

The Luxembourg tax authorities issued a circular on Islamic Finance dated January 25, 2010

On January 12, 2010, the Luxembourg tax authorities issued a circular on Islamic Finance providing guidance on the Luxembourg direct tax treatment of some of the common Shariah compliant financial instruments.

The circular addresses the following points:

- Brief description of the main Shariah principles and Islamic Finance instruments (i.e., Murabaha, Mudaraba, Musharaka, Ijara, Ijara wa Iqtina Sukuk, and Istinah), and
- Guidance on the Luxembourg direct tax treatment applicable to Murabaha and Sukuk instruments.
- The circular explicitly excludes from its scope Luxembourg mutual funds making investments in Islamic assets.

As mentioned above, the circular mainly confirms the Luxembourg direct tax treatment applicable to two of the most important Islamic finance instruments, namely Murabaha and Sukuk.

Murabaha (forward sale)

- A Murabaha transaction is similar to a sale contract where one party (providing the financing) purchases the required assets and sells them to the other party (the customer) at a pre-determined price (with an agreed margin) paid on a deferred payment basis. In practice, the customer will then generally resell the asset immediately.
- From a Luxembourg tax perspective, the circular mentions that this profit on Murabaha instruments may be spread and taxed on a straight line basis (at the level of seller providing the financing) over the life of the contract, irrespective of the actual payments made, under certain conditions (including the proviso that the profit must also be recorded on a straight line basis from an accounting point of view).

Sukuk (asset-backed securities)

- A Sukuk agreement is a financial certificate representing the proportional ownership in an underlying tangible asset. Sukuk holders are entitled to a share in the profits generated by the underlying asset and suffer the economic risk relating to this asset.
- The circular confirms that payments made under a Sukuk agreement are, in principle, treated as tax deductible and are not subject to dividend withholding tax. The circular thereby puts Sukuk agreements on an equal footing with conventional debt instruments for Luxembourg direct tax purposes.

The issuance of this circular aims to confirm the compatibility of the Luxembourg tax framework with Islamic Finance requirements and thereby emphasises that Luxembourg is a location of choice for this type of investment. The circular will also help further cement the economic ties between Luxembourg and the Middle East and demonstrates Luxembourg's proactive attitude and openness towards Islamic Finance.

Contact

For further information, please contact the PricewaterhouseCoopers Luxembourg Investment Management expert:

Wim Piot

Partner
+352 49 48 48-57 73

wim.piot@lu.pwc.com

Serene Shtayyeh

Director
+352 49 48 48-61 13

serene.shtayyeh@lu.pwc.com

PricewaterhouseCoopers

400, route d'Esch, B.P. 1443
L-1014 Luxembourg
Telephone +352 49 48 48-1
Facsimile +352 49 48 48-2900

PricewaterhouseCoopers cannot be held liable for mistakes, omissions, or for possible results obtained further to the use of this document, which is issued for information purposes only. No reader should act on or refrain from acting on the basis of any matter contained in this publication without considering and, if necessary, taking appropriate advice upon their own particular circumstances.

© 2010 PricewaterhouseCoopers. All rights reserved. PricewaterhouseCoopers refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.