

Islamic Finance Tax Alert

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PwC Ireland Financial Services Tax Group

Please feel free to contact a member of the PwC Islamic Finance tax team if you have any further questions on this or any other issue.

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Irish Revenue issue guidance notes on the tax treatment of Islamic financial transactions

Following initial commentary from the Irish tax authorities (Irish Revenue) on the taxation of certain Islamic financial transactions in November 2009, in January 2010, the Irish government introduced significant amendments to Irish tax legislation to facilitate certain other Islamic financial transactions which had not been dealt with in the November commentary. While the legislation does not relate exclusively to Shari'a compliant transactions, it facilitates Islamic financial transactions by extending to this form of financing the relieving provisions which currently apply to conventional financing transactions.

Accompanying guidance notes on the Irish tax treatment of Islamic financial transactions have now been published by Irish Revenue. The notes seek to consolidate Irish Revenue's guidance on the tax legislation and the earlier commentary into one comprehensive reference document.

What has been clarified?

Sukuk: The legislation had clarified that a Sukuk should be considered a security for Irish tax purposes and that the investment return on a Sukuk should be treated as interest. Irish tax legislation generally contains a restriction on deductibility where interest is linked to the results of the borrower. This can be a common feature in Sukuk issuances but would not necessarily feature in a corresponding conventional financing transaction. The new legislation did not deal with this restriction on deductibility for payments to Sukuk holders which are directly linked to the return on the underlying asset but the guidance notes do now seek to rectify this by confirming that Irish Revenue will not seek to regard the Sukuk return as being dependent on the results of the issuer where a number of conditions are

satisfied. While the conditions might be seen as onerous, it should be possible to commercially satisfy them in order to secure a tax deduction for the return paid to the Sukuk holders which essentially represents the interest expense in a conventional financing structure. Irish Revenue has also confirmed that while the Sukuk does need to be issued to the “public”, it does not need to be listed to fall within the legislation.

Mudaraba/Wakala: The guidance notes also confirm the above treatment applies in certain deposit transactions which are structured as Mudaraba or Wakala contracts. Clarification is also provided that such transactions will not mean that the beneficial owner of the deposit is carrying on a trade in partnership with the deposit taker while the notes indicate that the income earned by a corporate in such a transaction should generally be taxed at 25% in line with Irish Revenue’s view on the taxation of deposit interest.

Ijarah: In Ireland, where the lessor under an operating lease bears the burden of wear and tear on the asset, the lessor is entitled to a deduction for tax depreciation over 8 years instead of accounting depreciation. This represents an acceleration of depreciation in larger ticket/longer life items. In the case of certain short life assets, a lessor can elect to instead be taxed on its accounting result. The guidance

notes confirm that an Ijarah operating lessor of such short life assets can similarly elect to be taxed in accordance with its accounting treatment.

Other: The guidance clarifies the time periods that are relevant in certain cases where the legislation was not specific.

In addition, it also clarifies the situations where Irish Revenue would not view the actions of a finance provider as creating a permanent establishment for a non-resident participant in the transaction – this clarification is important where the provider acts in an agency capacity.

There are still some outstanding issues to be addressed regarding stamp duty and capital gains tax matters which could facilitate the issuance of Sukuk in Ireland and provide a genuine alternative source from which Irish businesses can seek to raise finance. However, all in all, the notes are extremely helpful in consolidating Irish Revenue’s views on the legislation and practice in the area of Islamic finance and we hope they will be updated as developments in Islamic financial transactions take place.

Recent Irish tax treaty activity

The Irish government has continued to demonstrate its commitment to increase the number of double tax treaties in force, particularly with countries in the Middle East and

North Africa (MENA). We have seen significant activity in this area and Ireland has recently signed treaties with Bahrain, Morocco and the UAE and treaties with Kuwait and Saudi Arabia are imminent. Treaties had already been signed with Malaysia, Pakistan and Turkey. To date, Ireland has signed double tax treaties with 61 countries.

The increased number of treaties in place with Middle Eastern countries should enhance Ireland’s offering as a jurisdiction to locate Shari’a compliant transactions.

PwC Ireland’s Financial Services Tax group

PwC is a leading provider of tax services in Ireland’s financial services (FS) sector and its FS tax group provide advice on Irish and international tax issues and tax-related business issues affecting the sector. Specialisms within the group include asset finance, leasing, banking, treasury, securitisation, insurance and investment management.

This alert is intended to be a general guide. Professional advice should always be taken before acting on any information contained in this alert. Please feel free to contact a member of the PwC Islamic Finance tax team if you have any further questions on this or any other issue.

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