

## Appendix-E

### *TAX INCENTIVES FOR INDUSTRY – OTHER COUNTRIES EXPERIENCES*

#### **i. Malaysia**

In Malaysia, the government has introduced parallel Islamic Banking. For income tax purpose, Islamic banking transactions are accorded the same tax treatment as that accorded to similar, interest-based transactions. The Malaysian Income tax Act, 1967, was amended to accommodate the Shariah based transactions.

In seeking to promote Malaysia as an International Islamic Financial Centre, tax incentives have been proposed during the recent Budget 2007 announcement aiming to attract foreign Islamic finance players to establish themselves in Malaysia, make the market grow as well as encourage Malaysian players to innovate and seek new markets to export their expertise.

#### **Tax neutrality of Islamic financing products**

Section 2(8) of the Income Tax Act has provided tax neutrality of Islamic financing transactions by explaining that any reference in this Act to the disposal of an asset or a lease shall exclude any disposal of an asset or lease by or to a person pursuant to a scheme of financing approved by the Central Bank or the Securities Commission, as a scheme which is in accordance with the principles of Shariah where such disposal is strictly required for the purpose of complying with those principles but which will not be required in any other schemes of financing. Similar tax neutrality has also been provided for Real Property Gains Tax and stamp duty to facilitate Islamic financing transactions.

#### **Tax Exemption on Foreign Transaction Income**

Currently, banks in Malaysia are taxed normally at 28% (rate to be reduced to 27% with effect from year of assessment 2007) and on a worldwide basis. This means that a licensed bank in Malaysia will be subject to Malaysian income tax on income received from overseas, including the income of the foreign branches of the Malaysian bank.

Under Budget 2007, a 10-year tax exemption is provided to 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. This incentive is effective from year of assessment 2007.

This exemption means that the income received by an Islamic bank from transactions in foreign currencies with foreign parties as well as Malaysians will be tax-free until year of

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assessment 2016.

### **Promotion of Malaysian Islamic banks to foreigners**

Islamic banks normally share profits with their customers depending on the financing products offered. Section 2(7) of the Income Tax Act, 1967 (ITA) provides for the tax treatment of profits from Shariah products to be similar to interest under conventional financing products.

This section explains that the profits received by the Islamic bank on Islamic financing provided to customers will be taxed just like interest income. Customers receiving profits from Islamic banks will also be treated to have received interest for tax purposes and taxed accordingly.”

Normally, withholding tax of 15% would apply when a Malaysian resident pays interest to a non-resident. Conventional banks are specifically not required to withhold the tax under specific tax exemption.

### **Musharaka**

Currently, the definition of partnership for tax purpose is very wide and includes all types of partnership with certain exclusion. Based on this definition, it would appear that the Musharaka or "partnership" between the Islamic bank and the customer would need to file a tax return. Multiply this by the number of customers of the Islamic bank and this will be an administrative burden which adds to the costs of the financing.

As part of Budget 2007 initiatives, the Finance Bill 2006 amends the definition of "partnership" for the purposes of tax to exclude any association which is established pursuant to a scheme of financing in accordance with the principles of Shariah. This means that such financing products would not require the filing of separate tax returns.

### **Cheaper funding costs**

According to Budget 2007, the stamp duty for Islamic financing products has been reduced. Firstly, it was announced that 20% stamp duty exemption be given on instruments used in Islamic financing for three years. This exemption will be provided after the stamp duty is exempted for purpose of tax neutrality. It shows that the stamp duty payable under Islamic financing will be 20% less than conventional financing. This incentive is subject to the condition that the Islamic financial products are approved by the Bank Negara Shariah Advisory Council or Securities Commission Shariah Advisory Council.

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### **ii. United Kingdom**

In recent years there have been a number of prominent developments in the UK Islamic finance market, and there is now considerable interest in developing and marketing a wide range of products. Shari'a compliant current accounts, savings accounts, and house purchase facilities are now available. Since the early 2000s the government, for reasons of wider public policy, has introduced a series of tax and legislative changes specifically designed to remove obstacles to the development of Islamic finance. The first significant change came in the Finance Act 2003 which introduced relief to prevent multiple payment of Stamp Duty Land Tax on Islamic mortgages. The Finance Acts 2005 and 2006 contained further measures aimed at putting other Islamic products on the same tax footing as their conventional counterparts. Most recently, the Finance Act 2007 clarified the tax framework further, in the case of Sukuk. This is very much work in progress.

### **iii. Singapore**

Singapore is looking forward to be an international financial centre to play a role in the development of Islamic Finance through leveraging on its existing critical mass and capabilities in wealth management, project financing and trade financing. The Singapore government recognizes that given the nature and structure of Islamic financial products, they tend to attract more tax than their counterparts. The overall policy approach has been to align tax treatment of Islamic contracts with the treatment of conventional financing contracts they are economically equivalent to. In line with this policy, the Finance Ministry announced several changes in the 2005 and 2006 budgets. In 2005, Singapore waived the imposition of double stamp duties in Islamic transactions involving real estate and accorded the same concessionary tax treatment on income from Islamic bonds that are applicable to conventional bonds.

In 2006, income tax and GST (goods and services tax) applications on some Islamic products were further clarified. The government identified three Shariah compliant products and ensured that they do not suffer more taxes due to the nature of their structuring. The Monetary Authority of Singapore (MAS) has allowed Singapore banks to sell Murabaha investment products in order to cater the needs of Islamic Finance. MAS is working with the industry to constantly review tax and regulatory framework to ensure a level playing field between Islamic and conventional financing. This is to support and facilitate financial institutions who wish to provide a range of Islamic products and services to meet the needs of their clients and investors.

In addition, to level the tax playing field for Sukuk (Islamic equivalent of a bond), remission will be granted on stamp duty on immovable property, incurred under a Sukuk structure, that is in excess of that chargeable in the case of an equivalent conventional bond issue.

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