Mohammed Amin's
Finance and Treasury blog
Islamic Finance podpack

This podpack should be used in conjunction with the four associated podcasts taken from the Institute of Islamic Banking and Insurance seminar on 25 July 2006, available on the Finance and Treasury blog.

Associated podcast timings are provided throughout the pack and are shown on the top right-hand side of slides.

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Finance and Treasury blog
Islamic Finance podcast

Podcast 1:
Introduction and overview of conventional finance and its taxation

Duration: 03:52

00:00 – 01:51

Outline

Podcast 1
- Overview of conventional finance and its taxation

Podcast 2
- Typical Islamic finance structures and mapping to conventional finance

Podcast 3
- Overview of UK tax law changes and some remaining problems

Podcast 4
- Islamic property finance and Stamp Duty Land Tax relief
- Conclusion

Conventional Finance

Debt

- Fixed returns
- No upside participation
- Limited exposure to business risk
- Typical contracts
  - bank loans
  - tradeable bonds

Equity

- Returns depend on business performance
- Unlimited upside participation
- Share business losses
- Typical contracts
  - ordinary shares
  - partnership interests

Taxation of Conventional Finance

- Cost of debt finance tax deductible
- Cost of equity finance not deductible (“distribution”)
- Anti-avoidance rules to stop equity finance being disguised as debt
  - ICTA 1988 s.209(2)(e)(iii) “securities under which... the consideration given… is … dependent on the results of the company’s business”
  - interest treated as distribution
  - s.212, above rule does not apply if recipient is a company chargeable to UK corporation tax

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Part 2:
Typical Islamic finance structures and mapping to conventional finance

Duration: 11:18

00:00 – 00:31

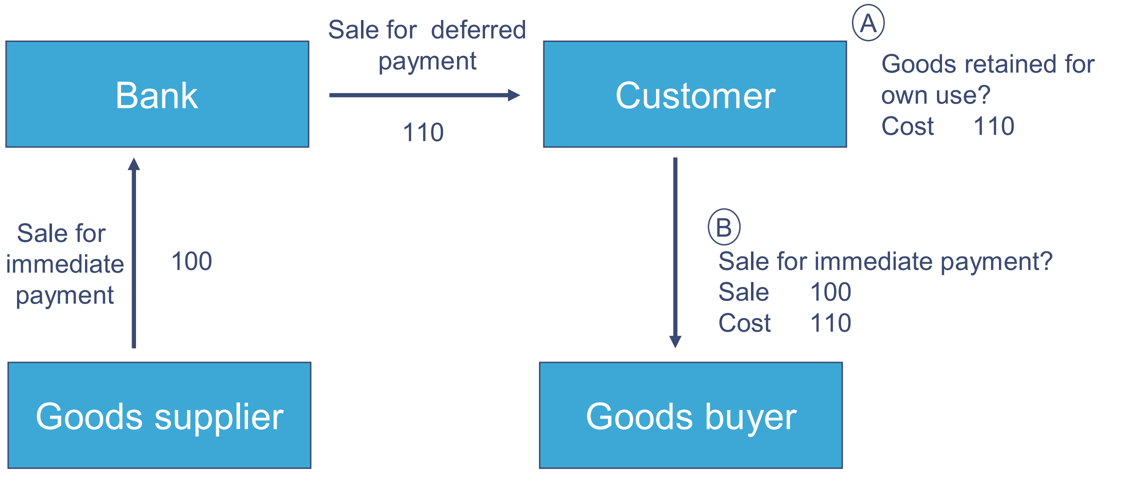
Islamic Finance : Typical Structures

- Murabaha
- Mudaraba
- Wakala
- Musharaka
- Diminishing Musharaka
- Ijara
- Sukuk

Overall questions regarding Islamic Finance Structures

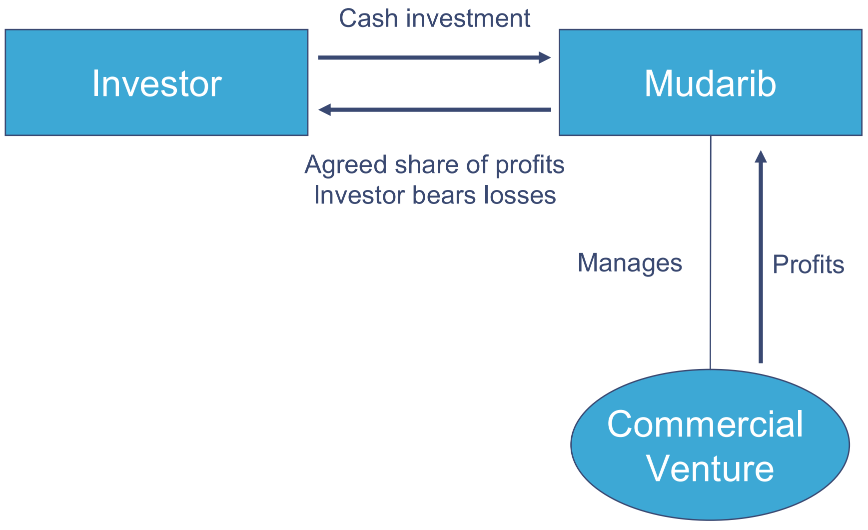
- What conventional finance structures do they mirror?
- Are they like debt or equity?
  - in theory
  - actual implementation
- NB. Cannot discuss extent of sharia compliance

Murabaha



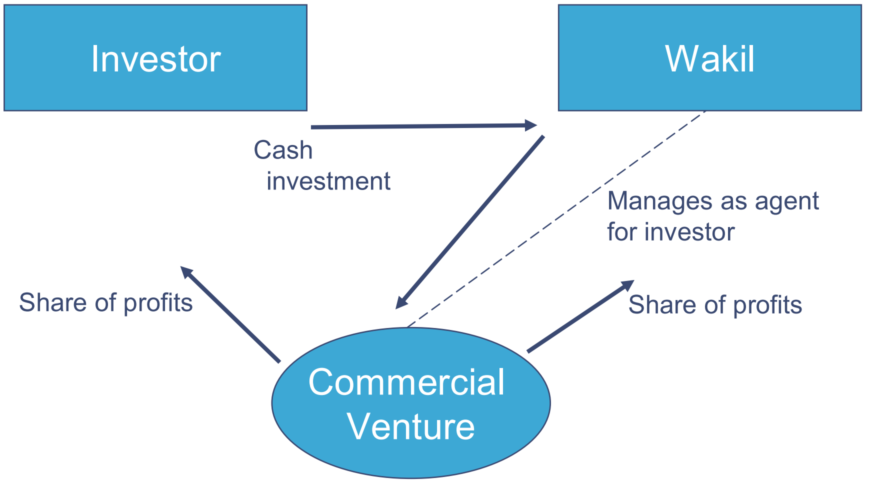
03:15 – 03:53

Mudaraba

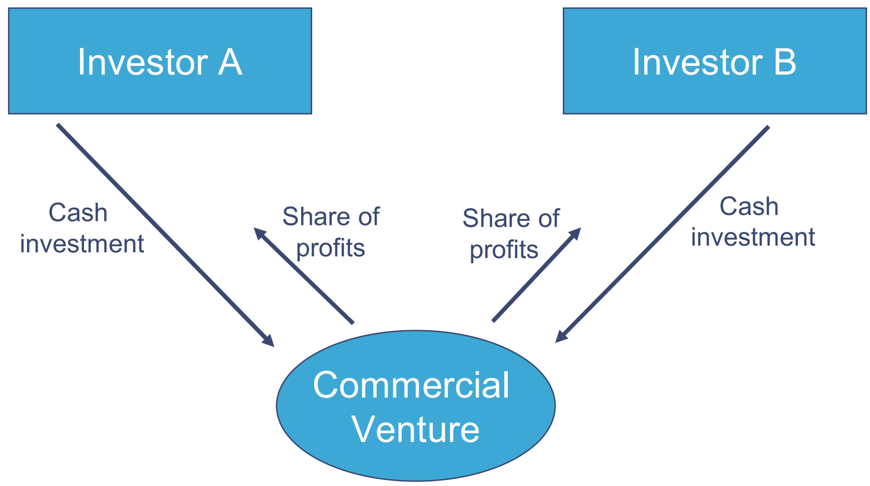


03:54 – 04:57

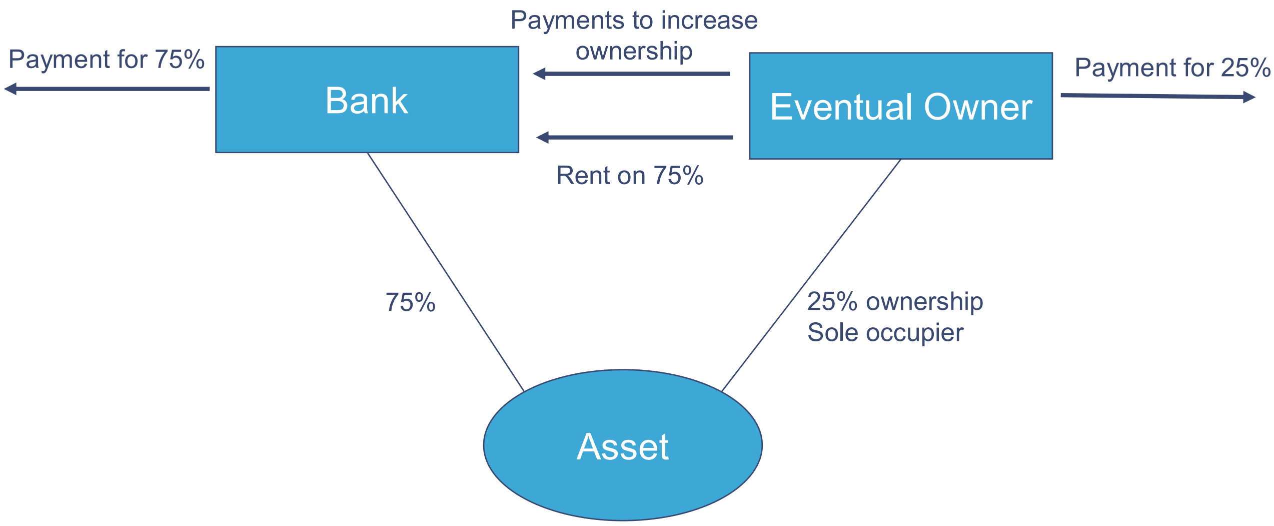
Wakala



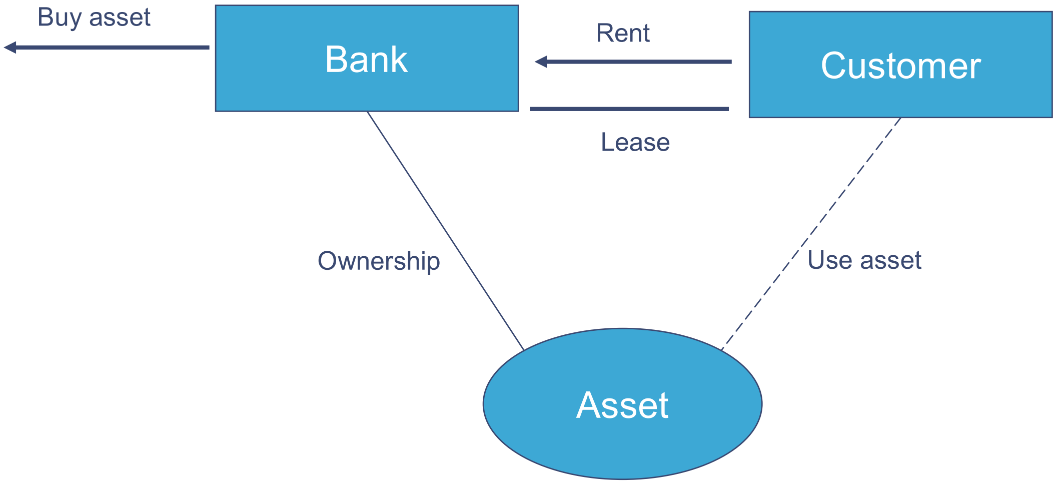
Musharaka



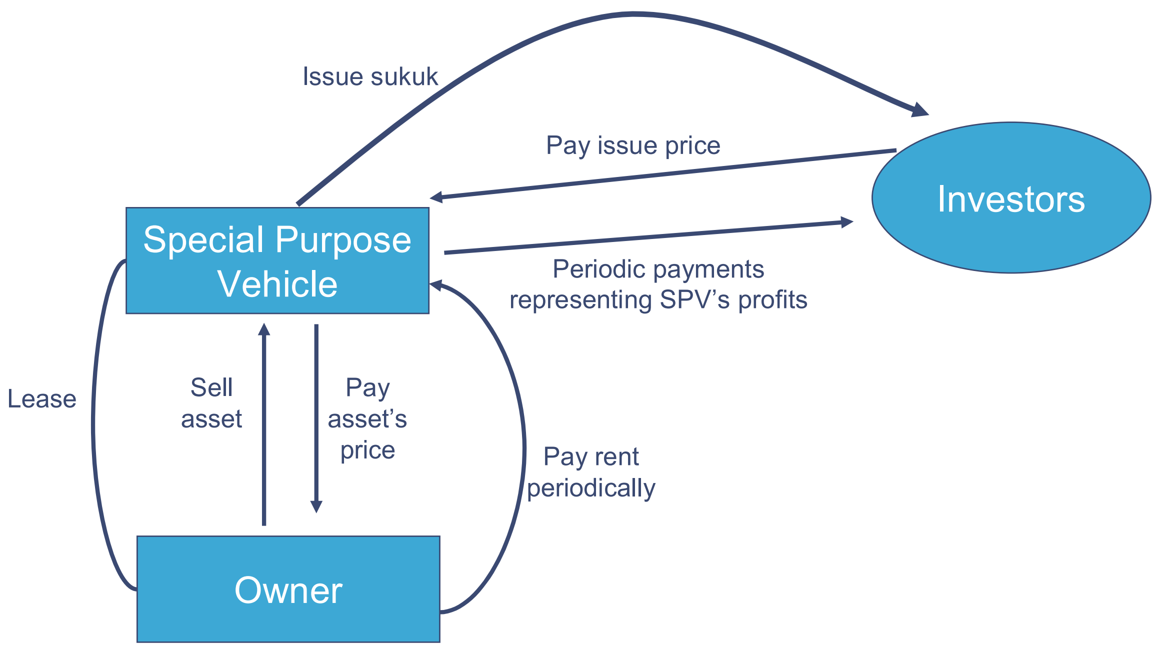
Diminishing Musharaka



Ijara


Buy asset
Bank
Rent
Customer
Lease
Ownership
Use asset
Asset

Sukuk


Issue sukuk
Pay issue price
Investors
Special Purpose Vehicle
Periodic payments representing SPV's profits
Lease
Sell asset
Pay asset's price
Pay rent periodically
Owner

Generic UK tax questions

- Does customer have a tax deductible cost?
  - Profit linked distribution?
  - Loss on goods sale?
- Transaction taxes?
- UK taxable presence created for foreign investors?
  - Foreigners earning interest in UK are generally not taxable

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Part 3:
Overview of UK tax law changes and some remaining problems

Duration: 14:26

00:00 - 03:15

New tax law FA 2005 & 2006

- Language religion free
- Key concepts
  - Alternative finance arrangements
    (a)alternative finance return
    (b)profit share return
  - Financial Institution
  - "Equate(s), in substance, to the return on an investment of money at interest"

03:16 – 04:26

New tax law consequences : overview

- If within statutory definitions
  - Customer's expense treated for tax purposes in the same way that interest is treated
  - Same for financial institution
- Financial institution's activities do not cause investor to have a UK taxable presence ("Permanent establishment")
- Tax definitions are precise

04:24 – 05:43

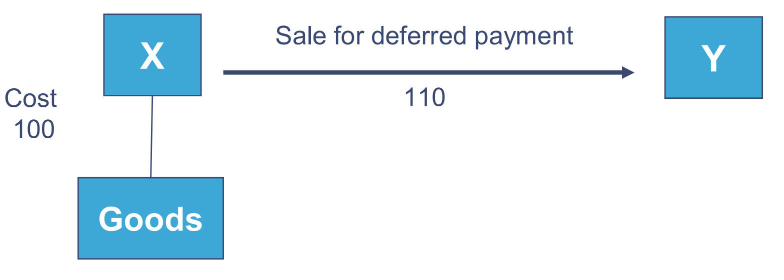
Mapping to Islamic Finance structures

- Alternative finance return
  - Murabaha (FA 2005)
  - Diminishing musharaka (FA 2006)
- Profit share return
  - Mudaraba (FA 2005)
  - Wakala (FA 2006)

Financial Institution (FI)
One of the parties must be a financial institution

- Bank (ICTA 1988 s.840A)
- Building Society (BSA 1986)
- Person licensed under Part 3, Consumer Credit Act 1974, to carry on consumer credit business or consumer hire business
- Person authorised outside UK to receive deposits from public
- Wholly owned subsidiary of a bank or building society

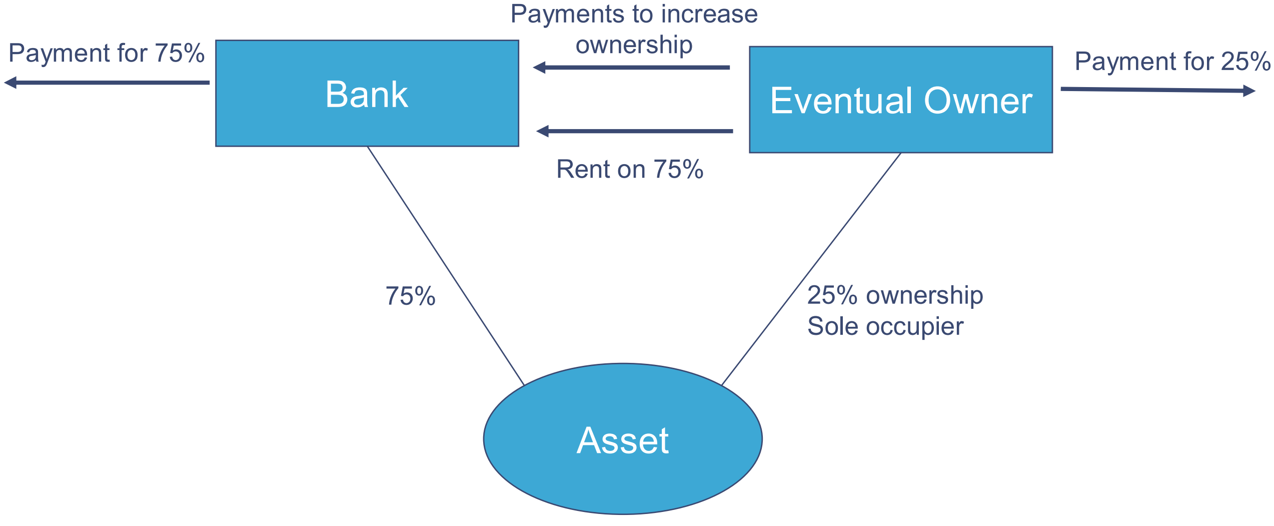
Murabaha : Detailed points



- One of X or Y must be an FI
- X must sell immediately on purchase, if X is not an FI
- X can sell non immediately if it is an FI, but must have bought goods for purposes of [murabaha]
- VAT position?
  - Sixth Directive constraints

12:10 – 12:36

Diminishing Musharaka

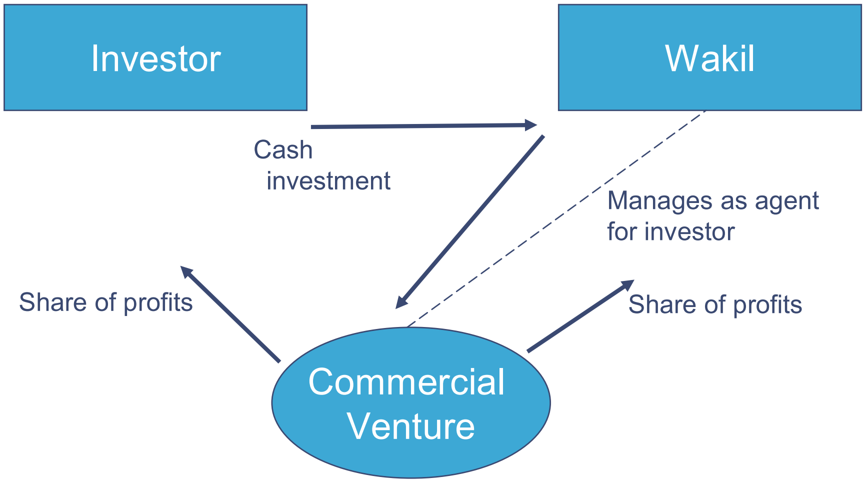


12:37 – 13:40

Diminishing musharaka

- FI can share in losses on the asset
- FI cannot participate in asset's value increase
- Sale and leaseback allowed

Wakala



Wakala

- Investor’s profit share must “equate, in substance, to the return on an investment of the money at interest”
- Cannot be used where Investor undertaking a commercial venture with equity-type returns

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Part 4:
Islamic property finance and Stamp Duty Land Tax relief
Conclusion

Duration: 07:31

00:00 – 00:19

Property finance : Stamp Duty Land Tax (SDLT) relief

- Vendor may be third party or the Person
- Until FA 2006, customer had to be an individual

00:20 – 03:18

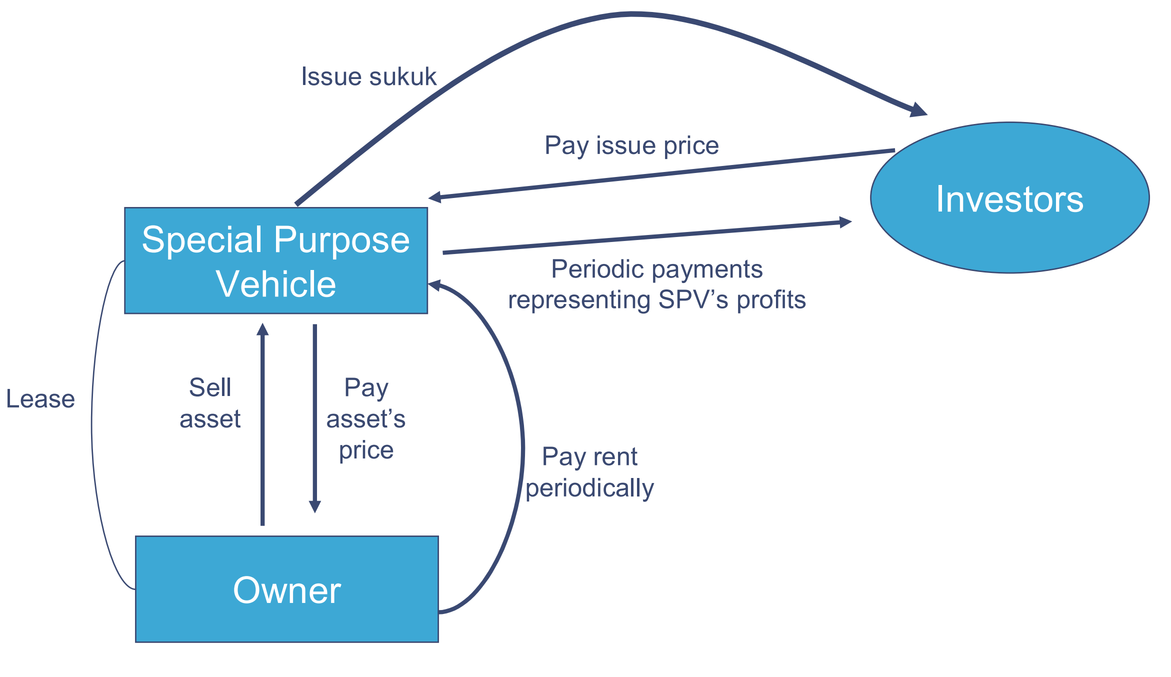
Property finance : SDLT Position

- FI definition narrower than for income tax /corporation tax rules
  - consumer credit definition not relevant
  - foreign authorised deposit taker also excluded

- FI permitted to participate in property value increase

03:19 – 03:31

Sukuk



Sukuk : SDLT Position

- Possible charges
  - Original sale to SPV
  - Lease back to original owner
  - Eventual sale back to owner
- SPV within owner's group
  - Original sale unlikely to qualify for group relief (equity holders entitled to more than 25% of profits available for distribution etc)
- SPV 100% owned by bank
  - Should be exempt under SDLT Alternative Property Finance Rules

Conclusion

- Event questions
- Islamic bonds by UK companies
- Islamic finance and the role of London
- For further information on Islamic finance and the Finance and Treasury blog, please contact Amin:

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PwC podcasts

Making tax accessible*

*connectedthinking

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