Islamic finance at Deloitte
No interest... but plenty of attention

Contents

Luxembourg is emerging to be one of the most important centres for Islamic finance around the world and was the first European country to become an associate member of the Islamic financial services board.

Luxembourg's involvement in the Islamic finance sector started over 30 years ago, when, in the late 1970s and 1980s, the first Islamic financial institution and the first Islamic insurance company of Europe were domiciled in Luxembourg respectively. Those initial moves paved the way for a steady growth and development as a leading non-Muslim jurisdiction in the Islamic finance world.

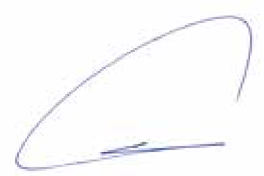
Since the first sukuk listing in Europe (Malaysia global sukuk) in 2002, Luxembourg has proved to be a key place for sukuk listing with its 16 sukuk listed on the Luxembourg stock exchange, representing approximately €5.2 billion. Besides, Luxembourg is also a host of choice for fund domiciliation with more than 40 Sharia'a compliant investment funds and sub-funds.

Favoured due to its extensive network of double tax treaties (in particular with Middle Eastern countries), a specific tax circular for Islamic finance transactions, specific guidances for sukuk and Sharia'a compliant investment funds published by the local regulator (CSSF) and the Luxembourg association for the fund industry (ALFI), and with the expertise of highly skilled professionals, Luxembourg is now ready to take on the challenge of further developing tailor made services for the fastest growing class of ethical investments. Moreover, thanks to the support and sponsoring of its authorities, Luxembourg embodies a primary location for Islamic finance investments and is striving to become the European capital for Islamic finance.

We hope this brochure will provide you with some useful insights. Please do not hesitate to contact us or any member of the Deloitte Islamic finance group should you have any questions concerning our capabilities and how we might support you in specific projects.

Yours faithfully,

David Capocci
Luxembourg Islamic Finance Leader



Introduction

Despite the financial crisis, fundamentals of the Islamic finance industry remain strong. With almost US$1.7 trillion of funds under management, significant oil and gas reserves and an expanding Muslim population in the MENASA (Middle East, North Africa and South Asia) region, Islamic finance protagonists have played their cards well. Among the 20 largest sovereign wealth funds, 11 of them, representing US$2.713 billion, are located in countries where Islam is the main faith.

Luxembourg offers custom-made structures to both sovereign wealth funds wishing to invest on a pan-European basis and to Sharia'a compliant funds looking at a perfect location to serve Muslims and non-Muslims in Europe and in the rest of the world.

In this environment, many states appear as specialist Islamic finance platforms through the implementation of dedicated regulatory and tax regimes (e.g. Malaysia, Saudi Arabia, Kuwait). In Europe, Luxembourg is clearly a leading jurisdiction. In 2014, the Grand Duchy was ranked as the largest non-Muslim place for fund domiciliation with 11.5% of the global market share.

Setting up Islamic investment ventures in Luxembourg is building a bridge between two worlds, at the crossroad of converging interests of investors in need of opportunities serving the real economy on the one hand and Islamic fund promoters keen to distribute their products worldwide on the other hand.

The flexible approach adopted by the Luxembourg government, the regulator and other actors of the financial sector, its worldwide established proficiency in terms of financial assets administration and distribution, as well as a highly skilled multilingual workforce, are some of the factors that make Luxembourg one of the most popular financial centres in the world.

Through its attractive financial market place and its worldwide recognised expertise Luxembourg is the ideal location to manage and distribute Sharia'a compliant financial instruments on the global market.

Islamic finance: moving from niche market to a mainstream market

History

Modern day Islamic finance emerged in the 1960s with the establishment of the first Islamic bank in Egypt by Ahmad El Najjar and the set up of Lembaga Tabung Haji in Malaysia.

Until the 1970s, Islamic banking was mostly focused on the retail market. The rise of Islamic finance in the late 1970s coincided with the oil crises of that decade, which created an immense amount of wealth by bringing a large amount of capital to oil producing countries. The emergence of wholesale banking and the associated product innovation is however a more recent development.

In recent years, Islamic finance has attracted a number of western multinational financial institutions, which started offering Islamic financial products in the International Islamic financial market and to a lesser extent in the western world.

Intensive efforts also have been made to harmonise Islamic financial practices, from creating accounting standards for Islamic financial products (through the Accounting and Auditing Organisation for Islamic Financial Institutions, AAOIFI), to integration of those standards with global corporate and risk management standards (i.e., Basel Accords I, II and III) through the Islamic Financial Services Board (IFSB). Islamic finance also falls within the scope of the IMF and of the World Bank.

Today, Islamic finance represents a small but growing segment of the global finance industry estimated at 1% to 2% of the global financial assets worldwide.

The market size of Islamic finance

The market size of assets held under Islamic finance is estimated at US$1.7 trillion suggesting an annual growth of 17.6% over the last four years.

Besides, Islamic finance also represents:

- More than 300 Islamic banks & windows that are present in at least 60 countries
- More than 750 Islamic funds worldwide with assets under management of more than US$60 billion. The growth of index funds has been underpinned by the launch of several Islamic indexes by prominent providers over the past few years. The first was the Dow Jones Islamic Market Index, launched in 1999, followed by the FTSE Global Islamic Index Series the same year and in 2006 by the Standard & Poor's Sharia'a indices

The future of Islamic finance

Islamic finance is set for more growth as the widespread socio-economic development in the MENASA region is expected to continue.

The growth is driven by multiple factors such as:

- A growing Muslim population standing at around 1.7 billion, out of which 50 million in Europe looking at investment products catered to their needs
- The search for ethical investments by Muslim and non-Muslim investors
- The need of investment products where to invest oil revenue surpluses
- The need for Islamic project financing for the infrastructure projects in the region
- A growing number of Islamic and conventional financial institutions entering the space
- A rise in sophistication through greater fundamentals in the contracts allowed under Sharia'a law and their appropriate utilisation in the development of modern financial instruments

By 2018, it is estimated that Islamic banking assets could reach about US$3.4 trillion.

The principles of Islamic finance: what is it all about?

Islamic finance is a subtle mix of economy, ethics and Islamic law (Sharia'a) resulting in financial transactions based on fairness, profit and loss sharing and real transactions.

The difference between Islamic finance and conventional finance in investment consists of the fact that investors should observe certain principles in order to reconcile their belief with their investment practices. This requires specific contracts and greements while doing business. Such contracts are generally based on a risk-reward distribution key and their drafting necessitates a lot of attention so as to exclude any ambiguity between the different contracting parties.

Main principles - restrictions

Avoid riba

Riba which has come to be interpreted as interest, is forbidden in Islamic transactions. This is a fundamental principle for Islamic finance and banking. Therefore a conventional loan, for instance, is impermissible as it includes interest.

Avoid gharar and maysir

Any agreement that has a significant part of gharar (excessive uncertainty) or maysir (speculation) will be considered as invalid from a Sharia'a perspective.

Preventable ambiguities and faults in the terms of the contract are also banned.

Avoid haram

According to Sharia'a, trade is only permitted in the goods and commodities that are declared halal (lawful). Consequently, any stock of a company that derives substantial income from haram (unlawful) activities (e.g. alcohol, gambling, non-halal meat, conventional banking) should not form a part of an Islamic investor's portfolio.

Stock screening

Two types of screening are performed as regards Sharia'a compliant portfolios: an ethical screening (sector-based) and a financial screening (accounting-based). Indeed, in addition to removing companies with non-compliant (haram) business activities, the companies are also examined for compliance with certain financial ratios. The screening process focuses on three main areas which are leverage, cash and the part of income coming from non-compliant activities. This evaluation is monitored on an ongoing basis by the Sharia'a board. It must be noted that some Sharia'a compliant indexes already exist (e.g. Dow Jones). Nevertheless, although there is growing consensus amongst Islamic scholars relating to the financial screening ratios to be applied, some differences in approach may still exist.

Some contracts and structuring

The main contracts that serve for developing more complex financial instruments, given the great potential for financial innovation and expansion in Islamic finance, are the following:

- Mudarabah (financing partnership): profit sharing partnership with only one of the partners providing the finance and the other having a return for entrepreneurial activity. This usually applies to bank deposits and is a common basis for structuring Sharia'a compliant investment funds
- Murabaha (cost-plus sale): purchase and sale for a mark-up which is disclosed

- Musharakah (equity partnership): a highly flexible tool for organising international business between several business partners. Losses must be shared in the same proportion as contributed capital and profits will be distributed according to a pre-defined ratio. An interesting application of such agreement is a partnership in goodwill in which there may not be any form of cash investment, but a partner contributes his name, credit or track record with a particular value, thereby allowing his partner to engage in business
- Salam (Islamic forward): similar to a forward sale contract consisting of a purchase of a commodity for future delivery with the price fully paid in advance. The salam purchaser (usually an Islamic bank) advances money to the salam seller, the latter delivers the commodities at maturity
- Sukuk (Islamic bonds): investment certificates evidencing a prorata ownership or a beneficial interest in an asset or enterprise
- Takaful (Islamic insurance): insurance provided on a mutual basis
- Ijarah (Islamic leasing): legally binding contract whereby the owner of something which has intrisic value will transfer its usufruct to a third party for a predefined period in exchange for an agreed consideration

The role of scholars and the Sharia'a board

In order to oversee the product development, and to get approval of a product as Sharia'a compliant, promoters will need a Sharia'a board.

The board is typically made up of a team of prominent Islamic legal scholars, well disciplined in jurisprudence (fiqh), particularly in areas of transactions and
business dealing.

The Sharia'a board is independent and has the duty to monitor the Sharia'a compliance of the transactions, the portfolio and the agreements as well as initially advising on the set-up of investment funds and contracts.

In addition to the purification obligation monitoring, advising on the zakat (alms tax) calculation is also one of the other Sharia'a board responsibilities. The purpose of zakat is to donate a part of one's wealth to the poor and needy.

As the board has an advisory and supervisory role, a close communication needs to be maintained between the product development team and the board.

Luxembourg, an ideal regulatory, legal and tax framework for Islamic finance investments

With its strong and stable legal environment and its flexible tax organisation, Luxembourg is a domicile of choice for cross border distribution of investment products. Total assets under management amounted to more than €2.7 billion and demonstrate that Luxembourg continues to be the European leader for fund administration and distribution around the world.

The attractiveness of Luxembourg is strengthened by the fact that tailor-made structures, adapted to specific situations in order to deliver expected commercial outcome, are coupled to tax efficient returns.

Its unique blend of specialist service providers enables Luxembourg to offer fund promoters an extraordinarily wide range of investment products having progressive levels of flexibility, stretching from unregulated (i.e. Soparfi) over lightly regulated (Specialised Investment Funds, SICAR) to strongly regulated (i.e. UCITS funds) vehicles.

Size, location and type of investors or investments will drive the choice of vehicle. SIF might be particularly suitable for structuring Sharia'a compliant investments for institutional investors, while Soparfi may be appropriate for MENASA based investment funds looking to use Luxembourg as a holding location.

The monitoring of potential withholding tax costs is one of the key aspects of the structuring. Similarly, the review and development of exit strategies in a tax efficient perspective need to be considered since they can dramatically impact the expected returns on investments.

In this respect, Luxembourg is particularly competitive thanks to its flexible environment allowing tax efficient structuring and its extensive network of including more than 90 double tax treaties in force, awaiting ratification or under negotiation, offering interesting withholding tax rates and taxation regime of gains. It includes notably in-force tax treaties with Azerbaijan, Bahrain, Indonesia, Kazakhstan, Malaysia, Morocco, Qatar, Singapore, Tadjikistan, Turkey, Tunisia, United Arab Emirates and Uzbekistan, signed treaties awaiting ratification with Albania, Kuwait and Saudi Arabia together with advanced negotiations with, Brunei, Egypt, Kyrgyzistan, Lebanon, Oman, Pakistan and Syria.

Aside its international initiatives, Luxembourg also acts domestically. The Luxembourg tax authorities issued a circular letter dealing with the tax treatment of murabaha and sukuk. The circular also describes other Islamic finance transactions such as musharakah, mudarabah, Ijarah and istisna. The tax authorities have taken a very pragmatic position, based on the substance over form approach, which renders such transactions very attractive from a tax point of view (for more details on this subject please see Appendix 2).

In addition, the Luxembourg investment funds regulatory environment is particularly flexible and offers the possibility to structure regulated vehicles in such a way that they can accommodate Sharia'a compliant investments.

Finally, besides an appealing tax and regulatory regime, Luxembourg benefits from a full range of highly skilled service providers such as administrative agents, custodian banks, domiciliation agents, paying agents, transfer and register agents, lawyers, chartered accountants and tax advisors.

How can Deloitte help you?

First, what sets Deloitte apart is the fact that we are the only big four firm that offers the market a holistic proposition by having a Sharia'a scholar within our network enabling us to provide Sharia'a compliant solutions to our clients. Deloitte has appointed Mufti Hassaan Kaleem, a pupil of the industry renowned Sheikh Mohammed Taqi Usmani.

Apart from this, Deloitte Luxembourg participates in various working groups of the Luxembourg Fund Association (ALFI). ALFI created a new working group in the Middle East to present the Luxembourg fund industry in the region. Mr. Aly El Azhary (audit partner of Deloitte Saudi Arabia) is a member of that working group and is participating actively as a local bridgehead to reinforce the relations with the Middle Eastern market.

Secondly, our global Islamic finance practice comprises a dedicated group of experienced Islamic finance professionals, backed by a global network of industry specialists drawn from our consulting, tax and financial advisory services dedicated to the seamless delivery of services.

Deloitte has also established an Islamic Finance Knowledge Center in Bahrain. Thanks to its research function (survey, publication and library compiling) and strong connections established with a wide range of Islamic finance markets (forum, seminar, webcast, workshop), our practitioners aligned to this centre of excellence may provide technical support and practical expertise relating to the Islamic finance industry. This ensures that we are acutely aware of the challenges that Islamic finance actors are facing around the world and are able to respond to their needs effectively.

With services encompassing financial advisory on sukuk issuances and financing transactions, tax and accounting advice on cross-border transactions, as well as Islamic finance conversions and compliance through our consulting practice, Deloitte's international capabilities provide a one-stop solution for clients seeking to undertake Islamic finance transactions by offering specialised solutions tailored to the needs of our clients.

Audit services

Deloitte's audit approach is partner-led, especially in the planning phase when significant audit strategy decisions are made. The extent of our industry experience allows us to design and implement an effective audit plan.

This enables us to accomplish our audit objectives efficiently while maximising our contribution to the clients' business through our audit, Islamic finance and asset management teams.

We continue to enhance the value of our audit services. As a result we have developed and integrated numerous innovative tools and techniques to perform value-added audits. We have developed accounting policies, accounting guidance and audit procedures for Islamic finance investment products.

Consulting and financial advisory

Enterprise risk services

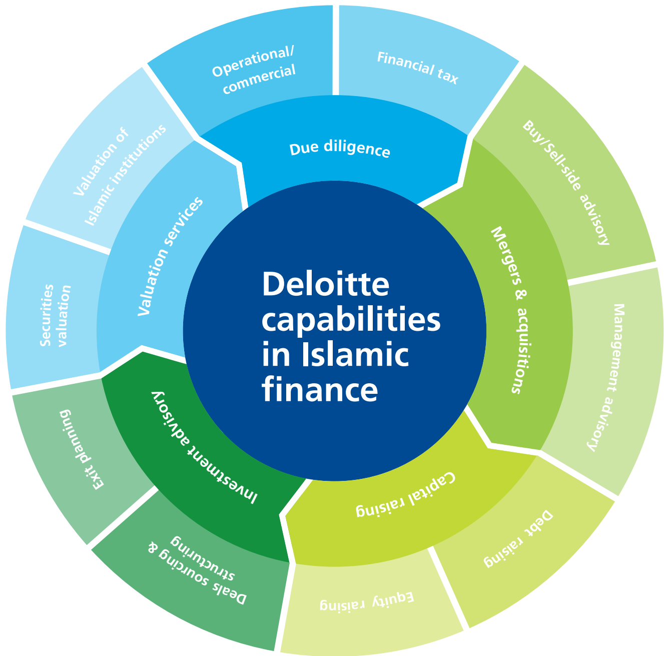
Identifying opportunities, avoiding risks, dealing with threats and developing a strong core business are all important in achieving business objectives along with considering Sharia'a compliance. Deloitte's risk professionals help clients to identify, analyse and control risk. Global leader enterprise risk management, our service offering covers the areas of strategy, operations, reporting and compliance across an entire business including people, process, technology and data.

Investment management services

This department includes, among others, the following relevant services lines to Sharia'a investment funds:

- *Fund engineering & fund registration*
  This service line is involved in the launch of new investment products, and is to be considered as a very efficient guide for new comers to the Luxembourg
  jurisdiction. We assist with the prospectus definition and team up as a partner throughout the fund set-up phase. Thanks to our "one-stop-shop" fund registration service, we are able to assist the registration of UCITS as well as non-UCITS funds in foreign jurisdictions from the beginning of the procedure until the maintenance of the fund registration in target markets. This service has been of great support to fund promoters distributing their products on a pan-European basis.

- *Investment compliance, business compliance & regulatory issues*
  Through cold testing processes of investment objectives and the investment universe of the funds, we can assist Sharia'a boards and fund directors in their ongoing monitoring of the investment portfolio. We may also provide resources to assist with the processing of the income purification calculations.



- *Fund service providers selection (custodian and fund administrator)*
  This service line evaluates the custody and fund administration service providers from both qualitative and quantitative perspective. We provide you with analysis and evaluation through scoring grids and analysis of pricing proposals to provide the fund sponsors with the necessary aids and market insights to identify appropriate service providers.

Corporate services

Our in-house corporate-legal experts, familiar with the Islamic finance principles, provide strategic solutions regarding the implementation of investment vehicles in Luxembourg, including financial instrument issuance, drafting of prospectus, co-ordination and representation in front of the Luxembourg financial supervisory authority.

Accounting services

Deloitte offers accounting consultancy and compliance services to Luxembourg Islamic finance investment vehicles, from initial thoughts over implementation
of Sharia'a compliant structures to the day-to-day management of these entities. This includes mainly:

- Accounting assistance when setting up the structure
- Accounting compliance and reporting for regulated and unregulated vehicles under Lux GAAP and IFRS (in accordance with CSSF and financial sector
  regulations for regulated vehicles if applicable)
- Consolidation under Lux GAAP and IFRS
- Specific assistance such as providing:
  - Financial analysis at group level for management or Sharia'a board purposes
  - Highly skilled Luxembourg chartered accountants to temporarily help with clients' organisation
  - Training sessions and hotlines on Lux GAAP and IFRS matters

Such accounting services are monitored by one key contact person who provides the entity with a cross practice support, follow up of its day-to-day operations and ensures compliance with Luxembourg requirements at all stages of its lifecycle.

Tax

Within the Deloitte Luxembourg international tax department, we have dedicated tax specialists who are also familiar with the principles of Islamic finance.

The Luxembourg international tax department therefore is very well placed to provide tax advice on Islamic finance products and Sharia'a investment funds.

Our tax specialists, familiar with the principles of Islamic finance can provide:

- Tax structuring advice for Islamic finance products and Sharia'a investment funds, both from a direct tax and indirect tax viewpoint
- Assistance regarding tax due diligence work
- Ongoing tax assistance regarding tax compliance (direct tax compliance and VAT)
- Assistance regarding the review or drafting of the tax sections of legal documents such as private placement memoranda or prospectuses

Our unique combination of knowledge in the Islamic finance and international tax area ensures that the Sharia'a compliant products or vehicles set up through Luxembourg will be structured in the most tax efficient way, whether these structures are unregulated (Soparfi) or regulated vehicles (such as UCITS, specialised investment funds, SICAR and securitisation vehicles).

Appendix 1
Vocabulary of Islamic finance

Fatwa
An authoritative legal opinion based on the Sharia'a provided by an Islamic legal specialist.

Gharar
Any element of uncertainty in a contract as to the existence, the quantity or the quality of the subject matter of the contract. It also involves any contractual ambiguity of the terms of the contract. Such doubt may render agreements void.

Ijarah
Agreement involving the usufruct of a specific non-monetary asset for a defined period of time in exchange of rental payments. For the leasing period, the lessor keeps the ownership of the asset and bears all liabilities non-connected to the use of such asset. The contract may also include a promise of ownership transfer (ijara muntabhia bi tamleek).

Istisna
Contractual agreement for producing well described goods or building at a given price and on a given date in the future. Such contract may be notably used for providing the financing of infrastructure projects (e.g., plant, bridge, highway, etc.).

Maysir
Literally this means gambling, playing games of chance or speculating with the intention of making an unearned profit. The prohibition of maysir is often used as the basis for criticism of standard financial practices such as conventional insurance, derivative contracts and speculation.

Mudarabah
An agreement made between a capital provider (rab al mal) and another party (mudarib) who manages the project using his entrepreneurial skills. Profits arising from that enterprise are distributed according to a predetermined ratio while financial losses are borne by the rab al mal except in cases of managerial misconduct or breach of contractual terms by the mudarib.

Murabaha
Agreement with a credit institution for the sale of a good at a price which includes a profit margin agreed by both parties. As a cost plus financing technique, it requires the good to be sold to the client with an agreed mark-up.

Musharakah
Agreement involving several capital providers towards the financing of a project or a business. Any profits will be shared on a pre-agreed ratio while losses are shared on the basis of contributed capital. Management may be carried out by all parties or solely by one of them.

Riba
Within the context of financial operations, it means an increase over the principal in a loan transaction which is not allowed by the Quran. Sharia'a strongly dislikes money earning solely by passage of time. Riba is generally defined as an unlawful advantage by way of excess or deferment.

Sharia'a board
Panel of qualified scholars delivering guidance and supervision on the development of financial services and products to ensure their compliance with Islamic precepts. It includes notably delivering annual letters of audited Sharia'a compliance as well as overseeing the portfolio's purification and advising on the alms tax (zakat) calculation.

Sukuk
Often considered as Islamic bonds, sukuk are in reality investment certificates evidencing an undivided prorata ownership of an underlying tangible asset. Sukuk are structured in such a way that their holders run a credit risk and receive part of the profit and not a fixed interest payment in advance. The products underlying sukuk could be represented by contracts such as ijarah, musharakah or mudarabah.

Takaful
System of mutual insurance in which the participants donate their contributions to a common fund. It may be used to pay claims for damages suffered by some of the participants. The company's role is restricted to managing the insurance operations and/or investing the insurance contributions.

Zakat
A religious obligation of alms-giving, to pay annually 2.5%[1] of certain categories of wealth to the poor.

Sources: Islamic financial services board and Deloitte

1 2.57575% for a solar calendar year.

Appendix 2 – Tax authorities issue guidance on Islamic finance

The Luxembourg tax authorities issued a circular letter on 12 January 2010 that clarifies the tax treatment of various Islamic financing arrangements and issues.

The circular essentially deals with the tax treatment of murabaha and sukuk but also describes other instruments, such as musharakah, mudarabah, ijarah, ijarah-wa-iqtina and istisna.

The circular coincides with other activities designed to market Luxembourg as a European hub for Islamic finance. The crown prince of Luxembourg and the finance minister recently led a successful mission to promote Luxembourg as a global financial services centre to Bahrain and the United Arab Emirates. This mission was embarked on shortly after it was announced that the Luxembourg-United Arab Emirates tax treaty would become effective as from 1 January 2010. Luxembourg's tax treaty network now includes signed treaties with Bahrain, Kuwait and Qatar, with negotiations in progress for treaties with Lebanon and Syria.

Luxembourg has actually played an active role in Islamic finance since the 1980s:

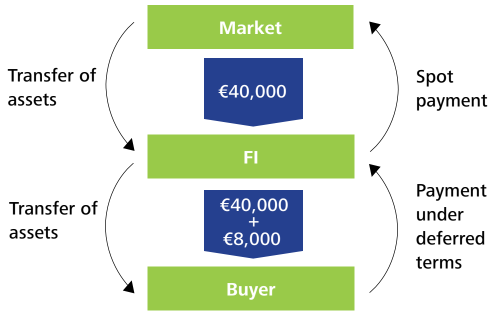
- The first Islamic insurance company (takaful) in Europe was established in Luxembourg in 1983
- 16 sukuk are currently listed on the Luxembourg stock exchange (representing approximately €5.2 bn in notes)
- Luxembourg hosts more than 40 Sharia'a-compliant investment funds and subfunds

The circular further enhances the attractiveness of Luxembourg as a hub for Islamic finance activities. It confirms Luxembourg's approach to Islamic finance and clarifies the tax treatment of Islamic finance instruments such as murabaha and sukuk.

The main features of the circular are as follows:

Murabaha:
Murabaha refers to a sale transaction whereby assets are sold under deferred terms at cost plus a profit mark-up. The cost price and the mark-up are known by both the buyer and the seller. Both Islamic and conventional financial institutions (FIs) can act as buyers-sellers in murabaha financing arrangement. The pre-determined mark-up represents the remuneration for the FI.

Example:



Buyer A approaches a financial institution (FI) to purchase a car, the market price of which is €40,000. FI buys the car on the market for €40,000 and obtains title to the vehicle. FI sells the car to its client, Buyer A, for €40,000, plus a mark-up of €8,000. FI transfers ownership of the vehicle to Buyer A against deferred payments (e.g., €12,000 per year over four years).

Since the total price of the car amounts to €48,000, FI would realise a gain of €8,000 on the sale. In a conventional 'buy-sell' transaction, that gain might be taxed in the year of disposal.

The circular however, adopts a 'substance-over-form' approach and provides that the taxation of the income can be deferred over the term of the transaction (as would be the case in a conventional financing arrangement). This favourable treatment will be granted if the following conditions are satisfied:

- The agreement between FI and Buyer A clearly states that the finance provider acquires the goods with the aim of reselling them (immediately or within a maximum period of six months following the initial acquisition)

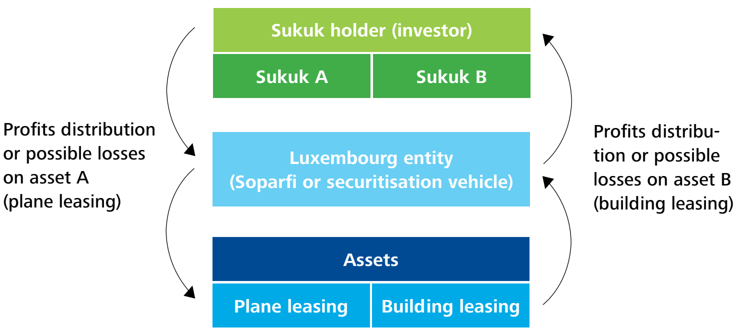
- The agreement clearly specifies the predetermined mark-up as remuneration for the services provided, and this mark-up must be known and accepted by both parties
- The remuneration must be deferred for accounting and tax purposes in the finance provider's books (based on a straight-line method), regardless of when reimbursement is actually made

Sukuk

Sukuk are the second type of Islamic financial transaction analysed in the circular. Sukuk are investment certificates evidencing the undivided pro rata ownership of an underlying tangible asset. Sukuk are structured in such a way that their holders, in principle, run a credit risk and receive part or all of the potential underlying profits.

Luxembourg-based Soparfi and securitisation vehicles, among others, are flexible vehicles that can be used to issue sukuk, as illustrated in the example below.

Example:



Sukuk holders (i.e., investors) acquire sukuk issued by the Luxembourg vehicle for cash payments.
The Issuer uses the funds to finance the acquisition of specific assets (e.g., real estate, airplane, etc.). Potential profits are paid periodically to the sukuk holders or the sukuk holders are exposed to losses incurred on the underlying investments. 'Tracking sukuk' can enable the tracing of the profits and losses to specific assets. The securitisation vehicle may provide more guarantees to investors in terms of the segregation of assets and profits/losses.

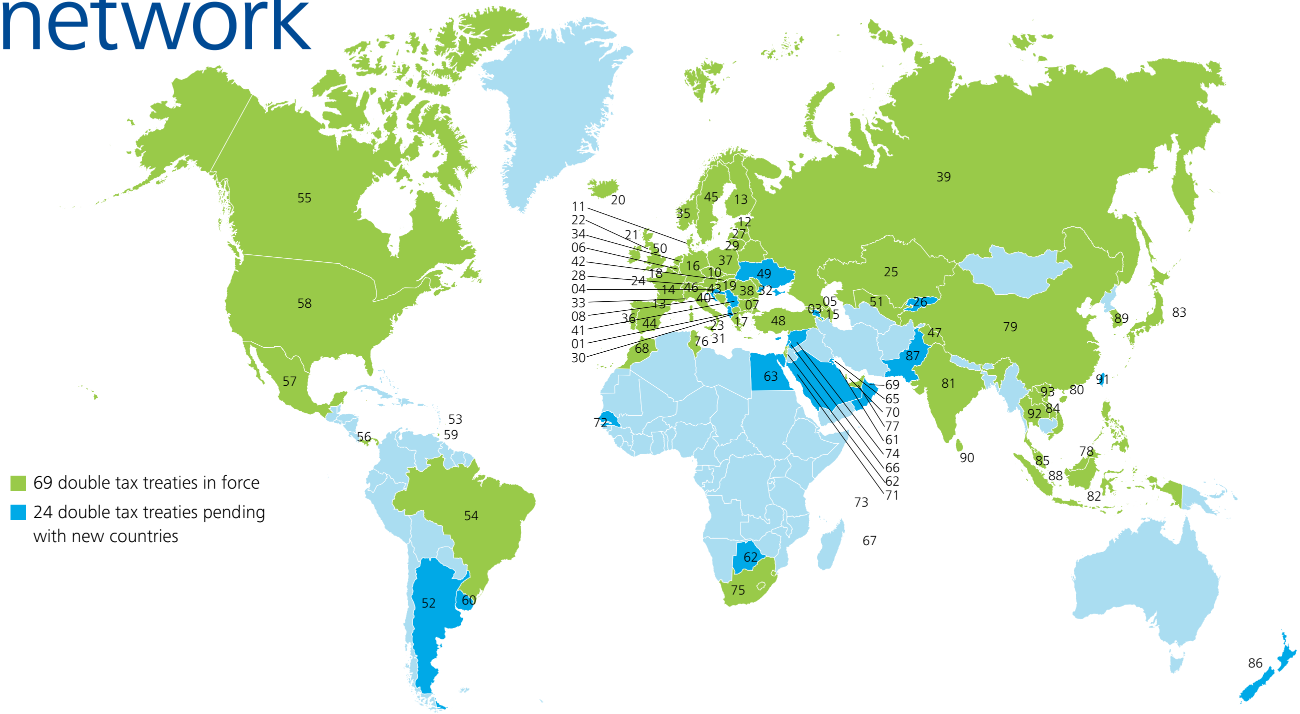
According to the circular, for Luxembourg tax purposes, sukuk would be treated like conventional bonds and the yield on sukuk would be treated as interest payments on conventional debt instruments. This tax treatment would apply even though the yield on the instrument is directly contingent on the income earned on the underlying asset. Hence, the yield will be tax deductible at the level of the sukuk issuer in the same way as interest on a conventional debt obligation. No withholding tax applies on such a yield under Luxembourg domestic law (implications of EU savings directive should be fairly limited given the nature of the instruments and the residency of the investors).

Conclusion

The circular letter confirms the pragmatic approach followed in Luxembourg for decades, thus facilitating the development of Sharia'a-compliant products and structures. The circular ensures clarity and security as to the tax treatment of, in particular, murabaha and sukuk, which is important for Islamic finance operators and investors.

The circular demonstrates a clear commitment on the part of the Luxembourg government and the tax authorities to position the Grand Duchy as a significant hub for Islamic finance.

Appendix 3 Luxembourg double tax treaties network



Europe and Central Asia

01. Albania	02. Andora	03. Armenia	04. Austria	05. Azerbaijan	06. Belgium	07. Bulgaria
08. Croatia	09. Cyprus	10. Czech Republic	11. Denmark	12. Estonia	13. Finland	14. France
15. Georgia	16. Germany	17. Greece	18. Guernsey	19. Hungary	20. Iceland	21. Ireland
22. Isle of Man	23. Italy	24. Jersey	25. Kazakhstan	26. Kirgizstan	27. Latvia	28. Liechtenstein
29. Lithuania	30. Macedonia	31. Malta	32 Moldova	33. Monaco	34. Netherlands	35. Norway
36. Portugal	37. Poland	38. Romania	39. Russia	40. San Marino	41. Serbia	42. Slovakia
43. Slovenia	44. Spain	45. Sweden	46. Switzerland	47. Tajikistan	48. Turkey	49. Ukraine
50. United Kingdom	51. Uzbekistan					

Americas

52. Argentina	53. Barbados
54. Brazil	55. Canada
56. Panama	57. Mexico
58. United states	59. Trinidad & Tobago
60. Uruguay	

Africa and Middle East

61. Bahrain	62. Botswana	63. Egypt
64. Israel	65. Kuwait	66. Lebanon
67. Mauritius	68. Morocco	69. Oman
70. Qatar	71. Saudi Arabia	72. Senegal
73. Seychelles	74. Syria	75. South Africa
76. Tunisia	77. U.A.E	

Oceania, South and East Asia

78. Brunei	79. China	80. Hong-Kong
81. India	82. Indonesia	83. Japan
84. Laos	85. Malaysia	86. New Zealand
87. Pakistan.	88. Singapore	89. South Korea
90. Sri Lanka	91. Taiwan	92. Thailand
93. Vietnam		

DTT Countries in MENASA		
Tax treaties in force	**Tax treaties signed awaiting for ratification**	**Tax treaties under negotiation**
Bahrain	Kuwait	Brunei
Indonesia	Saudi Arabia	Egypt
Kazakhstan		Kirgizstan
Malaysia		Lebanon
Morocco		Oman
Qatar		Pakistan
Tadjikistan		Syria
Tunisia		
Turkey		
United Arab Emirates		

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