenue)	Deemed PT rate (%)
Commerce	5	1.75
Production	8	2.8
Transportation and construction	10	3.5
Service	20	5.6

Stamp Duty

There are stamps in the Lao PDR. But, there are no stamp taxes in Lao PDR.

Indirect Tax

The standard VAT rate is 10%.

VAT is imposed on the final consumer of goods and services. Goods and services used for production, trading, and consumption in Lao PDR, goods imported into Lao PDR, and services rendered by foreigners to Lao PDR customers are subject to VAT. Certain goods and services are exempt from VAT.

Exported goods and services are zero rated. The conventional credit method is used to calculate the VAT payable (i.e. output VAT less input VAT). Excess input VAT can be carried forward for six months (extendable). Input VAT for exports is refundable.

One unique feature of Lao PDR VAT is that VAT is charged on withholding taxes (WHTs).

All goods imported into Lao PDR are subject to import duty. Exemptions are available to enterprises operating promoted investment activities. Duty rates range between 0% and 40%.

Islamic Finance - Tax Implications

Treatment for Islamic products including any special tax incentives

There is no special treatment or incentive for Islamic finance transactions in Laos. There is no law or regulation on Islamic Finance in the Lao PDR.

General comment on the tax treatment of comment Islamic financing products/principles

Sukuk (Bond)

If Sukuk is structured based on the contract of exchange such as Ijarah where the Sukuk holders bear no risk, but are entitled to periodical payments of rental/coupon, the rental/coupon received by the Sukuk holders may be regarded as interest of the bond and is exempted from income tax under Article of 56(9). But, if the Sukuk is structured based on the contract of participation such as Musyarakah, where the Sukuk holders and the Corporate bear a joint and several risk in the investment, the profit generated by Musyarakah may be subject to profit tax (CIT) at 28% and the periodic profit paid to the Sukuk holders and the Corporate may be regarded as dividends and subject to income tax of 10%.

Ijarah (Leasing)

In Ijarah (leasing), the rental paid to the lessor is subject to income tax 15% and VAT 10%.

Takaful (Insurance)

Takaful under Wakalah model is similar to insurance. If the Takaful is done based on the Wakalah model and the Takaful Operator is a corporation, the Wakalah fee may be regarded as corporate income and subject to CIT 28%.

In Takaful under Mudharabah model, the participants bear the risk of investment. Therefore, it may be regarded as normal investment. The participants may be regarded as shareholders of a company, and the Takaful operator may be regarded as a company. The operator may be subject to CIT as other enterprises and the surplus obtained by the participants may be regarded as dividend and subject to income tax 10%.

Mudharabah (Profit Sharing)

Investment in a form of Mudharabah (profit sharing) may be regarded as investment by investors in a company. The operator may be subject to CIT 28% and the profit distributed to the participants may be regarded as dividend and subject to income tax 10%.

Musyarakah (Partnership)

This form of investment is similar to partnership under Lao Enterprise Law. The partnership is subject to CIT 28% and the dividend distributed to the partners is subject to income tax 10%.

Murabaha (Cost plus)

The total sale price may be subject to VAT 10%.

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Malaysia

Corporate Tax

For both resident and non-resident companies, corporate income tax (CIT) is imposed on income accruing in or derived from Malaysia. The current CIT rates are provided in the following table:

Type of company	Chargeable income (MYR*)	CIT rate (%)
Resident company (other than company described below)		25
Resident company: • with paid-up capital of MYR 2.5 million or less • that does not control, directly or indirectly, another company that has paid-up capital of more than MYR 2.5 million, and • is not controlled, directly or indirectly, by another company that has paid-up capital of more than MYR 2.5 million.	On the first 500,000	20
	In excess of 500,000	25
Non-resident company		25

Withholding Tax

Withholding tax (WHT) rates in Malaysia are as follows, unless reduced by specific treaties:

Recipient	WTH (%)			
	Dividends	Interest	Royalties	Special classes of income/ Rentals
Resident corporations	0	0	0	
Resident individuals	0	0	0	
Non-resident, non-treaty corporations and individuals:	0	0/15	10	10

Stamp Duty

Malaysia imposes stamp duty, which is payable by the buyer/transferee, on chargeable instruments. Some examples are as follows:

Transaction type	Value chargeable	Stamp duty rate (%)
Sale/transfer of properties (excluding stock, shares, or marketable securities)	Market value	1 to 3
Sale/transfer of stock, shares, or marketable securities	Consideration paid or market value, whichever is higher	0.3
Service/loan agreements	Value of services/loans	0.5

Indirect Tax

A single-stage ad valorem tax (sales tax), at rates ranging from 5% to 10%, is imposed on all goods imported into or manufactured in Malaysia, unless specifically exempted. Service tax is imposed at the rate of 6% on the value of taxable services sold or provided by taxable persons.

A goods and services tax (GST) of 4% was originally expected to be implemented in mid 2011, but its implementation is now delayed indefinitely. When implemented, GST will replace the current sales tax and service tax.

In addition, there are also import and excise duties on a selected range of goods.

Islamic Finance - Tax Implications

General Overview on the Islamic financing industry / market overview

The Malaysian Islamic financial sector is seen as one of the most progressive and attractive in the world given the numerous incentives planned and further liberation in the coming years. Islamic finance players in Malaysia comprise institutions such as Islamic banks, Takaful operators, Islamic unit trusts, and Islamic fund management companies.

Malaysia

To date, Malaysia is home to one of the largest Islamic Banking and Financial Market with Islamic banking assets valued at RM113.5 billion (US$36.6 billion), and Takaful assets at RM6.2 billion (US$2 billion). Malaysia also has an active Islamic money market channelling about RM30 billion - RM40 billion (US$9.7 – US$12.9 billion) a month.

Underlying the Islamic financial sector in Malaysia is a robust regulatory framework that caters to the unique characteristics of Islamic finance. Rigorous standards have been set for corporate governance, transparency, disclosure, accountability, market discipline, risk management and customer protection alongside an effective legal and Shariah framework. The Islamic Banking Act 1983 and Takaful Act 1984 were enacted to govern the conduct of Islamic banking institutions and takaful operators respectively.

Other bodies supporting the Islamic financial sector in Malaysia include banking associations and educational institutions such as the Institute of Islamic Banking and Finance Malaysia, International Centre for Leadership in Finance, and International Centre for Education in Islamic Finance.

General tax principles / treatment for Islamic products, including any special tax incentives

The Malaysian taxation system caters for Islamic Finance by providing tax neutrality to Islamic transactions.

Under Syariah principles, the concept of "interest" is prohibited. The Malaysian tax legislation provides that all gains or profits received and expenses incurred, in lieu of interest, in transactions conducted in accordance with the principles of Syariah would be treated as interest for tax purposes. Therefore, the taxability or deductibility of "profits" would be similar to the treatment of "interest" in a conventional financing arrangement. All tax rules relating to "interest", such as interest withholding tax and tax exemptions will equally apply on the "profits". This ensures that Islamic financing is provided with the same tax treatment as conventional financing

Islamic financing products generally require assets to be the underlying transactions. For example, in a Sukuk Ijarah issuance, there will be a sale of asset and a subsequent leaseback of the asset. Tax neutrality is accorded to Islamic financing transactions where the acquisition and disposal of an asset or a lease pursuant to an approved financing scheme which is in accordance with the principles of Syariah would be ignored for tax purposes.

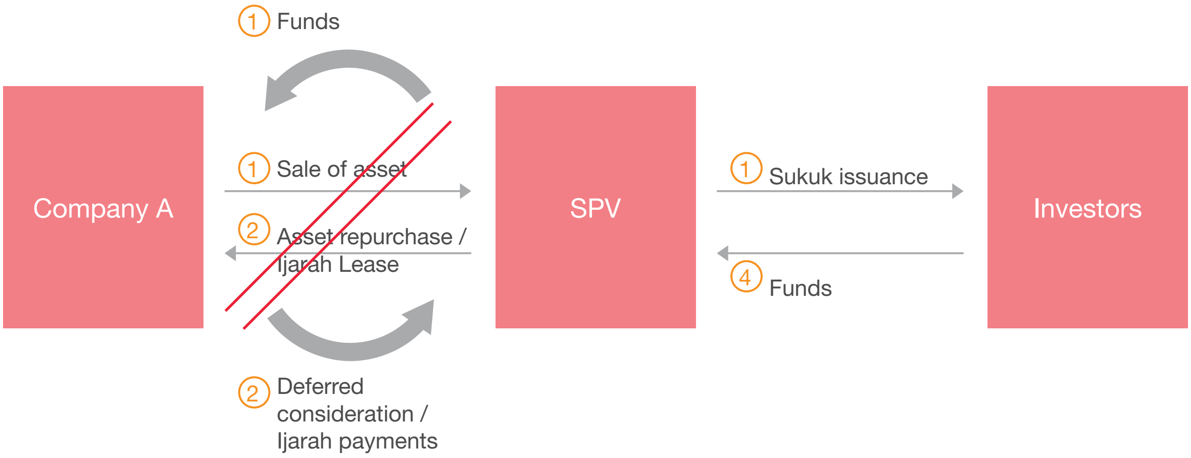


Illustration – Underlying disposal and leaseback ignored for tax purposes

The tax neutrality would be accorded so long as the Islamic Finance transaction has been approved by relevant authorities namely, Bank Negara Malaysia, Securities Commission and Labuan Financial Services Authorities.

The 2 main neutrality principles above effectively negate tax complexities which arise from the legal underlying transactions occurring with all Islamic financial products.

Tax treatment of common Islamic financing products / principles

The tax neutrality rules in Malaysia has facilitated Islamic Finance transactions so that most Islamic financing can be performed with the tax implications similar to conventional financing transactions.

i. Sukuk (bonds)

Sukuk would be treated similar to conventional bonds. Profit payments in lieu of interest would be treated as interest (i.e. tax deductible for borrower, and taxable income to Sukuk holder). Any underlying asset transaction for the purposes of Syariah compliance, depending on the Syariah principle adopted for the Sukuk, is ignored for tax purposes.

ii. Ijarah (leasing)

Islamic instruments adopting the Ijarah concept would be treated as a lease transaction, and subject to the conventional Income Tax Leasing Regulations 1986. Lease rental payments would be tax deductible for the lessee, and taxable income to the lessor.

iii. Takaful

Takaful business would be treated as ordinary insurance business. Contributions to Takaful funds would be taxable for the Takaful operator.

iv. Mudaraba (profit sharing)

Islamic instruments adopting the Mudaraba concept would be treated similar to the conventional financing instrument it takes the form of, most typically a loan. Profit payments in lieu of interest would be treated as interest (i.e. tax deductible for borrower, and taxable income to lender).

v. Musyarakah (partnership)

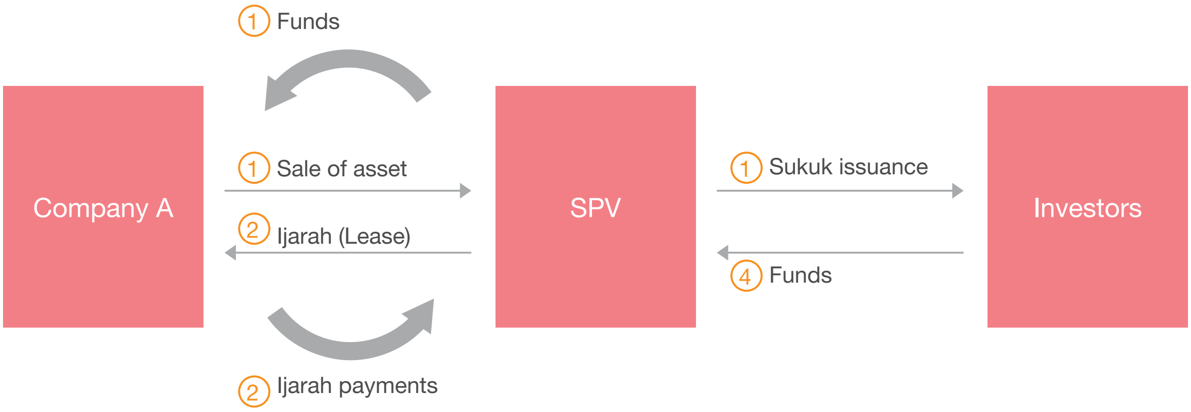
Similarly, Musyarakah financing transactions will be treated similarly to the form of its conventional financing transaction.

vi. Murabaha (cost plus)

Similar comments for Islamic instruments adopting the Mudaraba principle.

Analysis of structures

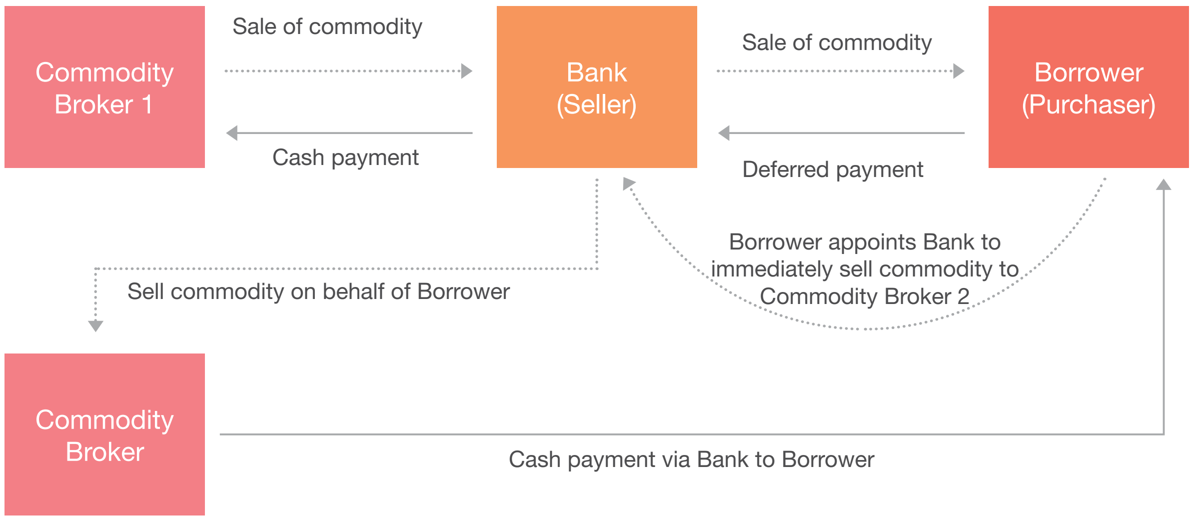
Sukuk Ijarah



Where the Sukuk Ijarah has obtained appropriate regulatory approval, it would be treated as a conventional bond. Profit payments in lieu of interest would be treated as interest (i.e. tax deductible for borrower, and taxable income to Sukuk holder). Any underlying asset transaction for the purposes of Syariah compliance (i.e. the sale and lease back mechanism under the Ijarah principle) is ignored for tax purposes.

Issuance costs are allowed a tax deduction, and stamp duty costs on the issuance of Sukuk Ijarah is exempted.

Commodity Murabaha



Where the financing instrument is structured around a Commodity Murabaha concept and has obtained appropriate regulatory approval, it would be treated as a conventional borrowing / loan. Profit payments in lieu of interest would be treated as interest (i.e. tax deductible for borrower, and taxable income to lender). Any underlying asset transaction for the purposes of Syariah compliance (i.e. the sale and purchase mechanism of commodities under the Murabaha principle) is ignored for tax purposes.

20% stamp duty remission available on Islamic financing.

Tax Neutrality Committee

The Malaysian Government has an informal arrangement where Islamic Finance transactions which need tax neutrality can be provided on a case by case basis. This arrangement allows new and innovative Islamic Finance transactions to be neutral from a tax perspective and facilitates the product to be issued in the market in a timely manner prior to any change in legislation.

The applicability of Double Tax Agreements with respect to such Islamic financing.

Cross border transactions involving non-resident borrowers would be treated in the same manner as conventional borrowings from non-resident borrowers. Islamic 'profits' would be seen as interest for Malaysian tax purposes. Generally, due to tax incentives provided to the Bond market and financial services, there is generally no withholding tax when profits or "interest" is paid to non-residents on Malaysian issued Sukuks or if paid by a licensed bank in Malaysia.

Tax Incentives

As part of the Government's initiatives to spearhead this industry in Malaysia and the branding of Malaysia International Islamic Finance Center, generous tax incentives have been accorded to the Islamic Finance Industry.

Tax exemption of Islamic banks and takaful companies	• Income tax exemption up to Year of Assessment (YA) 2016 for Islamic banks and Islamic banking units licensed under the Islamic Banking Act 1983 on income derived from Islamic banking business conducted in international currencies, including transactions with Malaysian residents; and • Income tax exemption up to YA 2016 for takaful companies and takaful units licensed under the Takaful Act 1984 on income derived from takaful business conducted in international currencies including transactions with Malaysian residents.
Exemption from withholding tax	Income received by non-residents from financial institutions established under the Islamic Banking Act 1983, and other financial institutions approved by the Minister of Finance be exempt from tax as well. This is to streamline tax treatment on profits received by foreign non-resident customers from all financial institutions. Profits paid in respect of Islamic securities/debentures (other than convertible loan stock) to non-residents are exempted from withholding tax. This includes Ringgit securities approved by SC and non-Ringgit instruments approved by SC or Labuan Financial Services Authority (Labuan FSA). Profits paid on non-Ringgit Islamic securities to residents are also exempted if approved by SC or Labuan FSA.
Facilitation of financing transactions	The definition of partnership for tax purpose is very wide and includes all types of partnerships. Hence, any type of partnership, unless specifically excluded, would have to file tax returns. In recognising and promoting Islamic financing structures based on the concept of Musharakah or Mudharabah, such financing transactions need not file partnership tax returns. This is effective from YA 2007.
Human Capital	In encouraging Malaysians to explore Islamic finance as a career choice, tax relief not exceeding RM5,000 (US$1,511) per annum is also provided on Islamic finance courses approved by BNM or SC at local institutions.
Extension of tax deduction on issuance costs of Islamic securities	Extension of an additional five years to 2015, tax deduction on expenses incurred on the issuance of Islamic securities based on Ijarah, Istisna', Mudharabah, Musharakah and other Islamic securities approved by SC or Labuan FSA.
Stamp duty	Further extension of stamp duty exemption of 20% on instruments of Islamic financing products approved by the SAC of BNM or SC up to 31 December 2015. This means that Islamic transactions will suffer less stamp duty by 20% compared to conventional financing instruments. 100% stamp duty exemption up to 31 December 2016 on foreign currency instruments executed by International Currency Islamic financial institutions.

Others	Other tax initiatives include: • Pre-commencement expenses of an Islamic stockbroking company will be allowed as tax deduction so long as the business commences within two years from approval by SC. Applications have to be received by SC before 31 December 2015. • Special purpose vehicles established under the Companies Act 1965 or Offshore Companies Act 1990 which elects to be taxed under the Income Tax Act 1967, solely to channel funds for the purposes of issuance of Islamic securities, is not subject to tax or tax administrative procedures, subject to approval from SC. • Double deduction on certain expenses incurred for the purpose of promoting Malaysia as an International Islamic Financial Centre (MIFC) is extended until YA 2015. • Tax exemption up to YA 2015 on profits derived from the regulated activity of dealing in non-Ringgit sukuk and advising on corporate finance relating to the arranging, underwriting and distributing of non-Ringgit sukuk approved by SC or Labuan FSA.

International Islamic Bank

Market type	International market
Tax exemption	Income tax exemption for International Islamic Bank (IIB) up to YA 2016.
Withholding tax exemption	Withholding tax exemption on: • profits received by resident depositors (individuals) and non-resident depositors (individuals and corporate bodies) • income received by non-resident experts in Islamic finance
Stamp duty exemption	Stamp duty exemption up to 2016 on underlying instruments executed pertaining to Islamic banking businesses conducted in foreign currencies.
Others	Fast and easy immigration approval for expatriates in Islamic finance and their family members. Tax neutrality has been accorded to Islamic financial instruments and transactions executed to fulfill Shariah requirements. Malaysia's tax neutrality framework promotes a level playing field between conventional and Islamic financial products.

International Takaful Operator

Market type	International market
Tax exemption	Income tax exemption for International Takaful Operator (ITO) up to YA 2016.
Withholding tax exemption	Withholding tax exemption on income received by non-resident experts in Islamic finance.
Stamp duty exemption	Stamp duty exemption up to 2016 on underlying instruments executed pertaining to takaful businesses conducted in foreign currencies.
Others	Fast and easy immigration approval for expatriates in Islamic finance and their family members.

Islamic Fund Management Company

Market type	International market
Tax exemption	Income tax exemption for Islamic Fund Management Company (IFMC) on all income derived from a business of providing fund management services to local and foreign investors up to YA 2016.
Withholding tax exemption	Income tax exemption on income received by non-resident experts in Islamic finance.
Others	Fast and easy immigration approval for expatriates in Islamic finance and their family members. Islamic fund management companies are allowed to invest all their Shariah funds abroad.

Sukuk Issuance

Issuer

Special Purpose Vehicles	Issuer	Instruments
• Special purpose vehicles (SPV) established solely to channel funds for the purpose of issuance of Islamic securities (excluding asset-backed securities) approved by Securities Commission (SC) is not subject to tax or tax administrative procedures. This incentive is also extended to SPV established under the Labuan Companies Act 1990 electing to be taxed under the Income Tax Act 1967	• Tax deduction on expenses incurred in the issuance of Islamic securities under certain principles approved by the SC until year of assessment 2015. The incentive is also extended to expenditure incurred on the issuance of Islamic securities approved by Labuan Financial Services Authority (Labuan FSA)	• 100% stamp duty exemption on instruments used to issue sukuk in any international currency by International Currency Islamic financial institutions • Stamp duty exemption on investing and trading of sukuk

Investor

Institutional	Individual
• Tax exemption and withholding tax exemption on interest or profits received by non-resident investors from investment in Islamic securities issued in any currency, other than convertible loan stock, approved by the SC • Tax exemption on profits received by resident and non-resident investors in respect of foreign currency Islamic securities approved by the SC and originating from Malaysia, other than convertible loan stock. This exemption extends to profits received from non-ringgit sukuk originating from Malaysia approved by Labuan FSA	• Tax exemption on interest or profits paid to an individual from investments in: - Securities issued or guaranteed by the Government - Debentures, other than convertible loan stocks, approved by the SC - Bon Simpanan Malaysa issued by BNM • Tax exemption and withholding tax exemption on interest or profits received by non-resident investors from investments in Islamic securities issued in any currency, other than convertible loan stock, approved by the SC. This exemption extended to profits received from non-ringgit sukuk originating from Malaysia approved by Labuan FSA

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Philippines

Corporate Tax

A domestic corporation is subject to tax on its worldwide income. On the other hand, a foreign corporation is subject to tax only on income from Philippine sources.

The following corporate income tax (CIT) rates apply to domestic corporations:

Income	CIT rate (%)
In general, on net income from all sources	30
Minimum corporate income tax (MCIT) on gross income, beginning in the fourth taxable year following the year in which business operations commence. MCIT is imposed where the CIT at 30% is less than 2% MCIT on gross income.	2

Certain passive income from domestic sources is subject to final tax rather than ordinary income tax.

An improperly accumulated earnings tax of 10% is imposed on improperly accumulated income. The tax applies to every corporation formed or used for the purpose of avoiding income tax with respect to its shareholders, or the shareholders of any other corporation, by permitting earnings and profits to accumulate instead of being divided or distributed. Exceptions are made for publicly held corporations, banks and non-bank financial intermediaries, and insurance companies.

Withholding Tax

Corporations and individuals engaged in business and paying certain types of income to non-residents are required to withhold the appropriate tax, which generally is 30% in the case of payments to non-resident foreign corporations or 25% for non-resident aliens not engaged in trade or business.

Stamp Duty

Documentary Stamp Tax is payable at varying rates on various documents and transactions.

Indirect Tax

VAT applies to practically all sales of services and imports, as well as to sales, barter, exchange, or lease of goods or properties (tangible or intangible). The tax is equivalent to a uniform rate of 12%, based on the gross selling price of goods or properties sold, or gross receipts from the sale of services.

Certain sales of services exempt from VAT, including services provided by financial intermediaries, are subject to percentage taxes based on gross sales, receipts, or income. A 3% percentage tax also applies to persons who are not VAT-registered, subject to conditions.

Philippines

Islamic Finance – Tax Implications

General Overview on the Islamic financing industry/market overview

The Philippine government has formally structured Islamic financing activities with the passage of Republic Act (R.A.) No. 6848, known as the "Charter of the Al-Amanah Islamic Investment Bank of the Philippines" in 1990. Under this law, the Bank is allowed to engage in several banking activities based on the Islamic concept of banking.

Al-Amanah Islamic Investment Bank of the Philippines (Al-Amanah Bank) is the first and only Islamic Bank under the supervision of the Bangko Sentral ng Pilipinas (BSP) in the country. It is duly authorized to engage in several financial services such as opening of accounts, foreign exchange transactions, and financing through lease, sale or cost plus sales arrangement.

From 1990 to 2007, Al-Amanah Bank managed its operation with the support of the Bureau of National Treasury.

In 2006, there was a proposed plan to privatize Al-Amanah Bank, which however did not materialize.

The bank was acquired by Development Bank of the Philippines (DBP) in 2008 allowing it to extend financial assistance to micro, small and medium enterprises in Mindanao.

In 2009, the Monetary Board approved the Bank's 5 year Rehabilitation Plan, wherein Al-Amanah Bank is allowed to continuously do both conventional and Islamic banking.

Major issues faced within industry - tax and regulatory-wise

Currently, there are no existing tax laws and regulations covering Islamic products, including any special tax incentives.

General tax principles / treatment for Islamic products, including any special tax incentives

Under R.A. 6848, Al Amanah Bank is entitled to the basic rights of investors applicable to the commercial operations of the Islamic bank such as repatriation of profits and protection against sequestrations or nationalization.

In the early stage banking operations of Al Amanah Bank, it has enjoyed tax incentives such as:

(i) exemption from all national taxes from year 1 to year 8 of the operations with certain limitations;

(ii) tax exemption of earnings from investment in Islamic banking activities except income tax;

(iii) investment tax allowance shall be permitted as a deduction from taxable income subject to certain conditions;

(iv) exemption from customs and duties during the first 5 years of the operations.

The aforesaid tax exemption privilege shall cover only internal revenue taxes for which the Bank is directly liable. It shall not include taxes which are payable by persons merely doing business with the bank.

The incentives mentioned in (i) and (iv) above ended in 1997 and 1994, respectively. We are not aware of any law extending the tax incentives granted to Al-Amanah Bank.

General comment on the tax treatment of common Islamic financing products / principles (if any):

Currently, there are no existing tax laws and regulations covering Islamic banking products. As such, the Philippine tax treatment is the same as that applying to conventional transactions:-

i. Sukuk (bonds)

Sukuk transactions are subject to the following taxes:

(a) Documentary Stamp Tax (DST)

0.50% of the face value of the bonds issued to the Sukuk holders

(b) Final withholding tax (FWT)

The return is considered interest for tax purposes as the Al Amanah Charter does not change the nature of the financial arrangements.

- Residents

  20% shall apply to coupon payments made to resident Sukuk holders (applicable to both corporations and individuals as the sukuk is considered deposit substitutes

- Non-residents

  20% FWT on coupon payments made by the Special Purpose Vehicle (SPV) to the non-resident corporation Sukuk holders.

25% FWT for non-resident alien individuals not engaged in business in the Philippines.

The above rates may be reduced under the relevant tax treaty. Note, however, that an application for tax treaty relief must be filed with the tax authorities before the first taxable event to avail of the tax treaty benefits.

ii. Ijarah (leasing)

If the SPV maintains ownership of the property leased, the tax authorities may classify the transaction as an ordinary lease subject to the following taxes:

(a) Income tax on rental income;

(b) Gross Receipts tax (GRT) on the rentals received if SPV is a bank / non-bank financial intermediary (NBFI) or Value-added Tax (VAT) if otherwise;

(c) LBT on gross receipts and

(d) DST on the lease agreement, if involving a real property.

If ownership of the property will be transferred to the lessee after the end of the lease term, it may be considered as a finance lease subject to the same taxes as above.

However, under a finance lease arrangement, the rental amounts received by the bank/SPV shall be divided into two components, namely principal and interest. Only the interest portion shall be subject to GRT.

iii. Takaful

We are not aware of any insurance products of the like or whether the same can be treated as a partnership for having a profit element or an association for the purpose of mutual help.

Nonetheless, partnerships and associations are generally considered corporate taxable entities. The distribution of the profits to the SPV and the client will be considered as dividends. Under the Philippine Tax Code, inter-corporate dividends are not subject to income tax.

iv. Mudaraba (profit sharing)

The tax authorities may treat the pooling of capital and industry by the SPV and the client as a joint venture. As a general rule, a joint venture is taxable as a corporation under Philippine laws.

The distribution of the profits to the SPV and the client will be considered as dividends. Under the Philippine Tax Code, inter-corporate dividends are not subject to income tax.

v. Musyarakah (partnership)

The tax authorities may tax the partnership or joint venture as a corporation.

The distribution of the profits to the SPV and the client will be considered as dividends. Under the Philippine Tax Code, inter-corporate dividends are not subject to income tax.

vi. Murabaha (cost plus)

On its face, the tax authorities may consider two transfers of properties from the seller to the SPV and ultimately to the SPV's clients. Consequently, the set-up will result to two (2) taxable events.

However, the tax authorities may also treat the transaction as one of lending applying the substance over form rule. In such case, the mark up may be treated as interest income. DST applicable to loans may likewise be imposed.

Analysis of structures:

i.Sukuk Ijarah

Generally, the transactions below are subject to the following taxes:

Step 1- Company A sells property to the SPV

(a) Income tax on the gain if the property is considered an ordinary asset. Otherwise, if the property is considered capital asset, the sale shall be subject to 6% final tax based on the selling price or the fair market value (FMV) of the property, whichever is higher

(b) VAT based on the selling price or FMV, whichever is higher

(c) DST on the deed of sale if involving real properties

(d) LBT based on selling price

Step 2- SPV leases the property back to Company A

(a) Income tax on rental income;

(b) Gross Receipts tax (GRT) on the rentals received if SPV is a bank / NBFI or Value-added Tax (VAT) if otherwise;

(c) DST on the lease agreement, if involving a real property;

(d) LBT on gross receipts

Step 3- SPV issues trust certificates and makes coupon payments to investors

(a) DST of 0.25% applies to the issuance of trust certificates

(b) FWT of 20% applies (unless reduced under a treaty) on the coupon payments to non resident investors. A 20% FWT shall also apply to residents. See related comments under Section 2.4 (i) above.

Step 4- Company A buys back the property from the SPV at an agreed price upon maturity then SPV pays investors for sukuk redemption

Taxes mentioned under Step 1 apply in terms of SPV's sale of properties to Company A. However, instead of VAT, GRT will apply on the gain derived from the sale if SPV is a bank / NBFI.

However, if the transaction is considered an equitable mortgage, the taxes mentioned under sale and buyback arrangements mentioned under Steps 1 and 4 above would not apply.

Under Article 1602 of the Civil Code, a contract shall be presumed an equitable mortgage when (a) the price of a sale with right to repurchase is unusually inadequate; (b)

the vendor remains in possession as lessee or otherwise; and

(c) it can be fairly inferred that the real intention of the parties is that the transaction shall secure the payment of a debt or the performance of any other obligation.

In any of the foregoing cases, any money, fruits or other benefit to be received by the vendee as rent or otherwise shall be considered as interest which shall be subject to the usury laws.

The mortgage transaction shall be subject to DST.

ii. Commodity Murabaha

Step 1 - Company A purchases commodities from Broker 1

Step 2 - Company A sells the commodities to Purchaser A at cost plus mark-up on deferred credit terms (original Murabaha contract)

Step 3 - Purchaser A enters into a revolving Murabaha contract with Company A whereby the latter acts as an agent of the former and sells the commodities to Broker 2. The proceeds from such sale will be netted against the Purchaser's payable to Company A

The above transactions may be considered by the tax authorities as regular sales/transfers of properties. As such, the transaction steps above are subject to the applicable taxes e.g., income tax on the gain, VAT on the gross selling price, LBT based on gross receipts.

On the other hand, the tax authorities may also treat the transaction as one of lending applying the substance over form rule. In such case, the mark up will be considered interest.

DST on loan agreements may also be imposed on the amount involved.

The applicability of Double Tax Agreements with respect to such Islamic financing.

Generally, interest and dividend payments to non-resident corporations are subject to Philippine income/ withholding tax at 20% and 30% (15% subject to certain conditions), respectively.

For non-resident alien individuals not doing business in the Philippines, the tax rate is 25%.

The taxes mentioned above may be reduced under the applicable tax treaty.

However, availment of treaty benefits must be preceded by an application for a tax treaty relief.

The FWT rate in terms of the interest payment is 15% for both individuals and corporations while dividend payment to Malaysian residents is subject to the rates of 15% for corporations and 25% for individuals pursuant to the tax treaty between the Philippines and Malaysia.

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Qatar

Corporate Tax

Unless specifically exempt from tax, an entity will be taxable in Qatar if it has generated Qatar-source income, regardless of the place of its incorporation.

Currently, no corporate income tax (CIT) is levied on a corporate entity that is wholly owned by Qatari nationals and Gulf Cooperation Council (GCC) nationals. In addition, the profit share attributable to Qatari shareholding in a company which is partly foreign owned is generally exempt from CIT.

The standard rate of CIT is 10%.

It should be noted that the Qatar Financial Centre (QFC) was established in 2005 to attract companies in the financial services sector. The QFC has its own tax regulations and rules, and the State of Qatar tax laws do not apply to the licensed activities of entities established in the QFC. QFC entities are subject to CIT in respect of activities undertaken pursuant to their QFC licence at the rate of 10%.

Withholding Tax (WHT)

WHT is levied on certain payments made to non-residents in relation to royalties and technical services (the applicable rate is 5%) and on interest, commissions, brokerage fees, directors' fees, attendance fees, and any other payments for services carried out wholly or partly in Qatar (the applicable rate is 7%).

A retention equivalent to the higher of 3% of the contract value or the final contractual payment will apply to branches registered for activities of at least one year until they produce a tax clearance certificate from the Qatar tax authorities.

There is no WHT in the QFC.

Stamp Duty

There are no stamp taxes in Qatar.

Indirect Tax

Qatar imposes no VAT or sales tax on operations in Qatar. However, a GCC wide VAT is under consideration and the expectation is that it will be introduced by 2014-2016.

Customs duties are applied to goods with an origin outside the GCC countries. The general rate is 5% but a different rate may apply depending on the classification of the goods.

Qatar

Islamic Finance – Tax Implications

General Overview on the Islamic financing industry / market overview

The Islamic Finance industry has seen rapid growth in Qatar over the past decade. In 2011, Qatar had a 4.8% share of the total Islamic finance assets in the world. During the same year, the overall volume of Islamic Finance assets in Qatar was recorded at US$ 52 billion. Qatar also had an 11% share of the Sukuk issuances out of all the Organisation for Islamic Cooperation member countries. The growth trends has also been experienced in the Islamic banking sector. From 2006 to 2010, the assets of Islamic banks increased by around 43 percent, which was faster than the rate of expansion of conventional banks' assets over the same period. In 2010, the assets of Islamic Banks amounted to 23% of the overall banking assets in Qatar.

There are a number of Shariah compliant banks and financial institutions in Qatar including, amongst others, Qatar Islamic Bank, Qatar International Islamic Bank, Masraf Al Rayan, Qatar First Investment Bank, QInvest and Al Jazeera Finance. There are also Takaful insurance companies operating in Qatar. The Qatar Takaful Insurance market is however yet to take off with only a single operator thus far in Qatar Islamic Insurance Company.

Major issues faced within the industry – tax and regulatory

In February 2011, in what was a major development in the Islamic Finance industry, the Qatar Central Bank announced that conventional banks with Islamic windows should immediately cease offering Islamic banking services, stop accepting Islamic deposits and close down their Islamic windows by the end of 2011. This decision was partly due to concerns that conventional banks may use conventional funds to support Islamic lending and also to promote the growth of Shariah compliant banks in Qatar. Previously conventional banks were permitted to enter the Islamic Finance market in Qatar.

The applicable tax code (and the regulatory code) depends on where the entity was established. If the Islamic Finance entity is formed in accordance with the laws of the State of Qatar, the laws and tax system of the State of Qatar will apply. On the other hand, if the entity is licensed to operate in the Qatar Financial Centre ("QFC"), it will be subject to the QFC's own tax rules and regulatory framework and the State of Qatar's laws will not apply.

The Qatar tax law does not contain any specific Islamic Finance legislation on Islamic Finance. As a result, the tax position is not straightforward and the normal tax treatment based on the legal form of the transactions may apply. A ruling from the Qatar tax authorities may be required in order to confirm the precise tax treatment.

General tax principles/treatment for Islamic products, including any special tax incentives

As noted above, there are no specific provisions on Islamic Finance transactions in the Qatar tax law. Unless a ruling is obtained from the Qatar tax authorities, the normal tax treatment would apply and accordingly any income generated would be taxable if it is derived from a source in Qatar. Corporate income tax applies at the standard rate of 10% where the entity which has generated the income is resident in Qatar or has a permanent establishment in Qatar. Withholding tax applies on payments made to non-residents which are not connected to a permanent establishment in Qatar at 5% on royalties and technical fees and 7% on interest. The income attributable to Qatari and GCC nationals may be exempt.

The QFC tax law does however have a brief provision which broadly serves to ensure that the tax treatment of Islamic Finance institutions and Shariah compliant transactions is comparable to that of the conventional equivalent. An exemption may also be available for special purpose vehicles established to support or facilitate an Islamic Finance transaction. Local source profits are subject to corporate tax at 10%. There is no withholding tax in the QFC.

Analysis of structures

Under the Qatar tax law, any Qatar sourced income that arises would either be subject to income tax at 10% or liable to withholding tax at the appropriate rate.

The sale of any assets in a Sukuk Ijarah and Commodity Murabaha transaction may give rise to capital gains issues in Qatar where the asset is located and the seller based in Qatar. Any lease rental and interest payments may attract withholding tax. In addition, management fees may be subject to withholding tax where the management agent is based in Qatar. In the event that the underlying asset is real estate, additional complexities may arise.

The QFC law would treat the transactions as the conventional equivalent and, therefore, a Sukuk and Murabaha would expect to be treated as a bond or loan respectively. Local source profits are subject to tax at 10%.

The applicability of Double Tax Agreements(DTA) with respect to such Islamic financing.

Qatar has more than 50 DTAs in place with other countries. Most of these DTAs generally follow the OECD model convention and do not have specific provisions dealing with Islamic Finance transactions. There is no withholding tax on dividends under Qatar's and QFC's tax laws in any event.

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Singapore

Corporate Tax

Companies (resident and non-resident) which carry on a business in Singapore are taxed on their Singapore-sourced income when it arises and on foreign-sourced income when it is remitted or deemed remitted to Singapore.

Tax on corporate income is imposed at a flat rate of 17% for the year of assessment 2012. There is an exemption of up to SGD 152,500 out of the first SGD 300,000 of taxable income.

For qualifying start-up companies, a three-year tax exemption on the first SGD 100,000 and a further exemption of up to SGD 100,000 on the next SGD 200,000 of taxable income are available.

Withholding Tax

Unless a lower treaty rate applies, interest on loans and rentals from movable property are subject to WHT at the rate of 15%. Royalty payments are subject to WHT at the rate of 10%.

The tax withheld represents a final tax, and applies only to non-residents who are not carrying on any business in Singapore or who have no permanent establishment in Singapore. Technical assistance and management fees for services rendered in Singapore are taxed at the prevailing corporate rate, unless specifically exempted or reduced.

Stamp Duty

Stamp duties are levied on written documents relating to stocks and shares at 0.2% and on those relating to immovable property in Singapore at graduated rates of up to 3%.

Indirect Tax

GST is charged at 7% on the supply of goods and services made in Singapore by a taxable person in the course or furtherance of one's business.

Singapore is essentially a free port with minimal import restrictions.

Islamic Finance

General overview on the Islamic Financing Industry

Singapore is well-placed to offer a complete suite of financial products and services, including that of Islamic finance. The Monetary Authority of Singapore (MAS) aims to develop Islamic finance in Singapore by leveraging on its existing strengths in banking, trade finance, and wealth management, insurance and capital markets. MAS adopts a level-playing field approach towards Islamic finance and has accommodated this growing sector within its single regulatory and licensing framework.

In recent years, the diversity of players offering Islamic financial services in Singapore has increased. Regional banks have contributed significantly to the Islamic finance landscape here, bringing with them years of experience and expertise from their home countries. International banks have supported the investments of Singapore players such as AEP Investment Management and Keppel Data Centre Investment Management, who jointly manage the world's first Shari'ah-compliant data centre fund. In addition, a growing cluster of Middle Eastern banks operating in Singapore has begun to offer Islamic financial services. Players in Singapore have established the world's largest Shari'ah-compliant REIT, which draws in conventional and Islamic investors around the world.[1] Together with the local banks who have been serving the market, such diversity will bring about a more vibrant and competitive industry.

To ensure that Islamic finance competes on an equal footing with the broader financial sector, MAS has worked closely with the industry and various government agencies to remove regulatory and tax impediments. As the industry evolves, MAS has reiterated its commitment to continuously refine its regulations to cater to the needs of the market.[2]

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[1] *Reported in "The Next Phase in Islamic Finance" by Ravi Menon, Managing Director, Monetary Authority of Singapore, Opening Address at the 3rd Annual World Islamic Banking Conference: Asia Summit, 5 June 2012*

[2] *Extracted from Opening Remarks by Mr Tai Boon Leong, Executive Director, Monetary Authority of Singapore, at the Islamic Finance News Roadshow Singapore, 13 March 2012*

Singapore

Regulatory treatment of Islamic products

Under the Banking Act, a bank in Singapore is generally prohibited from carrying on non-financial businesses. Because Islamic financing arrangements invariably involve transactions in underlying non-financial assets, there was a need for the MAS to specify a number of Islamic financing arrangements as prescribed businesses which banks may undertake.

Islamic Regulatory Development in Singapore

Year	Regulatory Development
1998	• Islamic financial services available through certain banks in Singapore.
2005	• MAS joined the Islamic Financial Services Board (IFSB). • MAS actively participate in task forces in area like supervisory review, Islamic money market, capital adequacy, liquidity management and solvency requirements for takaful operations.
2007	• Retail murabaha investors were accorded the same regulatory protection as conventional depositors.
2009	• Launch of MAS sukuk facility to help meet regulatory and liquidity requirement for Singapore-based financial institutions. • MAS issued guidelines on the application of the banking regulations to Islamic finance new regulations permitting banks to conduct murabaha interbank placements, ijara, diminishing musharaka financing and spot murabaha.

Major Issues faced within the industry – tax and regulatory-wise

The following are some of the ongoing issues faced within the industry:

1. The Islamic finance space is an evolving one, and Islamic financial institutions will have to commit to remain responsive and relevant to this fast-growing and ever-changing industry and to meet the ongoing regulatory reforms. International institutions like the Islamic Development Bank (IDB), IFSB, Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) and International Islamic Financial Market (IIFM) have been active in developing Islamic finance and global harmonisation of standards. For example, the IIFM in Bahrain supported by financial authorities in Asia and Middle East is working towards greater standardisation of Islamic capital and money markets, including Shari'ah-compliant derivatives; and the IFSB, of which Singapore is a Council member, is active in building awareness and understanding across Asia.

2. Challenges in using Shari'ah-compliance in conventional banks.

3. The number of financial professionals who are well-versed in Shari'ah-compliant products is still relatively small.

General tax principles/treatment for Islamic products, including special tax incentives

Singapore's policy intent has been to align the tax treatment of Islamic financing arrangements with that of conventional financial transactions which are economically equivalent. To achieve this goal, the Singapore government has since 2005 introduced a series of changes. The approach taken has been cautious – the tax changes have been made on a product-by-product basis, where only financing techniques based on Shari'ah compliant principles have been accorded tax symmetry with conventional financial transactions. To date, it remains the government's intention to review the level of market activities on an on-going basis and to include new Islamic financing arrangements within the tax framework as and when the need arises.

Income tax treatment

The principal legislative provision that accords tax symmetry between Islamic financial products and their conventional counterparts can be found in section 34B of the Income Tax Act (ITA). This provision, together with the accompanying subsidiary legislation, applies to prescribed Islamic financing arrangements entered into between financial institutions and their customers. Very broadly, it provides that the tax treatment of interest in relation to any loan, deposit and mortgage will similarly apply to the effective return from prescribed Islamic financing arrangements. Accordingly, the effective return will be excluded from the consideration for the sale and purchase of the underlying asset in a prescribed Islamic financing arrangement.

Effective return in this context means the prescribed return in lieu of interest derived, received or incurred under the arrangement (i.e. it will be treated as interest from both the holder's and the issuer's perspective for tax purposes). In turn, an Islamic financing arrangement means a financing arrangement which is endorsed by any Shari'ah council or body, or by any committee formed for the purpose of providing guidance on compliance with Shari'ah law, and permitted under any written law in Singapore or elsewhere.

At present, the following arrangements have been prescribed under section 34B of the ITA: [3]

(a) Islamic deposit based on the murabaha concept;

(aa) Islamic financing based on the diminishing musharakah concept;

(ab) Islamic financing based on the istisna concept;

(b) Islamic financing based on the murabaha concept;

(ba) Islamic inter-bank placement based on the murabaha concept;

(bb) Islamic inter-bank placement based on the wakalah concept;

(c) Islamic mortgage based on the ijara wa igtina concept; and

(d) Islamic transaction based on the spot murabaha concept.

Concessionary tax rates for financial services providers

As part of the package introduced by the government to encourage more Islamic financing activities to be carried out in Singapore, financial institutions which meet certain criteria may apply to be a financial sector incentive (Islamic finance) company (an "FSI-IF company"). Very broadly, income derived by an FSI-IF company from qualifying Islamic banking and fund management activities may be taxed at a concessionary rate of 5%. Similar to the transaction-specific approach taken for according tax symmetry, only income from transactions arranged in accordance with prescribed Shari'ah concepts are covered under this concession. [4]

Relevant income derived from Shari'ah compliant insurance activities performed by a qualifying insurer is also taxed at 5%.

[3] *Based on the law and practice as at 23 August 2012*

[4] *Currently, in relation to an FSI-IF company that is a bank, the 5% tax concession applies to income from activities structured in accordance with murabaha, ijara wa igtina, musharaka or istisna. The 5% tax concession is also available for income from banking transactions structured in accordance with mudaraba and salam concepts*

General income tax comments on common Islamic financing products/principles

Sukuk (Islamic debt securities)

Islamic debt securities (sukuk) are not one of the prescribed Islamic financing arrangements under section 34B of the ITA. Instead sukuk that constitute qualifying debt securities (QDS) are accorded the same tax treatment as QDS, i.e. will be accorded the concessionary tax treatment that QDS enjoys.

The QDS regime forms part of the measures introduced in the late 1990s to promote the development of Singapore's debt capital markets. Very broadly, debt securities that are arranged by specified financial institutions[5] and that meet certain qualifying conditions will constitute QDS. Interest and certain prescribed payments made in relation to QDS are not subject to withholding tax. In addition, such income derived by specified investors in Singapore will be taxed at a concessionary rate of 10% or 12%, instead of the prevailing tax rate (17% for the year of assessment 2012).

In addition, any amount payable on Islamic debt securities which are QDS and issued during the period 16 February 2008 to 31 December 2013 to all investors will be exempt from tax, provided the amount payable by the issuer is not deductible against any income of the issuer derived in Singapore.[6]

Finally, payout from Islamic debt securities (regardless whether they are QDS) to individuals is exempt from tax in the hands of individuals, provided the income is not derived through a partnership in Singapore or through the carrying on of a trade, business or profession. This provision was introduced to extend the tax exemption for investment income derived by individuals from conventional debt securities (regardless of whether they are QDS) to payout from Islamic debt securities.

Ijara wa igtina (leasing with option to purchase)

Under this arrangement, the difference between the total receipts and the cost of the property paid by the financial institution is the effective return to the financial institution for providing financing. The effective return will be treated as interest for income tax purposes. For a transaction to qualify as an Islamic mortgage based on the ijara wa igtina concept, it must be carried out in accordance with certain prescribed conditions.

Takaful

A 5% concessionary tax rate will be granted for five years to the relevant income derived from specified Shari'ah-compliant insurance and investment activities performed by a qualifying insurer approved for this purpose. The applicant will need to be a company registered under the Insurance Act to carry on insurance business in Singapore; or a person (including a partnership), other than an individual, permitted under the Insurance Act to carry on insurance business in Singapore under a foreign insurer scheme.

Mudaraba (investment-partnership concept)

While guidance has been given by the MAS in relation to investment partnership based on the mudaraba concept, the tax treatment of this product has not been legislated.

Based on the guidance provided by the MAS, payments made by the financial institution to a customer pursuant to a financing arrangement based on the mudaraba concept is the effective return on the sums invested by the customer. This effective return will be treated as interest for income tax purpose, subject to certain prescribed conditions being met.

5 *Including a financial sector incentive (bond market) company approved under section 43Q of the ITA*

6 *For an investor who is a related parry of the issuer, such exemption is further subject to the condition that the sukuk are not substantially held or funded, directly or indirectly, by related parties of the issuer*

Diminishing musharaka (partnership)

Under this arrangement, the difference between the total receipts and the contribution paid by the financial institution is the effective return to the financial institution, and will be treated as interest for income tax purposes. For a transaction to qualify as a partnership based on the diminishing musharaka concept, it must be carried out in accordance with certain prescribed conditions.

Murabaha (Cost-plus concept)

There are two forms of financing transactions based on the murabaha concept that have been prescribed under the legislation: Islamic financing and Islamic deposit. Under this concept, the difference between the selling price and the cost of the asset is the effective return which is treated as interest for income tax purpose. It follows that this amount will be excluded from the consideration for the sale of the asset.

For a financing transaction to qualify as a prescribed Islamic financing arrangement based on the murabaha concept, it must be carried out according to certain prescribed steps.

Analysis of structures

Commentary on Sukuk Ijarah Structure

With regard to Singapore stamp duty, given the necessity to transfer real assets (commonly real estate) into an SPV for the issuances of sukuk, there would be additional stamp duties imposed for such issuances as compared against conventional debt securities.

To facilitate the arrangement and issuance of sukuk in Singapore, stamp duty remission may be granted for sukuk involving immovable property. This is given in respect of any stamp duty in excess of that chargeable in the case of equivalent conventional debt securities. This remission may be granted, upon application, and subject to various conditions.

Commentary on Commodity Murabaha Structure

With regard to Singapore GST, for financing arrangements based on the murabaha concept, the financial institution will need to purchase the underlying asset before on-selling it to the customer at a mark-up. In the absence of specific provisions conferring tax neutrality, the financial institution may not be able to fully reclaim any input tax incurred on the purchase. This is because financial institutions typically make exempt supplies, for which the attributable input tax is generally not creditable. Further, the customer is faced with increased cost as the financial institution is required to charge GST on the entire sales proceeds (including the profit mark-up), as compared to interest under conventional financing being GST-exempt.

To place the GST outcome of a murabaha arrangement on par with a conventional financing arrangement, the following GST treatment will apply to a qualifying murabaha arrangement:

(a) The mark-up charged by the bank will be exempt from GST; and

(b) The bank can claim GST on the purchase of the asset in full (both movable and immovable assets).

With regard to Singapore stamp duty, where the asset is an immovable property, the need to transfer title more than once in a murabaha arrangement could result in imposition of additional stamp duty. This would result in Islamic financing becoming less competitive than comparable conventional financing. Therefore, additional stamp duty chargeable on the instruments related to a qualifying arrangement will also be granted remission.

Any other major tax matters relevant to Islamic Finance

Goods and Services Tax

In general, goods and services tax (GST) is charged on taxable supplies[7] made by a taxable person in the course or furtherance of his business. The standard tax rate is 7%, except for export of goods and international services (as defined) which are zero-rated (i.e. taxed at 0%). Various classes of financial services have been specified as exempt supplies for which GST is not chargeable.

Like in the case of income tax, the Goods and Services Tax Act (GSTA) has been updated to grant tax symmetry between certain Islamic financial arrangements and their conventional counterparts.

It should be noted though that the above treatment applies only to qualifying Islamic financial arrangements as defined – among other things they refer to transactions between a financial institution[8] and a purchaser, and the underlying asset is confined to non-residential real estate.[9] Transactions in other classes of assets are not included, and are to be treated under general GST law.

Stamp duties

Very broadly, stamp duties are imposed on instruments that give effect to transactions in shares in Singapore companies and real properties situated in Singapore.

Islamic financing transactions would invariably require multiple transfers of ownership of assets, including shares and real properties, to and from the financier. For example, in a financing based on the murabaha concept, the financial institution would need to acquire the real property before on-selling it to the customer. This results in two sets of ad valorem duties payable.[10]

Consistent with the approach taken for income tax and GST, stamp duty remission will be available for qualifying Islamic financing arrangements, though these are largely confined to transactions involving financial institutions.

International aspects

Interest and other payments in connection with indebtedness are subject to withholding tax when made to non-residents. The rate of withholding is the prevailing corporate tax rate (currently 17%), although it may be reduced to 15% if the income is not derived by the non-resident from a trade or business carried on in Singapore and that is not effectively connected with a permanent establishment which the non-resident has in Singapore, or to a lower rate under an applicable tax treaty.

There are no specific provisions in Singapore's tax treaties that deal with Islamic financial products. As the effective returns from prescribed Islamic financing arrangements are treated as interest for tax purposes, it is likely that the tax authorities will view them as falling under the interest article of the tax treaties which Singapore has concluded with its treaty partners. This is particularly so if the treaty definition of interest includes payments that are assimilated to income from money lent under Singapore law.

However, it remains unclear whether the payouts from Islamic financing transactions that have not been prescribed under section 34B of the ITA or those sukuk that do not constitute QDS will be treated as interest or in the nature of interest, such that they are subject to withholding tax when made to non-residents.

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[7] *A taxable supply is a supply of goods or services made in Singapore other than an exempt supply*
[8] *If the party to the transaction is not a financial institution, it is generally expected that it should not face a significant problem with reclaiming input GST, as it should be making taxable supplies*
[9] *Transactions in residential real estate are exempt supplies for which no GST needs to be charged*
[10] *In relation to transfer of real property, the duty is approximately 3% of the amount or value of consideration*

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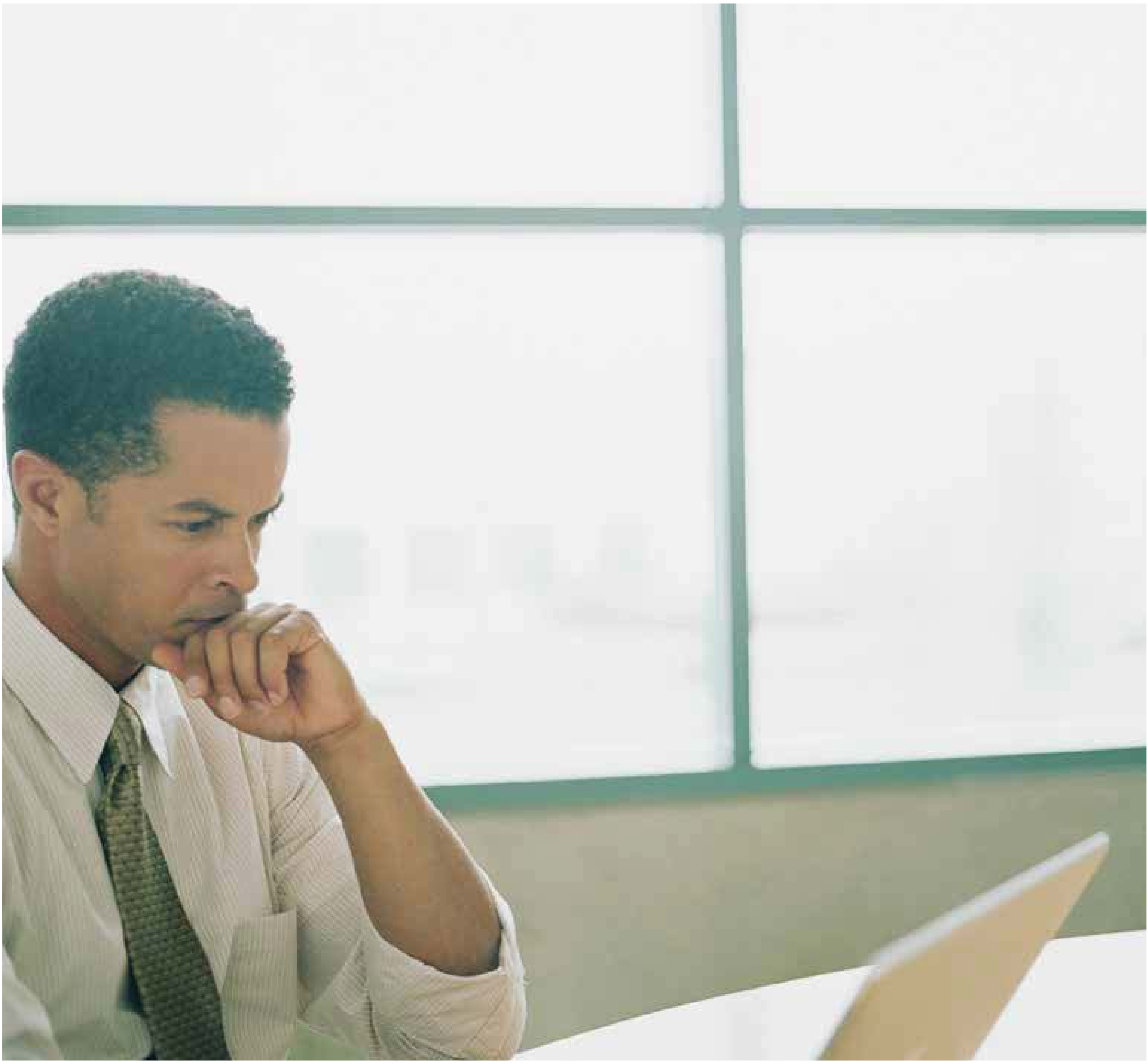

Corporate Tax

A South African-resident company is subject to normal corporate income tax on its worldwide income, irrespective of source. Non-resident companies are taxable on income received by or accrued from a source in South Africa, subject to the provisions of double tax agreements. The normal corporate income tax rate applicable to companies for tax years ending between 1 April 2012 and 31 March 2013 is a flat 28%.

Withholding Tax

Royalties payable to non-residents

Royalties and know-how payments made to non-residents for the use of or right to use intellectual property rights in South Africa are deemed to be from an SA source. The payer of the royalty or know-how payment is obliged to deduct a withholding tax of 12% of this payment, which is a final tax payable by the recipient of such income. The withholding tax percentage may be reduced by the relevant Double Tax Agreement between the respective countries.

Dividends payable to non-residents

A dividend withholding tax of 15% applies from 1 April 2012 to any dividend paid by a resident company or non-resident company in respect of shares listed on an South African exchange to South African residents. The tax is imposed on the beneficial owner of the dividend and not on the company, with the exception of in specie dividends. The payer of the dividend or regulated intermediary is obligated to deduct the 15% withholding tax from the payment.

Interest payable to non-residents (as of 1 January 2013)

Currently, South Africa does levy withholding tax on interest paid to non-residents. However, a 10% withholding tax on interest will apply to interest payable to non-residents that are not a controlled foreign company ('CFC') on certain debt instruments from 1 January 2013 on interest from an SA source. The resident payer of the interest is obligated to deduct the 10% withholding tax from the payment. Draft amendments propose to increase the rate to 15% and defer the effective date to 1 July 2013.

Double tax agreements

The withholding tax percentages in respect of royalties, dividends and interest may be reduced by the relevant Double Tax Agreement between the respective countries.

Transaction Tax

Securities Transfer Tax ('STT') is levied at a rate of 0.25% of the taxable amount in respect of the transfer of a security. The taxable amount is usually the consideration for which the security is purchased or the market value of the security, if the consideration declared is less than the market value or if no consideration was paid. STT is payable by the company that issued the securities in question. However, the company can recover the tax from the person acquiring the shares. Slightly different rules apply in the case of listed securities.

Transfer duty levied on the sale of immovable property and is payable by the person acquiring the property. The transfer duty payable depends on the purchase price of the property and ranges from 0% - 8%.

Indirect Tax

Value-added Tax ('VAT') is an indirect tax, which is largely directed at the domestic consumption of goods and services and at goods imported into South Africa. The tax is designed to be paid mainly by the ultimate consumer or purchaser in South Africa. It is levied at two rates, namely a standard 14% rate and a zero rate (0%).

Islamic Finance – Tax implications

General Overview on the Islamic financing industry / market overview

South Africa has established a developed banking system which is in line with those in many developed countries. As South Africa's favourable banking system sets it apart from many other emerging market countries it has an opportunity to position itself as a leader in the Islamic finance industry in Africa. This will create more opportunities for foreign investment into South Africa as well as new business opportunities. Although the market share of Islamic finance is still small in comparison with conventional banking, it is expected that Islamic finance will become an important player in the South African finance sector in the near future. Banking institutions operate mainly through Islamic Finance "windows" with limited fully fledged Islamic Finance banks.

Major issues faced within industry - tax and regulatory-wise

As a general matter, the starting point for determining the tax consequences of any transaction is form. However, the concept of form in the arena of Sharia compliant products largely works against taxpayers because taxpayers lack this full freedom of control as a result of religious principles. These deviations in form often deprive investors of certain tax benefits available to conventional finance. In other instances, Islamic form can actually act as a tax barrier to tax cost-effective finance that can readily be performed by conventional counterparts. In 2010, the South African Revenue authorities acknowledged that tax had become a hindrance to a vibrant and growing Islamic financial market and specific provisions were added to the various tax acts in an effort to place Islamic finance on an equal footing with conventional finance. As part of this reform, the tax system was amended to accommodate the following forms of Sharia compliant arrangements: (i) diminishing musharaka, (ii) mudaraba, and (iii) murabaha. Although these specific provisions dealing with Islamic financing have been included in the South African Income Tax Act 58 of 1962 ('SA Income Tax Act') the effective date of these provisions has not been announced by the Minister of Finance.

However, creating an enabling framework for Islamic finance requires more than enacting accommodating tax legislation. For example, Islamic financing, like conventional financing, requires government bonds as a "risk-free" standard so as to set the pricing for all other privately issued Islamic bonds. Moreover, Islamic finance providers typically utilise (and even require) Government bonds for regulating cash-flow and for balancing portfolios.

In the case of banks, the need for Government-issued Islamic bonds is more acute. All banks must hold a certain percentage of investments in interest bearing instruments (including Government bonds) in terms of South African banking regulations. Yet, Islamic banks are precluded from yielding economic benefits from interest bearing investments according to Sharia law, even if required by local banking regulations. To balance both religious and regulatory interests, Islamic banks surrender the interest received in respect of these investments. This lack of return places Islamic banking at a competitive disadvantage in comparison with conventional banks, thereby lowering the overall yield of Islamic savings products.

In 2011 further provisions were introduced into the South African tax legislation to accommodate South Africa Goverment Sukuk. The effective date of these provisions are however yet to be announced. To date the South African Government has not issued any form Sukuk, however it is expected that such instruments will be issued in the near future.

General tax principles / treatment for Islamic products, including any special tax incentives

Specific provisions dealing with Sharia compliant financing arrangements have been included in South African tax legislation; however the effective dates of the various provisions have not been announced by the Minister of Finance.

Income tax

The income tax treatment of four of the more common Islamic Finance products is addressed in the new section 24JA of the SA Income Tax Act. The main objective of this legislation is essentially to treat these products similar to interest-bearing arrangements.

VAT

The new section 8A of the Value-Added Tax Act 89 of 1991 ('SA VAT Act') deals with Sharia compliant financing arrangements, specifically considering murabaha and diminishing musharaka arrangements. The definition of 'enterprise' in section 1 of the SA VAT Act has also been updated to deal with the activities carried on by a trust in instance of a Sukuk arrangement. The VAT treatment of the specific Islamic financing products is discussed in further detail in the section below.

Transfer duty

Where Sharia arrangements require a 'double transfer' of property (i.e. from the seller to the financier and then from the financier to the client) section 3(A) of the Transfer Duty Act of 1949 ('SA Transfer Duty Act') deems the property to be transferred directly from the seller to the purchaser, thus ensuring that there is no double transfer duty charge. In the instance of a Sukuk arrangement the property transfer and subsequent reacquisition is completely ignored and no transfer duty is levied.

General comment on the tax treatment of common Islamic financing products / principles (if any):

i) Mudaraba (Deposit Investment)

A client deposits funds with the bank and, as opposed to offering the client an "interest" return, the bank invests the funds on behalf of the client into so-called Sharia-compliant investment targets. The investment returns (typically dividends and rental or even trading or capital gains on share or fixed property deals, etc.) are then shared between the bank and the client in an agreed-upon ratio.

Income tax

Where the client is a natural person, section s24JA(2) deems his/her portion of the return to be interest. Note there is a general interest exemption for natural persons of R22,800 or R33,000 (in the case of taxpayers 65 years and older) in terms of section 10(1)(i). The position of corporate investors and of the bank itself is not specifically addressed, so presumably the income and gains retain their original nature and the general tax principles should be applied in determining the tax treatment of such returns.

ii) Murabaha (Financing)

This is essentially an asset-financing product in terms of which a financier purchases the target asset directly from the third-party seller, and the financier then resells it to the client (purchaser) within 180 days at a cost-plus mark-up. Note that these provisions only apply where either the financier or the client is a bank. Also, the amount payable by the client to the financier must:

- exceeds the amount payable by the financier to the seller;
- be calculated with reference to the consideration payable by the financier to the seller and the duration of the arrangement; and
- may not exceed the amount initially agreed upon between the financier and the client when the arrangement was entered into.

Income tax

The objective of section 24JA(3) is essentially to treat the financier's cost-plus profit as interest. It is also specifically determined that:

- The financier is deemed not to have acquired and disposed of the asset, and instead the client is deemed to have acquired the asset directly from the 3rd-party seller at the seller's original selling price (paid by the financier).
- The cost-plus arrangement between the financier and the client is deemed to be a s24J "instrument", and the original price paid by the financier (to the seller) is deemed to be the "issue price" of that instrument.
- The excess of the total amount payable by the client to the financier over the original cost paid by the financier to the seller is deemed to be a "premium" for the purposes of section 24J. A 'premium' is specifically included in the definition of 'interest' for purposes of section 24J.
- These rules appear to be applicable to both the financier as well as the client, i.e. it will be treated as interest received for the financier, and interest paid for the client.

VAT

Section 8A(1) of the South African VAT Act deals any with murabaha, specifically determining that:

- The financier is deemed, for VAT purposes, to have acquired the asset only as agent, which means that the financier cannot claim input tax and does not have to account for output tax on the supply of the asset made to the client;
- The client is deemed to have acquired the asset as principal from the outset from the seller, for the price paid by the financier to the seller, which means that the client may deduct the VAT (if the client is a VAT vendor and the asset is acquired for taxable purposes).
- The premium or mark-up payable by the client to the financier is regarded as consideration for the exempt supply of a financial service (i.e. effectively exempt interest). Any fee, commission or similar charge will, however, not be exempt from VAT

iii) Diminishing musharaka

This is an asset-financing product using a partnership (i.e. joint ownership) mechanism. In many respects, it is akin to a finance lease in that the bank acquires and retains ownership of the asset while the use of the asset is made available to the client. Technically, however, instead of leasing the asset from the bank, the client undertakes a piece-meal acquisition of the bank's ownership interest over the term of the arrangement. The arrangement could also be akin to a sale-and-leaseback, i.e. where the client sells its own asset to the bank and then repurchases it over an agreed term.

Income tax

The gain/profit that the bank makes in these arrangements is either, or a combination of:

- Rental payable by the purchaser (client), in respect of the portion of the asset still owned by the bank. The specific legislation dealing with Islamic financing does not determine the tax treatment of these rental payments. The normal tax rules therefore already apply to this rent.
- Gains on the piecemeal disposal of the asset to the client. The object of section 24JA is to tax these gains as income and spread them over the repayment term. In this case, section 24JA(6) deems a portion of each instalment to be interest. The amount of interest is determined in accordance with the following formula:
- $X = A – B$, where “X” is the interest amount to be determined in respect of an individual instalment.
- ‘A’ represents the total amount of instalments.
- ‘B’ represents the expenditure incurred by the bank to acquire the portion of the interest in the asset transferred to the client in exchange for the instalment payable by the client to the bank.

VAT

Section 8A(2) of the South African VAT Act deals with diminishing musharaka transactions. The form of the transaction, namely a purchase and resale by the bank, is effectively ignored for VAT purposes and:

- The bank is deemed to have acquired the asset only as agent;
- Where the bank and the client jointly acquire goods, the client is deemed to have acquired the bank's interest in the goods for an amount equal to the amount payable by the bank in respect of its interest in the goods and at the time that the seller of the goods sold the goods to the bank;
- The mark-up element is deemed to be consideration for the exempt supply of financial services. Any fee, commission or similar charge will, however, not be exempt from VAT.

iv) Sukuk

A sukuk is essentially a government issued bond. However, instead of the investor making a loan to the South African government (‘SA Government’) (and receiving interest from the SA Government), the investor invests in assets which are used by the SA Government thus producing a rental income for the investor. In substance, it is akin to a loan that is secured by the borrower's asset(s) or a sale-and leaseback.

The sukuk mechanism will (simply put) involve the following steps:

- The South African Government sells an interest in a government asset to a trust (the transferred "interest" could be full beneficial ownership, or a usufruct, etc.);
- Members of the public purchase interests or "units" in the trust. This represents the capital raised by the South African Government;
- The South African Government pays rent to the trust (for the use of the asset). This represents the return that flows through to the investors; and
- at the end of the pre-determined term, the South African Government re-purchases the asset from the trust (for the same original cost) and the trust redeems the investors' interests.

Income tax

As per section 24JA(7) both transfers are disregarded, i.e. original disposal from the South African Government to the trust as well as the subsequent reacquisition by the South African Government. The consideration (i.e. rental) paid by the South African Government to the trust, for the use of the asset, is deemed to be interest for purposes of section 24J. Section 24JA does however not make any reference to transactions between the trust and investors, e.g. the issue and redemption of the interest or 'units' in the trust. The general income tax and Capital Gains Tax ('CGT') principles will therefore have to be considered in this regard.

VAT

The trust will be deemed not to be an "enterprise" in order to eliminate any potential associated VAT charge with the trust.

Analysis of structures

a) Sukuk Ijarah

Sukuk Ijarah will fall within the ambit of a 'Sukuk' as defined in section 24JA to the extent that it is the SA Government selling the interest in an asset to a trust, and the SA Government undertakes to reacquire the same interest in the asset at a cost equal to the original selling price. To the extent that these requirements, please refer to the detailed discussion on the tax treatment of 'Sukuk' in the section above.

b) Commodity Murabaha

The typical Commodity Murabaha structure essentially involves two back to back Murabaha contracts. Please refer to the tax treatment of Murabaha transactions as discussed in detail in the section above.

The applicability of DTAs with respect to such Islamic financing

In general the tax treaties entered into by South Africa do not have any specific provisions accommodating Islamic finance. However, as South African income tax legislation generally deems Sharia compliant financing arrangements to be interest bearing arrangements there could be an anomaly regarding the interpretation of 'interest' in terms of the tax treaties.

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Switzerland

Corporate Tax

Corporate Income Tax (CIT) is levied at the federal, cantonal, and communal level. Foreign-source income attributable to foreign permanent establishments (PEs) or real estate property located abroad is excluded from the Swiss tax base and only taken into account for rate progression purposes in the cantons that apply progressive tax rates.

Switzerland levies a direct federal CIT at a flat rate of 8.5% on profit after tax. Accordingly, CIT is deductible for tax purposes and reduces the applicable tax base (i.e. taxable income). Consequently, the direct federal CIT rate on profit before tax amounts to approximately 7.83%. At the federal level, no corporate capital tax is levied.

In addition to the direct federal CIT, each canton has its own tax law and levies cantonal and communal income and capital taxes at different rates. Therefore, the tax burden of income (and capital) varies from canton to canton. Some cantonal and communal taxes are imposed at progressive rates.

As a general rule, the overall approximate range of the maximum CIT rate on profit before tax for federal, cantonal, and communal taxes is between 11.5% and 24.2%, depending on the company's location of corporate residence.

Withholding Tax

The statutory rate of Swiss WHT is 35% on dividends and interests.

There is no Swiss WHT on royalties, licences, and similar fees payable by Swiss individuals or corporations (provided that the dealing at arm's-length principle is met).

Stamp Duty

Swiss securities transfer tax (often called 'securities turnover tax' or 'transfer stamp tax') is levied on the transfer of Swiss or foreign securities in which Swiss security dealers participate as contracting parties or as intermediaries. The ordinary tax rate of Swiss securities transfer tax is 0.15% for securities issued by a tax resident of Switzerland and 0.3% for securities issued by a tax resident of a foreign country.

Swiss security dealers are defined as any person professionally engaged in the buying or selling of securities for one's own account or for another person, including Swiss banks and other Swiss bank-like institutions. The definition also includes companies holding taxable securities whose book value exceeds CHF 10 million.

Taxable securities include, but are not limited to, shares bonds and fund units. Options and many other derivative instruments are not subject to Swiss securities transfer tax. However, the exercise of such financial instruments or derivatives may result in a taxable transfer of a security.

Generally, issuance stamp tax (often known as capital duty) on the issuance and the increase of the equity of Swiss corporations is levied at the rate of 1% on the fair market value of the assets contributed. The issuance of Swiss bonds and money market instruments are not subject to Swiss issuance stamp tax.

In addition, the conversion of contingent convertible bonds (CoCos) into equity will also not trigger Swiss issuance stamp tax on the newly created equity. This relief applies to CoCos according to the Swiss banking law only; other convertible bonds will still trigger Swiss issuance stamp tax if converted into equity.

Indirect Tax

As a matter of principle, proceeds of sales and services conducted in Switzerland are subject to VAT at the standard rate of 8%. Goods for basic needs are subject to VAT at the rate of 2.5%.

All goods arriving in Switzerland from abroad are generally subject to customs duty and import VAT.

Any other major taxes applicable to Financing and Islamic Financing

Investors accessing Islamic Financing products via Swiss securities dealers (e.g. Swiss regulated banks or securities brokers) may become liable to Swiss transfer stamp tax. This duty is levied if the Islamic Financing products do qualify as taxable securities for Swiss transfer stamp tax purposes which are transferred in ownership against remuneration with the involvement of a Swiss securities dealer be it as counterpart of the trade or as broker amongst the buyer and seller of the securities. Specific exceptions and exemptions may apply based on the qualification of the underlying transaction or product. The applicable tax rate is of 0.15% for domestic securities and of 0.30% for foreign securities and is split equally between the parties involved in the transaction (unless a specific exemption applies).

In case of domestic real estate that might be used as the underlying for Islamic Finance products, such as for Sukuk Ijarah on real estate, income taxes and real estate capital gains taxation as well as real estate transfer stamp taxes and duties may occur at the level of the SPV utilised for the investment structure. The applicable income tax rates, real estate capital gains tax and real estate transfer stamp taxes do vary depending on the location of the real estate within Switzerland and the detention term of the real estate.

Islamic Finance – Tax implications

General overview on the Islamic Financing industry / market overview

The demand for Shariah compliant financial products has been recognised in the Swiss financial market as an area for future growth for the financial services industry. Many domestic Swiss banks are currently offering Shariah compliant investment products as well as wealth management services. Islamic Finance is broadly recognised as one of the global trends in the financial industry.

Major issues faced within industry – tax and regulatory-wise

From a tax perspective the main issue that Islamic Finance products face is the fact that no specific rules or guidelines on the taxation of such products do currently exist in Switzerland. As the Swiss tax treatment depends mainly on the legal design of the investment product, each single product needs to be analysed from a legal standpoint in order to assess the relevant Swiss tax treatment. This means that the Islamic Finance products must be "translated" into the Swiss legal thinking. As the Islamic Finance products can be structured in different ways, each product needs to be analysed based on its components.

From a regulatory perspective no differentiation is made in general between Shariah compliant or non-compliant products or service providers. This is underpinned by the increased domestic Shariah compliant investment possibilities and service providers in Switzerland.

General tax principles / treatment for Islamic products, including special tax incentives

Switzerland does not have specific taxation principles or tax incentives for Islamic Finance products. The taxation follows the general Swiss taxation rules based on the legal composition of the relevant products.

General comment on the tax treatment of common Islamic financing products / principles (if any)

In general, the taxation of Islamic Finance products does not differ from the taxation of conventional finance products held by Swiss resident investors.

Swiss resident individuals holding Islamic Finance products as a private wealth asset will in general not be taxed on capital gains generated from the sale of Islamic Finance products – correspondingly, any capital loss will not be tax deductible. Other income generated by Islamic products that qualifies from a Swiss tax perspective as income from movable property (e.g. dividends, liquidation proceeds, rental income from such property, usufruct, etc.) or immovable property will be subject to income tax depending on the income qualification under the generally applicable income tax rules. In case of equity investments a partial dividend exemption from income taxation may be available if the relevant requirements are met.

Swiss resident corporate investors or Swiss resident individuals holding

Islamic Finance products as business assets will be taxed based on their commercial profit generated according to their bookkeeping records. This means that realised capital gains will be in general taxable whereas capital losses will be in general tax deductible. Income payments received from Islamic Finance products is in general taxable, but may be offset against other cost incurred and capital losses. If the product qualifies as equity, corporate investors may be entitled to participation relief on capital gains and dividends, if the relevant requirements are fulfilled. The same applies to Swiss resident individuals with business assets, who may claim a partial dividend or capital gains exemption from income taxation , if they fulfil the relevant requirements.

As stated above, the tax wise qualification of the income components of an Islamic Finance product will follow the legal qualification of the income. Due to the different structuring alternatives for such products, it is highly advisable to clarify the relevant income tax treatment prior to distribution to investors in order to ensure that the product is tax efficient and suits the needs of the potentially targeted Swiss domestic investors and to include the tax wise qualification in the product description or term sheets. Please also note that such qualification can easily be confirmed with the Swiss tax administration in a written ruling request.

Analysis of structures

a) Sukuk Ijarah

The Sukuk Ijarah structure can be compared from a Swiss domestic perspective to a sale and lease back transaction to the extent that the owner of a specific asset sells the asset to an investment vehicle (typically a special purpose vehicle) from which the asset is then leased back to the seller. In order to finance the purchase price, the investment vehicle issues either trust certificates or participation securities to investors, which economically represent a share of the asset held in the vehicle and which entitle to the income and liabilities of the asset.

The Swiss tax wise qualification of the Sukuk Ijarah will strongly depend on its legal structuring, the qualification of the investment vehicle and the nature of the asset transferred. Depending on the legal structuring of the transaction and of the SPV, the investor may hold from a Swiss tax perspective an investment in equity, fund units or a bond like product.

For the purpose of this analysis we have assumed that SPV used for the Sukuk Ijarah would qualify from a Swiss tax perspective as a corporate entity.[1] In addition we have assumed that the SPV would not be Swiss resident due to possible Swiss withholding tax issues on distributions to non-Swiss resident investors.

Swiss resident individuals holding Islamic Finance products as described as a private wealth asset will be in general subject to income taxation on the dividend income generated from this product (income from movable property). If the relevant requirements are fulfilled the partial dividend exemption from income taxation may be claimed by the Swiss resident investor. Income that qualifies as capital gain e.g. realised upon the sale of the shares held in the foreign SPV should not be subject to income taxation in Switzerland.

Swiss resident corporate investors or Swiss resident individuals holding this product as a business asset will be taxed on their commercial profit generated according to their bookkeeping records. If the product qualifies as equity, corporate investors may be entitled to participation relief on capital gains and dividends, if the relevant requirements are fulfilled. The same applies to Swiss resident individuals with business assets, who may claim a partial dividend or capital gains exemption from income taxation, if they fulfil the relevant requirements.

Finally, Swiss transfer stamp tax may apply if a Swiss securities dealer is involved either as a counterpart or as an intermediary.

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[1] *Depending on the effective legal structuring, the SPV may qualify under certain circumstances as a collective investment scheme (fund), even if organised as a corporate entity. In this case different tax consequences may apply to the investors*

b) Commodity Murabaha

The commodity Murabaha may be characterised as a purchase of an underlying commodity by a corporate investor with a deferral in payment of the purchase price (e.g. of 3 months for the original Murabaha) with a profit rate. The profit rate is calculated as being an interbank offer rate plus a profit margin of some basis points. Instead of unwinding the contract after the original term of the Murabaha, it may as well be converted into a revolving Murabaha contract against the amount due under the original Murabaha. Under the revolving Murabaha contract the maturing original Murabaha and the purchase price of the new revolving Murabaha contract will be netted and the only cash movement will be the difference in amount payable by the purchaser to the seller.

The Swiss tax wise qualification of the commodity Murabaha will strongly depend from its legal structuring. In general, the corporate purchaser of the commodity Murabaha will either generate a profit or a loss from the product, depending on how the value of the underlying commodity will develop under the term of the product. Swiss resident corporate investors as purchasers or sellers will be taxed on their commercial profit generated according to their bookkeeping records, which means that profits will be taxable whereas losses will be tax deductible.

Applicability of double tax agreements with respect to Islamic Financing

Switzerland disposes of a large double taxation agreement network. Income generated from Islamic securities should benefit from the double taxation agreements in place if the income generated falls into one of the covered qualified income streams (dividends, interest, royalties, capital gains, etc.).

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Turkey

Corporate Tax

Corporations are liable for CIT at a rate of 20% on net profits generated, as adjusted for exemptions and deductions and including prior-year losses carried forward, to a limited extent.

Withholding Tax

There is no WHT on payments to resident corporations by other resident corporations, except for a 3% WHT on progress payments to contractors, both domestic and foreign, within the scope of construction work spanning more than one calendar year.

WHT on payments to non-residents vary significantly depending on the nature of the payment and can range from 0% to 35%. Examples include:

Income derived by non-resident individual or corporation not constituting PE in Turkey	WHT (%)
Rental from immovable assets	20
Leasing of goods (within the scope of the conditions regulated under Turkish Financial Leasing Law No. 3226)	1
Royalties (e.g. on patents, copyrights, license)	20
Professional services	20
Interest on loan arrangements	
Interest payments made to foreign banks and corporations that are authorised in their own jurisdictions and customarily lend not only to related parties but also to third parties	0
Interest payments made in relation to securitisation loans	1
Other loans	10
Interest on time deposits	15
Reverse-repo income derived from bonds	15

Stamp Duty

Stamp tax applies to a wide range of documents, including but not limited to agreements, financial statements, and payrolls. Stamp tax is levied as a percentage of the value stated on the agreements at rates varying between 0.165% and 0.825%.

Indirect Tax

Deliveries of goods and services are subject to VAT at rates varying from 1% to 18%. The general rate is 18%.

The purchase of goods and services by banks and insurance companies are subject to VAT, but this is considered an expense or cost item. Therefore, it is not recoverable (i.e. for VAT purposes by offsetting against the output VAT) in the hands of these corporations.

Transactions performed by licensed banks and insurance companies are generally exempt from VAT but are subject to Banking and Insurance Transactions Tax at a rate of 5%, which is due on the gains of such corporations from their transactions.

Foreign loans (including trade payables) obtained by Turkish resident individuals or legal entities (except for banks or financial institutions) are subject to Resource Utilisation Support Fund at the following rates:

- 6% at the customs stage on purchases on credit.
- 3% over the principal or the interest amount (note that this depends on the currency denomination and on the average maturity).
- 0% in case of locally obtained loans.

The transactions being performed by licensed banks and insurance companies are generally exempt from VAT but are subject to BITT at a rate of 5%, which is due on the gains of such corporations from their transactions.

Deliveries of goods and services are subject to VAT at rates varying from 1% to 18%. The general rate is 18%.

Islamic finance in Turkey

General Overview of the Islamic Financing Industry in Turkey

As part of a plan to attract more foreign direct investment from the Arab Gulf states, a 1983 federal decree legalized the operation of “special finance houses” to provide interest free banking without any direct reference to Islam or religion. These institutions were highly regulated by a skeptical bureaucracy, however, and did not have the same status as conventional banks. They were not covered by the Central Bank of Turkey’s insurance program and could not invest in government securities.

Islamic finance grew during 1980s and 90s, but still with a low share in banking sector, where special finance houses offer mainly retail banking and deposit account as basic services.

In 2006, banking law No. 5411 officially replaced the term of “special finance institutions” with “participation banking”, where Savings Deposit Insurance Fund has been created for the participation banks as a guarantee. Accounts of up to TL 50,000 became insured and additional uninsured deposits became eligible for protection under Turkey’s bankruptcy laws.

Four participation banks are currently operational in Turkey: al Baraka, Bank Asya, Kuveyt Türk, and Türkiye Finans. These banks offer a wide range of services (like in other banks), including savings (gold, investment funds) and checking accounts, loans, and even Islamic bonds, or “sukuk”.

Islamic banks offer customers profit-sharing proceeds instead of interest, and charge borrowers participation-sharing, instead of loan interest. For instance, customers with savings accounts at participation banks do not receive monthly interest payments at a certain rate. The banks use funds to supply goods and services directly according to a profit/loss investment model. Savings funds are invested in tangible goods, real estate, or industry, and at the end of the month profit and loss is shared with the customer. A profit margin is not guaranteed, and no investment is made in companies dealing with pork, alcohol, or other banned commodities, according to the Participation Bank Association of Turkey.

Participation banks engaged in both retail and commercial banking, where they serve in individual finance, corporate finance, trade finance, financial leasing and profit/loss sharing based on projects. In retail segment they offer instruments such as current/participation account, brand new gold accounts (where the conventional banks have also started to be active in), personal loans, credit card, FX transactions, payments, stock trading transactions and investment funds. The Islamic banks also provide cash and non-cash loans to the SMEs, Project (trade) finance, leasing finance, cash management and profit-loss partnership to the corporates as well.

Participation banks have experienced steady growth as a result of encouraging regulatory and legislative measures taken by the current ruling party. The change in political leadership has led participation banking to gaining a wider level of acceptance.

Turkey recently passed new legislation in order to encourage Islamic banking in the private sector and also some other upcoming incentives such as leasing may give rise to the business area of the participation banks, called sukuk.

The creation of the regulatory framework for corporate sukuk demonstrates the Turkish government's proactive interest in enabling the means for more Islamic finance.

In addition to this, government officials have indicated an interest in issuing sovereign sukuk as a funding for budget requirements.

As it seem from the figure, participation banks posted a sluggish but a steady growth over years, where the asset share reached 6% of the banking sector.

Major issues from a tax and regulatory perspective

Capital market instruments are supervised/authorized by regulatory authorities (the Capital Market Board, the Banking Regulatory and Supervision Agency) in Turkish judicial system. Creating a new instrument is judicially difficult other than authorized ones. In other words, authorization is a must for creating a financial instrument.

The first legislation directly relating to Sukuk bonds, also known as the "Sukuk Communiqué" was issued by the Capital Markets Board (CMB) on 1 April 2010. The Sukuk Communiqué includes provisions about certificates and Special Purpose Vehicle (SPV) instruments.

Then, the Turkish Parliament has passed the Law No. 6111 on 13 February 2011, which brought certain tax exemptions or favorable tax treatment for Sukuk.

Amendment to Income Tax Law

Turkish Income Tax Law gives a list of earnings which shall be considered as income from movable property. All bonds including treasury bonds were already in the scope of this article. The amendment added "earnings on Sukuk" to this list. As a result, the same rates shall be applied to earnings on conventional bonds and to earnings on Sukuk bonds.

Amendment to Corporate Tax Law

In order to issue Sukuk bonds, the originator shall transfer assets to an SPV and then lease them until the end of the term when it will repurchase them back from the SPV. The originator and SPV will not pay corporate tax on their earnings from the sale of those assets.

Turkey

Amendment to Value Added Tax Law

Conventional debt securities are exempt from VAT under Turkish Law. With the amendment to the Value Added Tax Law, Sukuk bonds shall also be exempt from VAT. Furthermore no VAT obligation shall arise upon sales between the originator and the SPV.

Amendment to Stamp Duty Law

Transfers of assets from the originator to the SPV and from the SPV back to the originator, mortgage transactions in connection with the aforementioned transfers, documents prepared in connection with the lease and Sukuk themselves are exempt from Stamp Duty under the amendment to the Stamp Duty Law.

Amendment to Charges Law

For transfers to be made between the originator and the SPV and mortgage transactions in connection with the aforementioned transfers in connection with a Sukuk issue, no charges shall be collected by the Land Registry Office

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United Kingdom

Corporate Tax

UK tax resident companies are subject to corporation tax on their worldwide income and capital gains on an arising basis.

The normal rate of corporation tax is 24% for the year ending 31 March 2013. It is proposed that this rate will fall to 23% from 1 April 2013 and to 22% from 1 April 2014.

For UK resident companies with tax-adjusted profits below GBP 300,000, a lower rate is generally applicable. This small profits rate is 20% from 1 April 2011 (21% to 31 March 2011). For companies with tax-adjusted profits between GBP 300,000 and GBP 1.5 million, there is a sliding scale of tax rates. For corporate entities with associated companies, both profit limits are divided by the number of active companies worldwide. There are no proposals for future changes to this small profits rate.

Withholding Tax

As a general rule, UK domestic law requires companies making payments of interest and royalties to withhold tax as follows:

Recipient	Dividends (%)	Interest (%)	Royalties (%)
Resident corporations	0	0/20	0/20
Resident individuals	0	20	20
Non-treaty, non-resident corporations and individuals:	0	20	20

Stamp Duty

Stamp duty is charged at 0.5% on instruments effecting sales of shares. Agreements to sell shares usually attract stamp duty reserve tax (SDRT) at 0.5%. Stamp duty is not usually charged on an issue of shares, but is charged at a higher rate of 1.5% on an issue of shares in bearer form. Issues or transfers of shares to clearance services or depositary receipt systems may attract SDRT at 1.5%.

Transfers of non-residential or mixed land and buildings are charged stamp duty land tax at graduated rates up to 4%. Acquisitions of residential property by companies are charged at graduated rates of up to 15% (whereas acquisitions by individuals are capped at 7%). Grants of new leases are also subject to stamp duty land tax.

Indirect Tax

The standard VAT rate of 20% applies to most goods and services. Certain other reduced-rate supplies are subject to VAT at 5%.

A bank levy was introduced as of 1 January 2011 and takes the form of an annual tax on certain liabilities of most UK-based banks and building societies. The tax is levied at varying annualised rates on chargeable liabilities exceeding GBP 20 billion, and is non-deductible for corporation tax purposes.

Many goods imported into the United Kingdom from outside the European Union are subject to customs duties. The rates of duty are provided by the EU's Common Customs Tariff and vary widely.

Islamic Finance - Tax Implications

General Overview on the Islamic financing industry / market overview

London's existing strength in financial services and its position as a global financial hub have facilitated rapid growth as a key centre for Islamic finance. The UK Government has supported Islamic Finance with the Treasury adjusting fiscal policies to facilitate sukuk (Islamic bonds) and home financing products. UK has always been an attractive location for foreign conventional and non-conventional investors to invest in opportunities across all sectors.

United Kingdom

The dominant investment asset class has been real estate and some of the landmark buildings in the City of London are owned and funded with Shariah compliant financing methods. Islamic mortgage products and banks accounts are generally available through UK established Islamic banks and the Islamic windows of the mainstream retail banks.

Major issues faced within industry - tax and regulatory-wise

From a tax perspective, the UK tax legislation (known as "alternative finance arrangements") includes certain provisions covering most commonly used structures in the field of Islamic finance so as to ensure that Shariah compliant investors are afforded similar tax treatment as that of conventional investors when using specific Islamic finance products. Of course, more could be done to broaden the rules to capture other areas; however, this depends on the level of use of other financing instruments and structures before a case can be made to HM Treasury and HM Revenue & Customs to consider introduction of further rules.

General tax principles / treatment for Islamic products, including any special tax incentives

The alternative finance arrangement legislation does not create nor does it provide any special tax incentives for Shariah compliant products as the main purpose of the legislation is to create a level playing field to ensure that non-conventional investors are afforded the same tax treatment as that of conventional investors when using non-conventional products or arrangements.

The UK tax legislation initially introduced specific rules to provide relief from property transfer taxes (stamp duty land tax) for diminishing musharaka type property transactions back in 2003. The tax rules were further expanded between the years 2005 to 2009 covering different products and arrangements. It should be noted that the UK tax rules do not make any references to Islamic finance.

In the early years of funding acquisitions of notably real estate transactions, most structures tended to use the so-called simple or leveraged ijara type of financing methods. The use of such structures was prevalent until at least the introduction of the alternative finance arrangements rules which addressed some of the uncertainty associated with the direct tax treatment of certain financing products and arrangements. The use of leveraged Ijara type structures was expensive which in most cases involved the use of a large number of entities to undertake a simple property acquisition transaction. In the absence of any specific rules governing the tax treatment of non-conventional structures, the UK tax treatment of such structures relied entirely on general tax principles.

General comment on the tax treatment of common Islamic financing products / principles (if any):

(i) Sukuk (bonds)

Provided that certain conditions contained in the alternative finance arrangements legislation are met, returns payable on Sukuk would be treated as deemed interest for UK tax purposes and hence tax deductible in arriving at the profits chargeable to UK tax. No UK stamp duty should also arise on the issuance and transfer of Sukuk. Sukuk issues involving sale and leaseback of properties should not result in any charge to UK tax (capital gains or stamp duty land tax) subject to certain qualifying conditions being met. No withholding tax will arise on deemed interest payments as it is the requirement that Sukuk must be listed on a recognised stock exchange to enjoy the withholding tax exemption.

(ii) Ijarah (leasing)

The direct tax rules do not contain any specific rules to deal with sale and leaseback type arrangements. General tax principles will apply to determine the amount of tax payable under a leaseback arrangement. In order for the stamp duty land tax relief rules to apply (assuming a real estate transaction), one of the parties to the transaction must be a financial institution. Rental payments due under the arrangement should be tax deductible for the lessee and taxable for the lessor.

(iii) Takaful

There are no specific tax rules dealing with re-takaful.

(iv) Mudaraba (profit sharing)

One of the parties to the transaction must be a financial institution and provided that certain other conditions contained in the alternative finance arrangements legislation are met, any profits payable under a Mudaraba arrangement would be treated as deemed interest for UK tax purposes. In general, interest is subject to withholding tax at the rate of 20% unless reduced under one of the exemptions.

(v) Musyarakah (partnership)

There are no specific tax rules governing this type of arrangement and hence general UK tax principles will apply to determine the amount of profits attributable to partners.

(vi) Murabaha (cost plus)

One of the parties to the arrangement must be a financial institution and provided that certain other conditions contained in the alternative finance arrangements legislation are met, any mark up would be treated as deemed interest for UK tax purposes. In the case of property related transactions, the legislation also prevents a double charge arising under the stamp duty land tax rules provided that certain other conditions are satisfied.

Analysis of structures

Sukuk Ijarah

Provided that certain conditions contained in the alternative finance arrangements legislation are satisfied, the following UK tax implications would arise:

Stage 1 –the sale of the asset would not be treated as a disposal by the owner so no tax charge would arise on the owner and no stamp duty land tax would be payable by the SPV on the acquisition of the property

Stage 2 – no disposal or part disposal of asset by the SPV and no liability to stamp duty land tax on the leaseback for the owner.

Stage 3 - Returns payable under the arrangements to Sukuk holders would be treated as deemed interest and tax deductible against the rental income. No withholding tax on deemed interest payments as the bonds will be listed on a recognised stock exchange.

Stage 4 – no disposal by the SPV of the asset and no acquisition by the Owner. Any claim for tax depreciation will remain with the owner.

Commodity Murabaha

Steps1 -4 – provided that the Seller is a financial institution and certain other conditions contained in the alternative finance arrangements legislation are met, the mark up on the deferred payments would be treated as deemed interest for UK tax purposes and tax deductible over the term of the arrangement. UK withholding tax on deemed interest payments will apply subject to certain exemptions.

The applicability of Double Tax Agreements with respect to such Islamic financing.

The double tax treaties do not include any specific provisions dealing with alternative finance type arrangements. In applying the terms of the treaties concluded by the UK with other countries, OECD guidelines and UK domestic law will need to be considered to determine the nature of returns/ payments falling under particular arrangements. In order to claim relief under a treaty, the relevant claim procedures must be followed (i.e. treaty relief application) by claimants.

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Vietnam

All taxes are imposed at the national level (no provincial income tax).

Corporate Income Tax (CIT)

There is no consistent definition of tax residency for CIT. From a tax perspective, any organisation incorporated under the laws of Vietnam (irrespective of Vietnamese owned or foreign owned) are tax residents of Vietnam, subject to CIT and taxed on their worldwide income.

The standard CIT rate is 25% on taxable profit (other incentive rates are available). Taxable profit is the difference between total revenue (whether domestic or foreign sourced) and deductible expense, plus other assessable income Enterprises operating in the oil and gas industry will be subject to CIT rates ranging from 32% to 50%, depending on location.

Foreign Contractor Withholding Tax (FCWT)

FCWT on payments to foreign contractors applies where a Vietnamese contracting party (including a foreign-invested enterprise incorporated in Vietnam) contracts with a foreign party that does not have a licensed presence in Vietnam. FCWT comprises CIT and Value Added Tax (VAT) elements.

FCWT generally applies to payments derived from Vietnam, except for the pure supply of goods (i.e. where title passes at or before the border gate of Vietnam, and there are no associated services performed in Vietnam), services performed and consumed outside Vietnam, and various other services performed wholly outside Vietnam (e.g. certain repairs, training, etc).

Foreign contractors can choose between three methods for tax payment, i.e. deduction method, deemed method (i.e. most common) and hybrid method. The Vietnamese party is responsible to withhold and declare the tax unless the foreign party registers to pay the tax directly itself.

For deemed method, VAT and CIT will be withheld by the contracting party at a deemed percentage of taxable turnover. Various rates are specified according to the nature of the payment (CIT varies from 0.1% to 10%, VAT ranges from 3% to 5%). The VAT withheld by the contracting party is an allowable input credit in its VAT return if the contracting party produces VATable supplies.

FCWT rates for interest and royalties are 5% and 10% respectively. There is no FCWT on dividends.

Stamp Duty

Certain assets, including houses, land, automobiles and motorcycles, etc., that are subject to registration of ownership are subject to stamp duty. The stamp duty rates vary depending on the asset transferred.

Indirect Tax

VAT applies to goods and services used for production, trading, and consumption in Vietnam (including goods and services purchased from abroad), with certain exemptions (e.g. financial services supplied by credit institutions). The general VAT rate is 10%, with rates of 0% and 5% applying in certain cases.

Special Sales Tax (SST) is a form of excise tax that applies to the production or import of certain goods and the provision of certain services. Goods and services that are subject to SST are also subject to VAT.

General Overview on the Islamic financing industry/market overview

Islamic finance has not yet been introduced in the Vietnamese financial markets/banking industry. This is primarily due to the small Muslim minority in Vietnam (i.e. approximately 0.08% of the total Vietnamese population).

Major issues faces within industry – tax and regulatory-wise

As Islamic finance has not been introduced in Vietnam, there are no specific regulations on Islamic finance from both tax and regulatory perspectives. The banking industry of Vietnam is heavily regulated; the introduction of Islamic financing products may require approval from the State Bank of Vietnam.

Vietnam

General tax principles/treatment for Islamic products, including any special tax incentives

The current regulations do not contain any particular tax principle/treatment for Islamic products. The tax treatments of Islamic products follow general tax provisions and the tax treatment normally follows the contracts' legal form.

General comment on the tax treatment of common Islamic financing products/principles:

In-country transactions:

Islamic financing products	General treatment	In-country transactions		
		CIT	VAT	Other taxes/fees
Sukuk (bonds)	Tax treatment differs whether Sukuk is considered by tax authorities as securities or other financial assets.			
	a. If treated as securities	25% on capital gain and profits received by Susuk holder. Loss is deductible upon realization.	Exempt	No stamp duty nor registration fee
	b. If treated as financial assets	25% on capital gain and profits received by Susuk holder. Loss is deductible upon realization.	10%	No stamp duty nor registration fee
Ijarah (leasing)	It is more likely that this product would be treated as operating lease rather than finance lease. The sales and lease transactions will be treated separately.	25% on gains from sale of the assets and on profit from leasing activities. Gains from sale of assets are determined as the difference between the selling price and net book value of the assets. Lease payment will be treated as deductible expenses. No depreciation charged is claimed by the lessee.	10% on sale of assets and rental payment.	N/A

Islamic financing products	General treatment	In-country transactions		
		CIT	**VAT**	**Other taxes/fees**
Takaful	Tax treatment differs whether the (re) takaful is treated as a contribution or a donation to a mutual insurance fund.			
	If it is treated as a contribution to a qualified mutual insurance fund	Contribution to qualified Takaful fund could be deductible. Compensation and surplus from the fund is treated as taxable income. Loss may be considered as “contribution”.	It is not clear whether contributions to insurance funds would be subject to VAT. In the absence of any regulation, a position could be taken that 10% VAT would apply	No
	If treated as donation	If treated as “donation”, contribution to Takaful might not be deductible. Surplus from Takaful is taxable at 25% CIT rate. Loss from Takaful might not deductible	No	
Mudaraba (profit sharing)	The distributed profit could be treated as dividends or share of pre-tax profits.	25% if sharing of pre-tax profits; not taxable if sharing of after tax profits.	Exempt in respect of after tax profits. 10% for before tax profits.	No
Musyarakah (partnership)	Same as Mudaraba			
Murabaha (cost plus)	The tax treatment would depend on whether the transaction would involve physical movement of goods. If it involves physical goods moving, general rules on sale transactions would apply. Vietnam does not have developed regulations on tax treatment of financial derivatives. For commodity trading, the VAT implication would be very complicated because the assessment should take into consideration the location of the commodity and any physical movement.	Each sale and purchase transaction would be considered separately. In principle, revenue is recognised when the ownership of goods is transferred. Cost of sales is recognised when goods are sold. Gains from the transaction will be taxed at the standard rate of 25%.	10% on each sales transaction.	No

Vietnam

Cross-border transactions::

Islamic financing products	General treatment	In-country transactions		
		CIT	VAT	Other taxes/fees
Sukuk (bonds)	Tax treatment differs whether Sukuk is considered by tax authorities as securities or other financial assets.			
	c. If treated as securities	Capital gain: 0.1% on total gross proceeds; Profit received: 5% withholding tax (on the basis that the profits will be treated as interest).	Exempt	No stamp duty nor registration fee
	d. If treated as financial assets	It is unclear how sales of financial assets will be treated. Under current tax regulations, it is likely that it will be treated as other business activities and subject to 2% CIT, 3% VAT on gross proceeds. Treatment of profit received by Susuk holder: unclear. Can be treated as: • Interest (5% CIT, VAT exempt); or • Other business activities (2% CIT, 3% VAT)		No stamp duty nor registration fee
Ijarah (leasing)	It is more likely that this product would be treated as operating lease rather than finance lease. The sales and lease transactions will be treated separately.	On the assumption that the Owner of assets is based on Vietnam and SPV is an offshore entity, the local sellers will be taxed at 25% on the profits derived from the sales of assets. Lessee can claim deduction for the lease payment. 5% withholding tax will be imposed on rental made to offshore SPV.	10% VAT would be charged on the sales of assets. This VAT is not recoverable by the SPV. 5% deemed VAT will be charged on the rental fee made to offshore SPV. This VAT is recoverable by the lessee.	No

Islamic financing products	General treatment	In-country transactions		
		CIT	VAT	Other taxes/fees
Takaful	Tax treatment differs whether the (re) takaful is treated as a contribution or a donation to a mutual insurance fund.			
	If it is treated as a contribution to a qualified mutual insurance fund	Similar to in country. Moreover, for payment from a local participant to an overseas participant account could be subject to FCWT at the rate of 2% (both contribution and loss).	Not clear. 5% deemed VAT could apply.	No
	If treated as donation		Not applicable.	
Mudaraba (profit sharing)	The distributed profit could be treated as dividend or shares of pre-tax profits.	25% if sharing of pre-tax profits; not taxable if sharing of after tax profits.	Exempt in respect of after tax profits. Deemed 5% for before tax profits	No
Musyarakah (partnership)	Same as Mudaraba			
Murabaha (cost plus)	The tax treatment would depend on whether the transaction would involve physical goods movement. If it involves with physical goods movement, general rules on sales transactions would apply. Vietnam does not have developed regulations on tax treatment of financial derivatives. For commodity trading, the VAT implication would be very complicated because the assessment should take into consideration the location of the commodity and any physical movement.	No withholding tax if goods' title pass at/ before Vietnam's border gate or goods do not enter Vietnam. 1% withholding tax on gross proceeds if goods are delivered within Vietnam.	No VAT if the goods are located outside Vietnam. If the goods are located in Vietnam, 10% VAT would apply unless there is a physical movement of goods from Vietnam to overseas in such case 0% VAT would apply on the export of goods from VN to overseas. Import VAT of 10% would apply on physical movement of goods from overseas to Vietnam.	No

Analysis of structures and comments on the tax issues/treatment

Sukuk using Ijarah structure

Stage	In-country transactions	Cross-border transaction
1. Contract of Cash sale Special Purpose Vehicle (SPV) purchases property (eg. hospital) from the owner of asset. The asset purchased by the SPV is funded by the issuance of sukuk (trust certificates) which represents beneficial ownership in the asset and the lease. Owner of the asset receives cash proceeds.	• CIT: 25% on net gain from the sales by the owner (calculated as difference between selling price and net book value) • VAT: 10% • No stamp duty • Registration fee: 0.5% of the property price, borne by buyer • Buyer (SPV) can capitalize the property in its book	• Under current regulations, non-residents are not allowed to own property in Vietnam. However, non residents can own shares in the company which owns and operates the property • Capital gains derived from sales of shares are subject to 25% capital gain tax • No VAT and no stamp duty • Note that the use of SPV for holding the assets for lease is not familiar in Vietnam
2. Contract of leasing SPV rents property to the owner of the asset for a specified period. SPV collects rental.	• CIT: 25% on income from rental fee • Lessee can claim deduction for the lease payment • SPV can claim deduction for depreciation charge • VAT: 10% on rental	• May not be possible under current legal framework
3. During the Tenure SPV passes the rental to investors (periodic distribution/coupon).	• Depending on the legal form of the payment • If it is a dividend payment, no withholding tax is payable if the investors are institutions and 5% if investors are individual • If it is an interest payment, no withholding tax with regard to institutional investors and 5% withholding tax for individual investors	• Treatment of non-resident investors is same as those applicable to residents
4. At Maturity (i) SPV sells the property to the owner of the asset at an agreed price. Owner of the asset pays cash to SPV.	• CIT: 25% on net gain • VAT: 10% • No stamp duty • Registration fee: 0.5% of the property price, borne by purchaser • Purchaser is allowed to depreciate the property during ownership	• Treatment of non-resident investors is same as those applicable to residents
(ii) SPV simultaneously pays investors cash for sukuk redemption	• No tax implications on repayment of investment	

Commodity Murabaha financing

Scenario	In-country transactions	Cross-border transactions
Assumption	All parties are Vietnamese tax residents	Seller is Vietnamese tax resident Other parties are non-residents
Transactions with physical goods movement	Profit from sales of commodity by Seller is subject to 25% CIT. Sales of commodity is subject to 10% VAT: • Commodity broker 1 issue VAT invoice to Seller • Seller issue VAT invoice to Buyer • Buyer issue VAT invoice to Commodity broker 2 If the net settlement is adopted, in order to claim input VAT credit, contract between Seller and Buyer should clearly specify the net off basis.	For sales of commodity into Vietnam, no withholding tax on the selling price if goods' title pass at/before Vietnam's border gate. 1% withholding tax if goods are delivered within Vietnam. No VAT if the goods are located outside Vietnam. If the goods are located in Vietnam, 10% VAT would apply unless there is a physical movement of goods from Vietnam to overseas in such case 0% VAT would apply on the export of goods from VN to overseas. Import VAT of 10% would apply on physical movement of goods from overseas to Vietnam.
Without physical commodity movement (i.e. selling position):	If there is no actual goods movement, the transactions might not be able to be carried out in Vietnam, especially with cross border transaction.	

The applicability of Double Tax Agreements with respect to such Islamic financing.

Vietnam has fairly strict foreign exchange controls for foreign currency remittance to overseas, as well as transactions entered between local parties. Payment for transactions made within Vietnam should generally be effected in VND.

According to Decree 108/2006/ND-CP dated 22 September 2006 on investment, investors are permitted to purchase foreign currency from authorized credit institutions to meet requirements for current transactions, capital transactions and other permitted transactions in accordance with the regulations.

In order to deal with Islamic securities with overseas entities, Vietnamese entities must obtain approval from the State Bank of Vietnam.

DTA Application

Vietnam has more than 60 DTAs signed, and numerous others at various stages of implementation and negotiation. The agreements in force include those with Australia, France, Korea, Malaysia and Singapore. Notably absent is a DTA with the United States of America.

As discussed above, as Islamic financial products are not yet familiar in Vietnam, the application of DTA protection would depend very much on whether the income would be considered: Business Profits, Interest, Capital Gains or Royalty under the relevant treaty. Vietnam normally takes an aggressive view in interpreting DTA provisions.

Please note that DTA is not automatically applied in Vietnam. Although no approval for the tax exemption is required, tax payers have to submit a Notification of Tax Exemption under the DTA to the local tax authorities with complex supporting documents.

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