

This decree has principally been set forth to be applied on the oil companies functioning in the State of Kuwait. These companies have sought to have this law issued at the aim of benefiting from the existence of tax legislation in the countries where they are functioning to be able to claim for the deduction of the taxes they pay to such country from the total taxes payable by them in the countries to which they belong . As those countries refuse to deduct the royalties or duties paid by such companies to the governments of oil producing countries as taxes from the tax bases of the countries they belong to because the technical meaning of taxes does not apply to these royalties or duties . This matter may lead to the abstention of the foreign countries from the merits of Foreign Tax Credit prescribed in the foreign tax legislation .

Therefore , this decree was meant for oil companies rather than for other companies. When drafting the decree those days it was based on the law of the British Oil Income Tax. However , the general provisions of such law that did not determine specific companies to comply with its provisions made it appropriate to be applied on all companies without taking into consideration the nature of their activities .

In spite of the statutory developments that followed the issuance of this decree and the occurrence of a number of statutes related to the tax law , of which was the Decree Law No.1 of Year1959 about the commercial register system , commercial companies law No. 15 of year 1960 and many other laws that were regulating the trade and industry activities in Kuwait , it was necessary to amend the previous tax statutes to complete and conform to the new laws .

The problems of applying the income tax decree No. 3 of Year 1955 :

The practical application of the decree for a long time revealed many problems in application and that it did not conform to both the economic and social developments in the State of Kuwait or to the development of tax laws and legislation in different countries . Such thing resulted in the disability of the State of Kuwait to attract and stimulate the Kuwaiti capital or to be on line with the developed general financial and economic structures in the other countries . The most outstanding problems of the income tax decree application are as follow ;

1. The historical background invoking its being oil tax law .
2. Its translation later on lacked the excellence in context and the precision in expression the thing that reflected in the difficulty of applying such law.
3. deficiency in applying the law on foreign companies and non – application of such law on Kuwaiti companies contributed in the absence of tax awareness at the Kuwaiti society

which made the use of taxation as an instrument among the other implementation instruments be surrounded with a number of social obstacles that hindered tax reformation for some time .

4. The decree also does not have any incentives or tax exemptions for the desired economic or social objectives .
5. The high tax percentage that may reach (55%) and which may lead to tax evasions or in the best cases the departure of capital owners from investing in the State of Kuwait .
6. Carrying forward the losses indefinitely .
7. There has been no certain provision for prescription which led to the loss of the state funds .
8. The refusal of some economically important countries to sign “Double Taxation Avoidance Agreements and the Encouragement and Protection of Investments” due to the incomprehensiveness of the Decree .

Solutions and Alternatives:

- Reformation of the present Taxation System .
- Providing a suitable Investment climate .
- Organizing tax relations between the state of Kuwait and the other countries .
- Modification of the general financial structure .

II. Law No.19 for Year 2000 for the Support and Encouragement of National Labour to work in Non-Governmental institutions .

The State of Kuwait legislated a law for the support and encouragement of national labour to work in the non- governmental institutions on 21/ 5/ 2000 . Enforcement of such law began on the 21/5/2001 for the sake of bringing the differences between work salaries and benefits closer together in the different sectors . This is based on the principle of equality in the rights and duties of the Kuwaiti nationals which has been ensured by the constitution of the State of Kuwait . One of the most distinguished rights is the right to work and ensure to have a stable social life. This matter requires restructuring the workforce , realizing the optimum use of human resources , and activating the non-governmental institutions role as partner in the process of development and absorbance of the national workforce .

The above mentioned law has included eighteen articles. It obliges every governmental and non – governmental body or individuals to enforce the part of this law that concerns them.

The first paragraph of Article (12) of the said law which aims to provide the required financial resources to support the salaries and benefits of the workers in the private sector , stipulates

that : “ a tax of 2,5% of the annual net profits shall be imposed on the Kuwaiti companies listed in Kuwait Stock Market . ”

The Ministry of Finance will take in charge the collection of the tax stipulated by the above mentioned article on condition that the system of restructuring the workforce and the state executive authority shall pay the collected sums to the Kuwaitis working in the private sector. However , the tax amounts collected and the amounts paid since the enforcement of this law are as follows :

Year	Number of workers in the private sector	Collected Sums(KD)	Paid Sums(KD)
2001	1,601	4,465,111	570,680
2002	1,770	6,083,524	2,983,538
2003	3,230	13,236,481	21,456,731
2004	5,198	26,617,242	35,712,934
2005	7,360	33,801,682	52,946,269
2006	14,008	49,011,924	77,432,174
Total	* 33,167	**133,215,946	*191,102,329

Advantages :

1. More Kuwaiti labour tends to work in the private sector .
2. Reduced average of unemployment and the pressure on government jobs .
3. Less need of foreign human resources for working in the private sector .
4. Motivation of the economic wheel cycle by maintaining the local currency from transfer to outside the country .

Obstacles of Application:

The Ministry of Finance met some gaps in applying the law and in the collection of tax of which the most significant were the following :

- I. Non-existence of executive bylaws for regulating the work by law , and how to define the net profit and the mechanism of collection which affected the application of the law .
- II. Imposition of taxes was limited to the Kuwaiti companies listed in Kuwait Stock Exchange Market . Other kinds of companies which were not listed were excluded .

1.

* According to the statistical data for the programme of “ Restructuring the Workforce and the Executive system of the State of Kuwait ” .

** According to the data of the State of Kuwait Ministry of Finance .

Third : The said law does not provide for any penalty for the delay of submittal of tax return and tax payment .

3. Law no. 46/2006 regarding Zakat and the contribution of public and closed shareholding companies to the state budget

Kuwait is an Arabian Islamic country emerged in the seventeenth century. Since its emergence , it has consistently adopted the rules of Islam , the provisions of Islamic Sharea and religion .

Kuwait people have been accustomed to charity deeds , whether people or rulers in the past as well as the present times . The third Amir of Kuwait Sheikh Jaber I was nicknamed “ Jaber of the Rice” because of the large quantity of rice he had donated to the poor and needy. These good offspring have continued until the thirteenth Amir of Kuwait , his late highness Sheikh Jaber Al Ahmed Al Jaber Al Sabbah was honored as the Charity Character of 1995. Many of Kuwait people including well-to-do merchants and the public were famous for charity. They established schools , clinics and other charity deeds .

The State of Kuwait became independent in 1961 . The Kuwaiti Constitution of 1962 stressed the Islamic identity of the State of Kuwait. The second article of the Constitution provides that “ Religion of the state is Islam and Islamic Sharea is a primary source of legislation ” .

The private sector in the State of Kuwait receives all forms of government , financial and service support in view of the semi-absolute absence of any income tax that is imposed at large rates of the net annual profit of companies in rich as well as poor countries.

In view of this fact , the legislators have decided to impose 1% of the net annual profit of shareholding and closed companies as contribution to the state’s public budget in general on the one hand and to enable those companies paying Zakat to direct this rate to the legal beneficiaries within a more comprehensive framework . This law consists of five articles , notably :

(**First Article**) A percentage of 1% per annum will be collected from the net profit of Kuwaiti public and closed shareholding companies. These companies may upon submission of their tax returns attached with their annual balance sheets hereunder specify a portion of the collected

amount representing Zakat due for their funds . They may also request to direct such portion in whole or in part to a certain public utility .

There will be penalized with imprisonment for no more than three years and a fine of no more than Kuwaiti Dinars five thousands or with either penalty together with ruling for payment of the due amount .

(Second Article) The Ministry of Finance shall be responsible for the collection of the rate stipulated in the first article for the state treasury in the manner regulated under this law and its executive bylaw .

(Third Article) The Minister of Finance shall issue the executive bylaw hereof , showing the rules and procedures of collection and expenditure of collected funds not later than one year from the date of publishing this law and containing the legal expenditure items of Zakat under the approval of the Fatwa panel of Ministry of Awqaf and Islamic Affairs , subject to the first article hereof .

Second : Islamic Financial Instruments

1. Islamic Financial System

The honorable Profit Mohamed (peace and blessing on him) established the Islamic state on well-established and strong foundations for maintaining the entity and existence of the Islamic state. The said foundations include economy which is the basic element of maintenance of the political and social components of the country . Since the early beginning of the Islamic state , the honorable Profit Mohamed laid down the regulations and rules related to the economic side of the state as derived from the rules of Islamic Sharea. One of the most important regulations and rules is Zakat imposed on Muslims. The honorable Profit Mohamed set the general rules of Muslim treasury as well as the appropriate procedures at the time and Gizyah imposed on non-Muslims in addition to other economic rules .

The Islamic Sharea including Holy Qura'n and Prophet Sunna (Traditions) has set many rules , guidelines and clarifications that are directly or indirectly related to financial dealings with individuals or firms.

Therefore , the Islamic financial institutions are an integral part of the Islamic economic system consisting of financial system , financial institutions and financial instruments. These institutions are defined as “ Those bodies , banks or companies whose articles of association are based on the provisions of Islamic Sharea , whether such bodies or institutions are public or private ” .

The Islamic financial institutions are playing important and critical role in the economic cycle , in particular as many financial instruments have been innovated in compliance with the provisions

of Islamic Sharea or what is termed as “Islamic Financial Instruments” which have greatly and effectively contributed to the boom of regional and world economy . It is noted that some of these instruments were available at previous Islamic times.

2- Islamic Financial Instruments

a. Definition of Islamic Financial Instruments

It is important to define what are the Islamic financial instruments being used now by many Islamic financial institutions and others , which instruments have become common now in view of their financial and economic importance in the respective field .

Islamic Financial Instruments are financial dealings of finance nature based on Sharea rules or compatible with the provisions of Islamic Sharea. Although the Islamic financial instruments have emerged in the last few decades , they have achieved very high profit in this relatively short period .

b. Types of Islamic Financial Instruments

Islamic Financial Instruments are characterized with diversity , resulting in their exposure and expansion in terms of form or content or even the expansion of geographic area. Over the last five years , the Islamic finance has increased in terms of not only volume but also complication in view of the bankers’ strong competition all over the world for the innovation of new concepts compliant with the Islamic Sharea and consistence of their provisions with modern finance. These instruments include but not limited to the following :

- **Islamic Sokouk (debentures)** : These are instruments of equal value representing common shares of the ownership of properties , goods , services or assets of certain project or private investment activity after collection of the value of Sokouks and closure of subscription and commencement of their use for the respective purpose .¹
- **Takaful Insurance** : It is a system where all participants donate all or some of their contributions for indemnifying the damaged participants. The underwriter and the fiduciary are one single entity , namely the holders of policies. The role of the underwriter is limited to the management of finance works on specific commission basis under authorization .
- **Murabaha** : It means credit sale (old term) i.e. the financial institution mediates for the purchase of a commodity or service upon the client’s request and then sell the same to him on credit for a price equal to the total purchase cost plus a specified profit rate .
- **Tawaruq** : It means the purchase of a commodity in the possession of the seller at deferred price and then the purchaser sells it in cash to a third party other than the seller , i.e. sells it to a third party for raising cash money² . The economic indicators and studies state that this type of Islamic financial instruments will undergo a boom amongst the Islamic financial instruments

in the near future .

- **Leasing** : It means such finance form based on the leasing contract which is well defined in the Islamic jurisprudence. Here , the bank sells an interest owned by it whether by way of asset ownership or title of usufruct .
- **Tooling (Istisnaa)** : It means the finance of manufacture of commodities or construction of a specific asset requested by the client in accordance with specifications set by the banking institution.

C. Features of Islamic financial instruments

- Wide range of negotiation between the savers and investors on the rate of profit sharing
- Reduction of exchange expenses for both savers and investors
- Increase of financial institutions access to the owners and users of financial resources

3. Tax on Islamic Financial Instruments

It is noted that the tax legislation in the State of Kuwait does not exercise any type of tax liability on Islamic financial instruments traded by Islamic institutions. However , the profits realized by the Islamic companies listed in Kuwait Stock Exchange Market are subject to national labor support tax .

4. Experience of Kuwaiti Islamic financial institutions

Islamic banks and financial institutions are intended to mobilize available Muslim resources and direct them to the investments that serve the objectives of economic and social development objectives. For this end , Islamic banks do their best efforts to promote the saving and investment awareness of individuals . They accept deposits for investment purposes under certain conditions , notably the investment shall be made in accordance with the provisions of Islamic Sahrea , whether as Mudharaba or otherwise . Islamic banks may invest the said deposits by itself or through Mudharaba (speculation) with another party observing the provisions of Islamic Mudharaba . As banks and institutions are partners to these investments and their returns , they are very keen in selecting their projects by carrying out some economic and technical studies for their projects before approval of their finance. Therefore , the finance operation is performed in banks and financial institutions according to the conditions of Mudharaba , Murabaha or any other method subject to non-conflict with the provisions of Islamic Sharea .

The leading Kuwaiti Islamic institutions in this regard include but not limited to Kuwait Finance House , which carries out Islamic investment business :

- a. Directly through several Islamic financial instruments including but not limited to :

- Murabaha
- Leasing
- Tooling
- Investment agency

b. Through indirect contracts (incorporation of companies for special objectives for issue of debentures)

Kuwait Finance House explained that Islamic investment in some countries faces major obstacles including :

- The tax legislation does not accommodate the nature of execution of Islamic finance instruments , resulting in the high cost of Islamic finance in comparison with non-Islamic finance instruments , resulting in the limitation of their popularity .
- Long procedures of execution of Islamic finance

Is there double taxation between tax and Zakat in view of Kuwait Finance House's experience?:

They explained that there is no double taxation between tax and Zakat in the present time as most investments of Kuwait Finance House are in countries where tax is low and therefore the same does not constitute an impediment to the bank. The bank pays the tax payable to the state in addition to the religious liability , namely Zakat.

In case of high tax at such countries where Kuwait Finance House carries out its investments on large scale , there might be double taxation between tax and Zakat if the tax legislation does not accommodate the religious aspect of Islamic institutions related to Zakat as religious duty .

The business of Islamic finance instruments is based on the transfer of title , resulting in tax liabilities and then resulting in the high cost of finance resources to the end beneficiary and consequently limiting the demand thereon .

Third : Future Expectations of State of Kuwait

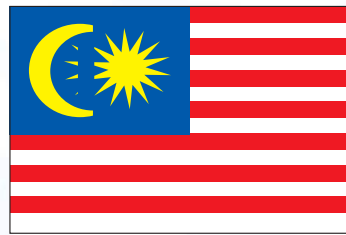
- Promulgation of comprehensive tax law
- Taking into consideration the nature of Islamic financial instruments upon promulgation of tax laws in the future .

(Footnotes)

- ¹ Guidelines for computation of Corporate Zakat – Kuwait Zakat House – 2006 , first edition
- ² Islamic Jurisprudence Compound



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WORKING PAPER
Kingdom of Malaysia

TAXATION OF ISLAMIC FINANCIAL INSTRUMENTS

1. Introduction

In Malaysia , Islamic finance traces its history back to 1963 , with the setting up of the Pilgrims Fund Board . This was a savings mechanism under which Malaysian Muslim set aside funds to cover the costs of performing the annual pilgrimage . These funds were in turn invested in syariah-compliance productive sectors of the economy with the objective to receive return uncontaminated by element interest (riba) .

The first Islamic bank established in Malaysia was Bank Islam Malaysia Berhad (BIMB) which commenced operation on 1st July 1983 . BIMB carries out banking business similar to other commercial banks but are based on Syariah principles . In March 1993 , in order to disseminate Islamic banking nationwide , the concept of Islamic window was introduced . This scheme allows conventional banking institutions to offer Islamic banking products and services using their existing infrastructure . On 1st October 1997 , a second Islamic bank in Malaysia , namely Bank Muamalat Malaysia Berhad commenced operations and carries out banking business similar to BIMB .

Currently , Malaysia has succeeded in implementing a dual banking system and has created a spill-over effect to the non-bank Islamic financial intermediaries which started to offer Islamic financial products and services . Such institutions include saving institutions and the development financial institutions .

1.1 Malaysian Tax Legislation

1.1.1 In the context of banking and finance , the factor that distinguishes Islamic financing and conventional financing is the absence of interest-based transactions . Islamic financing transactions would have a 'gain' or 'profit' element instead of 'interest' element as in conventional financing transactions . Malaysian Income Tax Act (ITA) 1967 treats 'gains' or 'profits' in Islamic financing transactions to be similar to interest in conventional financing . Under Section 2(7) ITA 1967 , 'gains' or 'profits' received and expenses incurred , in lieu of interest , in transactions conducted in accordance with the Syariah principles are taxed in the same way as 'interest' . Therefore , the taxability or deductibility of 'gains' or 'profits' would be similar to the treatment of 'interest' in conventional financing .

1.1.2 As 'gains' or 'profits' is treated as interest , it is an allowable expense if funding has been used for business purposes or purchasing assets to generate income . Similarly , all tax rules relating to 'interest' , such as withholding tax and exemptions on 'interest' will equally apply on the 'gains' or 'profit' .

1.1.3 Islamic financing transaction is not a debt-based transaction which the return is 'interest' . Islamic financing transaction is a trade-based transaction which the return is 'gain' or 'profit' . In order to facilitate financing in Islamic transaction , there will be an underlying transaction which the customer will sell an asset to an Islamic bank and repurchase the same asset or lease the same asset from the same Islamic bank . This underlying transaction would

attract tax provision . This underlying transaction does not appear in conventional financing as in conventional financing , the bank will give loan to a customer and expect the customer to pay back the loan plus interest . Section 2(8) ITA 1967 seeks to ignore the underlying transaction so that tax neutrality can be achieved in Islamic financing transaction . By using this section the Islamic bank will not be taxed twice on the profit from selling back the asset to the customer and on the 'profit' from the financing transaction .

1.2 Financing Operations

Financing operations adopted by Islamic banks and financial institutions are by no means new . They are only different from the traditional credit transactions undertaken by conventional banks and financial institutions . For example , Mudharabah is a type of investment trust or mutual fund and Musyarakah is a kind of joint venture which usually involves equity participation . Ijarah is leasing and Ijarah wa Iqtina is hire-purchase . All these modes of financing are recognized and undertaken by existing conventional banks and financial institutions .

1.2.1 Investment Financing

Investment financing is provided for a variety of profit-sharing arrangements . The concept of profit-sharing is fundamental to financing in Islamic banking . There are two types of profit-sharing arrangements adopted by Islamic banking and financial institutions .

1.2.1(a) Mudharabah (trust financing) means a business in which a person participates with his money and another with his effort or skill or both of his effort and skill . The capital provider (rab ul maal) provides the entire funds and the Islamic banks and financial institutions (mudarib) supply the labour and management only . The capital provider gets an agreed proportion of the profit actually realized but bears all the losses , if any . Losses sustained through negligence of the Islamic banks and financial institutions or breach of the terms of the agreement between the parties is borne by the Islamic banks and financial institutions . This mechanism can be seen in the operation of Mudharabah Current Accounts where the depositors will get their profit from the mobilized funds or it also can be seen in the unit trust activities where the unit holder will receive return in terms of dividend . These profit and dividend are taxable income .

1.2.1(b) Musyarakah (participation financing) is a form of joint venture or partnership for an agreed time under which both parties provide capital and either one or both may manage the business . The profits of the business are shared in a pre agreed ratio but losses , if any , are borne in proportion to the capital investment . The profit from the participation financing will be taxed . This is similar to a loan syndication arrangement . Thus , the fundamental difference between Mudharabah and Musyarakah is that in the former , capital and monetary loss belongs to only capital provider whereas the latter , both capital and monetary loss are shared by the partners .

1.2.2 Trade Financing

Trade financing generally consists of short-term placement of funds for trade purposes . The types of trade financing include cost-plus financing , lease financing and hire-purchase financing .

1.2.2(a) Bai bithamin Ajil / Bai Muajjal / Murabaha (cost-plus financing) involves the sale of goods at a mark-up price if payment by the purchaser is on a deferred basis . The financier arranges for the purchase of goods requested by the customer and sells them to him on the basis of cost plus agreed profit margin (mark-up) which can be paid lump sum or in installments over a specified time period . The mark-up element (profit) is a taxable income .

1.2.2(b) Ijarah (lease financing) involves the acquisition of certain goods by the financier from the customer and lease the same goods to the customer for fixed charge . The ownership of the leased goods reverts to the lessee after a certain period . This is similar to financial lease where the leased payment will be taxed .

1.2.2(c) Ijarah wa Iqtina (hire-purchase) is a mode of financing where the financier provides finance for the purchase of certain goods on the basis of an agreement under which the financier receives a payment of principal plus a share in nature of rental for the use of the goods . This rental is a taxable income and similar to interest in the conventional hire purchase financing .

2. Financing and Trading

Over the years Malaysian Islamic banking and financial institutions have operated as financiers as the explanation above describe . Some have argued that Islamic banking and financial institutions should operate more like traders as Kuwait Finance House and Al Rajhi Bank do in their home markets . The call to change the business operation is not new . Banking and religious scholars have raised concern that many of the retail banking facilities to credit cards and capital market products are mere duplication of the conventional products .

Malaysian financial products and services are Syariah compliant not Syariah based . With the participation of foreign Islamic banks in the Malaysian market and to compete with them , Malaysian banks will need to introduce new products and the banks must evolve to operate more like traders than lenders . Foreign Islamic banks like Kuwait Finance House and Al Rajhi Bank in their home markets actually buy/own products and sell to clients . These banks operate like a large supermarket offering cars , houses , electrical appliances and other consumer goods direct to their customers . As the banks face higher risk profile means that the make more returns .

By going to manufacturers , Islamic banks get products at cheaper prices and then mark-up the price before selling to potential customers . For property projects , the banks become owners or joint venture partners , often taking active participation in the development of the project and sometime selling the properties themselves . Kuwait Finance House , for instance has launched a USD600 million Islamic real estate funds called Baitak Asia Real Estate Fund to invest in properties in the Middle East region .

The second objective for the foreign Islamic banks is to provide financing which is another source of income . In the corporate financing work , the new foreign Islamic banks in Malaysia are providing financing for specialized sectors like aviation and construction . Kuwait Finance House for instance financed the purchase of Air Asia Berhad's planes .

3. Tax Issues

Taxation systems in Malaysia have developed over the years in a conventional financial environment and sometime fail to accommodate the type of transactions undertaken in Islamic finance . It is necessary for Islamic financiers to undertake careful and specific tax planning when implementing Islamic financial arrangements in Malaysia to ensure that they are not disadvantaged from a taxation aspect . Malaysia in particular has been changing or modifying its tax law in order to accommodate Islamic finance transactions .

3.1 Ijarah Transaction (Islamic Lease)

Ijarah transactions are fundamentally financing transactions which incorporate leasing of an underlying asset in order to conform to Syariah principles . Most Islamic bank especially foreign Islamic banks provide banking facilities under Ijarah transaction . It is important to note that Ijarah for movable assets will trigger the application of the Income Tax Leasing Regulation 1986 (ITLR) . Under ITLR , the gross income from lease transactions shall be deemed as separate and distinct business source from other activities . In addition , the gross income which includes the capital portion of the lease will be subject to income tax . As gross lease income is taxed separately , there is a need to apportion common expenses including interest cost . This could increase the effective tax rate of the Islamic banks due to the apportionment formula being adopted .

3.2 Ijarah Transaction in Property Development Activities

Ijarah contract also can be used in financing property development activities . An Islamic bank can purchase a parcel of land and develop the land until it is completed . Then , rents the completed properties to any interested party and the interested party will make an undertaking or a promised that he will buy the property and the end of ijarah period with an agreed price . This sale and purchase agreement is not part of Ijarah contract . This transaction is called Al Ijarah Muntahia bit Tamleek . Since the rental received from the property during the ijarah tenure is funding income of the bank , can the rental received be treated as business source?

3.3 Istisna (Manufacturing Contract) Transaction in Property Development Activities

Besides Ijarah contract , istisna contract also can be used in financing property development activities . The difference between ijarah and istisna is the latter is meant for properties which are under construction . Islamic bank will purchase a parcel of land and develop the land and will sell the properties under construction to any interested party . Should the profits on sale of the properties be taxed upfront or the profit will have to be apportioned according to the construction period because it is a funding transaction .

3.4 Commodity Murabaha

Malaysia is establishing a new Islamic financial tool known as the Commodity Murabahah using crude palm oil (CPO) as the underlying commodity . The mechanisms using this type of transaction are as follows:

A customer wants to buy a machine valuing RM 100,000.00. To start this type of financing , an Islamic bank buys the CPO in a commodity market immediately paying , says RM 100,000.00 for it and transfers the ownership of the CPO to the customer at a price of RM 105,000.00

payable in , say , 5 years . The customer can then immediately sell the CPO in the same commodity market for a price of RM 100,000.00. This gives the customer cash equal to what the Islamic bank laid out to him , RM 100,000.00 and he has an obligation to pay the Islamic bank RM 105,000.00 within 5 years . The extra RM 5,000.00 is the cost of the finance .

The principle issue under Malaysian tax law is that , the customer may not be entitled to a tax deduction . The customer has purchased an amount of CPO at a price of RM 105,000.00 payable in 5 years time and sold that CPO for RM 100,000.00 with the price being payable immediately . Accordingly , the customer has suffered a loss of RM 5,000.00. Is this loss tax deductible? Unless the customer can argue under Malaysian tax law that he is trading in CPO , it will not be entitled to deduct RM 5,000.00 loss against his income .

3.5 Diminishing Musyarakah

This type of transaction is often used by those who want to buy houses for owner occupation instead of using a conventional mortgage transaction . Diminishing musyarakah contract also can be used for the purchase of investment property .

Diminishing musyarakah is used when one party (eventual owner) wants to buy an asset , say a factory , but cannot settle the full selling price . For the first step , the bank buys , say 75% of the factory while the eventual owner buys the remaining 25% . Under this type of contract , the eventual owner has immediate rights to sole occupation of the entire factory .

The eventual owner pays rent to the bank on the 75% of the property that he does not own . Then , over the tenure of the agreement , as well as paying the rent , the eventual owner will make additional payments to the bank to purchase additional part of the property . The bank will also have a put option to require the property to be purchased at specific time period .

The price for the additional part of the property will be stated in the diminishing musyarakah agreement . Any pricing method or formula can be used but the normal pricing mechanism will be as follows:

- i. The price is equal to the original cost to the bank .
- ii. The price is equal to the market value of each part of the property .

Referring to the above scenario , we would expect that the eventual owner to receive tax deduction for the rent he is paying to the bank . This rent is being paid to enable him to occupy the whole property even though he only owns 25% of the property .

With a thorough examination , tax deduction is not entirely certain as the eventual owner has the right to purchase the bank's share of the property over a period of time by using the amount of rental paid .

If the purchase of the bank's share is made at market value for the eventual owner to occupy the property , the rent is likely to be the same as the rent that is paid in conventional property rental transaction and is a tax deductible .

Different tax treatment will arise when the eventual owner is entitled to purchase the bank's share of the property at a price equal to the original price paid by the bank . In this scenario , the rent paid by the eventual owner has two objectives:

- i. Entitlement to occupy the property;
- ii. Preservation of the entitlement to purchase the property at the bank's original cost .

This preservation of the entitlement to purchase at original price appears to be a capital transaction which would not be tax deductible .

At the bank's perspective , will the sale of the completed property and the rental of property be considered as separate business sources (financing business) and will the rental of property be seen as investment source?

3.5 Profit Equalisation Reserve (PER)

Islamic banks are required to have PER to reduce the fluctuation of dividend rates arising from the fluctuation of income generated , provisioning , total deposits etc and to ensure their competitiveness with conventional banking . PER is appropriated from gross income before arriving at the net distributable income . PER will be built up when a guaranteed rate of return is achieved and is written back when the guaranteed rate of return is not achieved . This is to meet the objective that the required rate of return to depositors can be achieved at all times . A question arises whether PER is an incurred liability or contingent liability in order to satisfy tax law .

4. Tax Incentives for Islamic Financial Institutions

Malaysian financial landscape is gradually changing with the participation of new international players . This paper looks at the incentives for Islamic banking sector and some of the important factors to be considered to ensure that investors would fully benefit from the incentives given by the Government of Malaysia .

4.1 Income Tax Exemption for Islamic Banking

Income tax exemption will be given for a period of 10 years from 2007 to 2016 for 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 .

An Islamic bank refers to a new conditional licence under Islamic Banking Act 1983 issued to foreign or local financial institutions to conduct a full range of Islamic banking business in international currencies . The new entities will be referred to as licensed International Islamic banks (IIB) . Whereas , Islamic banking unit refers to Malaysian Islamic banks that are offering Islamic financial services to set up an International Currency Business Units (ICBU) within the institutions itself .

IIB and ICBU can carry out a wide range of Islamic banking business in international

currencies such as commercial banking business , investment banking business and other banking business approved by Central Bank of Malaysia .

4.2 Tax Issues for Islamic Banking

There are some issues to be taken into account from a practical view point so that these IIBs or ICBUs of Islamic banks would fully benefit from the tax exemption . However , as far as IIBs are concerned , they primarily conduct transactions in international currencies and the issues below may not be that noticeable as compared to ICBUs within existing Islamic banks .

4.2.1 ICBUs of Islamic banks can carry out a wide range of banking businesses . As the Islamic banks would carry out businesses in both local and international currencies , there will be a need for legislative framework to clearly define the scope of “banking business conducted in international currencies” . This will determine the type of income of the Islamic banks that would be exempted . Financial transactions and products evolve over time to meet to the changing need of the public . A good example for this issue is the treatment for banking transaction in dual currencies . Therefore , a clear legislation is needed to avoid dispute with the tax authorities .

4.2.2 ICBUs of Islamic banks would likely share common resources and assets with business activities of the Islamic banks carried out in local currency . This leads to the issue of allocation of common expenses and capital allowances to the businesses carried out in local and international currencies .

4.2.3 The income of the ICBUs of Islamic banks is exempt is at statutory income level . If the business in international currencies were in a loss , could such losses be utilized to offset income from the other business , and vice versa? In addition , would the losses be entitled to be carried forward to offset future income of the Islamic banks after the expiry of the 10 year exemption period?

4.3 Tax Exemption – Profit paid by Islamic Banks to Non-Residents

Profit paid by Islamic banks to non-resident customers will be exempted from tax . This is in lieu of interest income received from conventional banks .

4.4 Musyarakah Financing – Tax Neutrality

The definition of partnership in Malaysian Income Tax Act 1967 is to exclude any arrangement which is established under a scheme of financing in accordance with the Syariah principles . Therefore , no separate partnership tax return is required to be submitted to the tax authorities .

5. Sukuk (Islamic Bond / Islamic Securities)

Sukuk have become extremely important in Islamic finance . The objective of sukuk transaction is to give investors an undivided ownership share in the income flows from the

assets , so that there is no debt obligation to them . Whereas , a conventional bond is a contractual debt obligation whereby the issuer is contractually obliged to pay to bond holders interest and principal . In short , sukuk are monetary denominated participation certificates of equal unit value to be issued to investors to represent their proportionate share in the ownership of the underlying assets and a pro rata share in the income generated by those assets .

Sukuk structures are developed based on the existing laws of a particular jurisdiction . However , the legal relationships are not about lending and borrowing but about sale , purchase , construction and investment which are operated under banking and securities laws . Therefore , it is extremely important to fine tune tax laws that govern sale , purchase , construction and investment . Besides any guidelines or orders issued , Section 2(7) and 2(8) of the Malaysian Income Tax Act 1967 have given the tax neutrality treatment in this aspect .

5.1 Tax Incentives for Sukuk Transaction

5.1.1 A deduction will be allowed until the year 2010 on expenses incurred on issuance of Islamic securities approved by the Securities Commission based on :

- (a) the principle of mudharabah , musyarakah , ijarah and istisna'
- (b) any other principle in accordance with the Syariah principle approved by the Minister

5.1.2 Tax exemption on income of a Malaysian resident Special Purpose Vehicle (SPV) established to ensure compliance with Syariah requirements for the issuance of Islamic Securities .

5.1.3 The cost of issuance Islamic securities (mudharabah , musyarakah , ijarah and istisna') incurred by the SPV can be claimed by the Malaysian resident company which establishes the SPV .

5.1.4 Remission of 20% of stamp duty imposed on principle or primary financing instruments made according to Syariah principles .

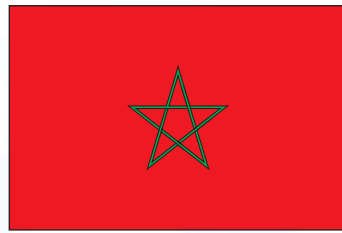
6. Conclusion

We should refrain ourselves from making a direct comparison between Islamic banking and conventional banking (apple to apple comparison) . The key difference is that Islamic banking is based on Syariah foundation . Thus , all dealings , transactions , business approaches , product features , investment focus and responsibility are derived from Syariah laws which lead to the significant difference in many parts of the operations as of the conventional banking system .

The demand for Islamic banking and finance is growing and leads to the establishment of new banks and to a number of others offering Islamic products alongside conventional ones through windows in branches . The system of Islamic banking and finance is based on the principle on interest-free financing . As such it is different from the conventional banking system . Islamic banks must operate to the highest ethical and moral standards and this

includes the principle of fairness to all . In turn , this leads to the practice of neither giving nor receiving interest . In addition , Islam states that there can be no gain without sharing in risk; therefore many deposit-like products have investment-like characteristics as depositor share not only in the profits but also the losses , either of the bank itself or of the SPV in which their funds are placed .

Malaysia has succeeded in implementing a dual banking system by having a full-fledged Islamic system operating side-by side with the conventional banking system . Nevertheless , there is an uphill task that lies ahead for the authorities . The challenge would be for the authorities to come up with a clear and administratively simple regulatory and supervisory framework within a short span of time and ensure that the frameworks achieve the Malaysian government's intention of spurring the growth of the Islamic banking in Malaysia . To achieve this , nurturing human resources and the availability of proper training are essential to sustain the growth of Islamic banking in Malaysia . Lastly , Islamic banking business in Malaysia is not just about tax exemption . The uphill tasks for it is to define clearly the target segment , the products that can be delivered and the capability in delivering the products .



WORKING PAPER
Kingdom of Morocco

The Use of Information Technology in Improvement of Tax Administration

Information constitutes a predominant factor in this world . Companies and organisations are no longer considered as simple producers of goods and services but are becoming entities which strength lies in the acquaintance and the mastery of knowledge .

In the absence or lack of useful and relevant information , companies will make inadequate decisions and would not aspire to growth and to sustainable development . The keys of progress and success lie in their abilities to take advantage from the information in order to innovate and turn ideas into new projects and new achievements .

In the case of Tax Administrations , information is so important that they are required to mobilize the maximum of financial resources . Without these resources , a State cannot face the increasing needs of economic , social and human development . Thus , information constitutes the real wealth and the privileged tool to support success of the Tax Administration's mission .

Beyond the unprocessed information , the economic and tax intelligence are required in order to structure and turn this information to knowledge , thus allowing the identification of opportunities and threats to the organization and to taxes . In this respect , the future use of “search engines” technologies (Google for example) to improve the tax effectiveness is perfectly conceivable .

All these needs related to information and its processing require the adoption of performant information systems . Beyond the management aspect , such systems help standardization of methods and procedures , to not only allow better strategic choices support but enable the adaptation to changes and the reduction of their impacts as well .

Being aware of the necessity and the importance of such a system , the General Tax Administration (GTA) has started to develop its information system since 1984 . Currently , the GTA continues its improvement and its extension as part of an important modernization program of the Moroccan tax system as a whole . This program deals with both tax policy and the General Tax Administration's organization .

Indeed , as regards tax policy issues , the GTA has placed the emphasis on the simplification and the harmonization of regulation and procedures . The objective is to facilitate their understanding by taxpayers , improve and standardize their use by tax officials . In this context , the major actions that have been undertaken are:

- 1 - Harmonization and review of tax laws have led to the adoption of the “General Tax Code” and the reduction in the number of articles that have been brought down from 415 to 248 .
- 2 –Release of annual reports on tax expenditures .

With respect to the modernisation of the Tax Administration and tax management , several actions have been undertaken at the organisational and procedural levels . The most significant of these actions are:

- 1- Reorganization of the GTA's structures by type and size of taxpayers (individual bodies corporate bodies , large companies and other corporate bodies) . The objective is to offer a more customized service which meets the needs of users .
- 2- Transfer of tax collection task from the General Treasury of the Kingdom to the General Tax Administration for an integrated tax management .
- 3- Development of Human Resources through training and improvement of functions .
- 4- Revamp of the information system .

These reforms have led the GTA to improve its integral performances and to sustain its yield which shows a double digit annual increase (14.8% in 2005 and 18.7 % in 2006) .

Contribution of the information system to the modernization of the General Tax Administration :

Information is at the core of the Tax Administration's missions and it constitutes a platform of all of its attributions and missions . A Tax Administration cannot perform its mission properly without a performant management information system which has to be continuously improved in order to consolidate the acquired performances and to develop them .

In 1984 , the General Tax Administration initiated the setting up of its information system which has been gradually extended . To further modernize and improve the quality of its services , the GTA has undertaken , in 2002 , the development of a new information technology master plan over the years 2003-2007 . This plan revealed some shortcomings in the existing system , among which:

- Spread of information over several no communicating applications and systems , despite the bulk of information available at the GTA that prevents to gather relevant information necessary to get an overall profile of the taxpayer;
- Limits in terms of functionalities' capacity and ability to appropriately respond to the evolving expectations of the users as a result of outdated technologies .

On this basis , the master plan 2003-2007 has recommended to revamp the existing information system into a centralised and integrated system . This option has become feasible due to the new technologies and lower equipments costs .

In this regard , the Integrated System of Taxation project (SIT) for indoors tax management has been set up as an integrated project , covering all the GTA'S missions . By the enlargement of the scope , the functional extension and the integration of applications , this project will allow further optimization of tax officers' duties and better assessment of the tax base .

Likewise , in order to improve the quality of service rendered to users , the master plan has set up a key project called SIMPL (on line tax services) . This project , embodying a real electronic desk , supports the opening of the Tax Administration on its environment .

The SIMPL , as part of the simplification process initiated by the GTA , will offer the possibility to users to comply with all their tax obligations on line through Internet .

The master plan encompasses also twenty other accompanying projects , supporting the

two above mentioned ones . Most of these projects , almost completed , relate mainly to infrastructure and support aspects . The main projects are:

- * Infrastructure projects (hardware and software of the future system):
 - upgrade the networks : LAN , WAN (98 access points) ;
 - upgrade data security and protection;
 - extend and generalize the workstation infrastructure (>3000 computers);
 - development and production platforms for the new information system;
- Support projects:
 - Internet website;
 - Widespread use of electronic mail service (> 3000 users);
 - Infocentre .

Although the contributions of the above mentioned projects are valuable , the SIT and the SIMPL remain the most important brought by the new information system and information technology . Therefore , the contribution of information technology to the GTA's mission can lie in the description of SIT and SIMPL projects .

Integrated System of Taxation (SIT) project:

To perform its various missions , the General Taxation Administration has retained computerization as a strategic choice . Evolving in an ever changing environment , this computerization had led , before 2003-2007 master plan , to a decentralised architecture . Through its new Integrated System of Taxation , the GTA tends to provide a better service to taxpayers , improve the assessment of tax base and ensure a greater productivity and efficiency of its Human Resources .

To achieve these goals , the following options were retained for the SIT:

- Computerization of all management processes and their extension to all GTA's missions;
- Revamp of the existing applications and the development of new ones in order to build an integrated system , focused on taxpayers and open to the GTA's Partners;
- Adoption of a centralised technical architecture accessible and operational from all over the national territory;
- Adoption of new standards based on 'technology Object' .

The SIT project has been split into two functional parts "SIT-ASSIETTE" and "SIT-PVRC" . The first one is related to tax assessment area , a part of which is already operational . Whereas , the second one "SIT-PVRC" which deals with programming , auditing , crosschecking and litigation , is still in the process of development .

Compared to the existing system , based on separate and non integrated applications , the SIT has brought the following innovations and contributions:

- Constitution of a single file per taxpayer;
- Setting up of the tax account and the tax statement;
- Integration of the patrimonial situation;

- Transformation of the system into a watch mode (alerts , crosschecking , decision-making assistance ,...);
- Widening the functional coverage (reimbursement , enforcement of tax collection ,...);
- Incorporation of taxpayer's behaviour and his scoring (respect of deadlines , irregularities ,...);
- Development of a system based on an integrated national and centralized database .

Besides the possibilities and benefits that the new information technology can offer in terms of data processing speed , larger storage capacity and network flows , the SIT will:

- Enable to have complete , coherent and cross-checked data on taxpayers , accessible from anywhere on the territory;
- Provide taxpayers with more visibility on their tax files and accounts;
- Relieve tax officials from low added value tasks and allow them concentrate on priority tasks with high yield;
- Avoid partial or incomplete treatment of tax returns and files through automated and systematic control;
- Allow more efficient and targeted actions due to alert system;
- Speed up file regularisation and collection procedures due to the systematization of controls;
- Allow further adaptability of the system to changes by using rules' engine;
- Increase the yield .

"SIMPL" Project:

The GTA has chosen to open its information system to taxpayers through the setting up of an electronic desk , materialized by the "SIMPL" project (online tax services) . This electronic desk will offer online services to users and partners of the GTA . Therefore , the quality of service will be improved , especially by the simplification of procedures , easy use and online assistance .

The first E-service that has been operational is the 'SIMPL- VAT' through which taxpayers can comply online with their tax obligations related to VAT . This E-service consists of :

- E-filing of periodical VAT returns (monthly , quarterly) and E-payment corresponding to these e-filed returns;
- E-filing of the annual "prorata " tax return;
- E-payment of VAT issued by regularization statements;
- Viewing tax situation as regards VAT and tracing e-filed tax returns .

Prior to its generalization to all taxpayers , this service has been made available in February 2007 to large companies which annual turnover is superior to 50 Millions MAD .

From taxpayers' point of view , this service has allowed to:

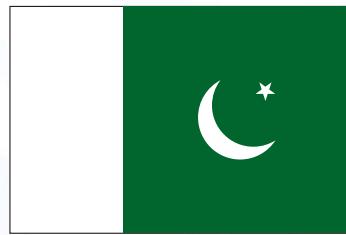
- Improve the quality of service since there are less taxpayers moving to tax premises ;
- Simplify procedures and payments;
- fill taxpayer in on the filing of his on-line tax return;
- Improve transparency vis-à-vis taxpayers .

Furthermore , by implementing this service that couldn't have been possible without internet and security technologies' maturity , especially those related to the electronic signature . The GTA endeavours to :

- Shorten the processing time of tax returns by making them available on the information system and accessible to tax officials right after their deposit;
- Improve the quality of tax returns information through on-line control before being deposited;
- Improve the quality of front desk services resulting from the reduction of the number of taxpayers queuing up ;
- Reduce litigation cases resulting from miscalculation and errors in data capture;
- Improve voluntary tax compliance by on-line assistance which contributes to reduce litigation cases originating from data capture errors .
- Reallocate Human Resources , currently in charge of the identification and data capture of tax returns , to other more added value tasks;
- Reduce the management costs (Human Resources and equipments , storage spaces and archiving of physical files , secure transfer of funds and their transportation...);
- Enhance the efficiency of the data available on the SIT and improve the crosschecking;
- Improve tax collection .

Conclusion:

By carrying out the above mentioned projects and those planned for in the information system master plan , the GTA is implementing a secure , reliable , modern and efficient information system .



WORKING PAPER
Islamic republic of Pakistan

Topic-1 : The use of Information Tehno in Improvement of tax Administration

In the contemporary global environment , Information Technology has assumed the primary role in transforming organizational structure , output and image . It is the lifeline of any organization whether public or private . Organizations all over the world have to keep pace with the increasing customer's requirements and demand and hence the use of Information Technology is the only answer . The tax administration is such part of public sector where the stakes of both the government and the customers are very high . The government need revenue for its socio-economic agenda and the customers closely watch their stakes as they pay taxes . The governments therefore require the highest level of efficiency , output , accountability , increased resource management , marketization at low cost and high service delivery . The stakeholders' demands can therefore be met through the use of Information Technology . The use of IT has three pronged basic change potential which is supplant , support and innovate . Supplanting is automating existing human executing processes — automating clerical functions . Supporting is assisting existing human executing processes of government decision making , communication and decision implementation . Innovation is creation of new IT executed processes and creating new methods of public service delivery . IT can bring five main benefits to any organization:

Quickness : Producing the same outputs in lesser time .

Cheaper : Producing the same outputs at lower cost .

More : Producing more outputs at the same total cost .

Better : Producing the same outputs at the same cost in the same time but to a higher quality standard .

For the first time: Producing new outputs .

The first three benefits represent gains for the public sector; the last two represent effectiveness gains . IT also gives many other benefits such as staff motivation , greater control , improved public image and one of the biggest benefit is availability of global information on all issues .

The Central Board of Revenue — Pakistan , introduced IT , in early 80's in selective projects like salary assessments and collation of tax payments challans etc . Pakistan Revenue Automation Limited (PRAL) was established within CBR in 1994 with a view to automate the various functions of system design development , implementation support and maintenance , procurement and maintenance of hardware , bulk document processing and generation of reports . The pace was , however , quickened after the introduction of the reforms after the government of Pakistan established a Task Force for Reforms in Tax Administration in 1999 , with a view to completely overhaul the tax administration . This Tax Force besides many other important recommendations , also recommended for a systematic Information Management System on permanent basis to increase efficiency accountability , quickness and accuracy and to ensure high quality of delivery of service . Their recommendations are as under:

- Identification of CBR's information needs for strategic , tactical , and operational

management which should be capable of being 'drilled down', preferably to the transaction level. Such information should be an important element in design of information architecture.

- Strengthening information management capacity within CBR by creating the position of member (IMS). Its functions should include defining information needs, developing and maintaining information systems strategy and information model, defining standards with regard to technology, documentation, data
- integrity and service levels, preparing and maintaining business continuity plans, and those concerning projects to be initiated, related expenditure and monitoring performance against plans.
- Outsourcing of systems and applications where necessary.
- Information management system should address matters concerning automation of business processes, creation of databases, generation of information for control and decision-making (MIS) and support decision making process (DSS).
- Separate taxpayer registration process presently in place in CBR should be replaced with single registration process. There should be separate processing of tax document from tax audit. Customer service centre may be established in all taxes to provide full range of services.
- Electronic declaration processing systems (customs) concerning import and export consignment, may be strengthened, document formats, simplified and standardized, risk management system for selection of cases for audit and scrutiny introduced.
- All core business processes concerning taxpayer registration, risk profiling, appeal tracking, internal survey, revenue accounting etc. may be automated.

Accordingly, Central Board of Revenue created the MIS Wing headed by the Member MIS. The MIS Wing of CBR is responsible for the following functions:

- A unique tax identification number that would identify each taxpayer.
- On-line access from any point in the network to the centralized database.
- Ability to enter, process data, correct arithmetic errors, generate notices, and compute taxes and penalties.
- Track tax collection and arrears, incorporate appeal effects, and monitor payment of refunds.
- Handle electronic filing of returns, receive information electronically from banks, employers, and withholding agents.
- Integrate sales tax, income tax, withholding tax, and customs information through a common tax identification number.
- Allow access to database on property transactions and major expenditures of taxpayers.
- Generate statistical information for policy analysis.
- Make all relevant rulings, SROs, notifications, and legal judgments available to the assessing officers.

- Generate refund checks automatically .

Along the lines of Tax Reforms , Central Board of Revenue got promulgated the New Income Tax Law i.e. Income Tax ordinance 2001 and Income Tax Rules 2002 to cope with the latest requirements and demands . Most of the above IMS tasks have been achieved besides the IT application has also been made to the HR area and the personal/official profile of all the CBR officials have been computerized . The integration of Direct Tax and VAT has been made to the extent of common audit and taxpayers data and the respective offices are located on the same premises . The manually filed returns are entered on the computers to make the data reporting accurate and efficient through generation of statistical information for policy analysis measures . The relevant rulings and SRO's are available on the website for use by the officials and the taxpayers . For corporate taxpayers the electronic filing of the returns of income has been made mandatory besides statements of withholding taxes . Officials of CBR are regularly trained for making use of information technology in accordance with the present requirements . CBR is in collaboration with Canadian Revenue Agency to further improve and utilize the information technology in a more useful manner .

Topic-2 : Taxation of Islamic Financial Instrument

Is financial instruments . Some of the more popular instruments in Islamic financial markets are Trade with markup or cost-plus sale (murabaha) . One of the most widely used instruments for short-term financing is based on the tradition notion of purchase finance .The investor undertakes to supply specific goods or commodities , incorporating a mutually agreed contract for resale to the client and a mutually negotiated margin . Around 75 percent of Islamic financial transactions are cost-plus sales .

Murabaha transaction is a sale at a stated profit . In a murabah transaction , the bank purchases something from a third party and sells it to the client at a stated profit on a deferred payment basis . In this way , the client can buy something without taking an interest-based loan .

Lease (ijara) . Another popular instrument , accounting for about 10 percent of Islamic financial transactions , is leasing . Leasing is designed for financing vehicles , machinery , equipment and aircraft . Different forms of leasing are permissible , including leases where a portion of the installment payment goes toward the final purchase (with the transfer of ownership to the lessee) .

Ijara is an Islamic lease . The bank purchases assets and leases it to a client for fixed monthly payments . An ijarah may include an option for the lessee to buy the asset at the end of the lease period .

Profit-sharing agreement (mudaraba) . This is identical to an investment fund in which managers handle a pool of funds . The agent manager has relatively limited liability while having sufficient incentives to perform . The capital is invested in broadly defined activities , and the terms of profits and risk sharing are customized for each investment . The maturity structure ranges from short to medium term and is more suitable for trade activities .

A mudaraba transaction is an investment partnership . In a mudarba arrangements , the contract is between an investor (or financier) and an entrepreneur or investment manager known as the mudarib . Risk and rewards are shared . In the case of a profit , both parties receive their agreed-upon share of the profit . In the case of a loss , the investor bears any loss of capital while the mudarib loses his time and effort .

Equity participation (musahraka) . This is analogous to a classical joint venture . Both entrepreneur and investor contribute to the capital (assets , technical and managerial expertise , working capital , etc) . of the operation in varying degrees and agree to share the returns (as well as the risks) in proportions agreed to in advance . Traditionally , this form of transaction has been used for financing fixed assets and working capital of medium and long-term duration .

Sates contracts . Deferred-payment sale (bay' mu'ajjal) and deferred — delivery sale (bay' salam) contracts , in addition to spot sales , are used for conducting credit sales . In a deferred-payment sale , delivery of the product is taken on the spot but delivery of the payment is delayed for an agreed period . Payment can be made in a lump sum or in installments , provided there is no extra charge for the delay . A deferred-delivery sale is similar to a forward contract where delivery of the product is in the future in exchange for payment on the spot market .

The Income Tax Ordinance 2001 , embodies tax treatment of most of the above financial instruments and the provisions in the tax law are existing . Zakat is an allowable expense from income under section 60 of the Income Tax Ordinance , 2001 . Donations to charitable organizations are entitled to tax credit /relief , under section 61 of the Income Tax Ordinance 2001 . Moreover , the 2 Schedule to the Income Ordinance 2001 gives exemptions to the following Islamic Schemes , Transactions and Instruments as under :

- Clause (16) Any income derived by the family of Shaheed's from the special family pension .
- (60) Any income of a religious or charitable institution derived from contribution applicable to religious or charitable institution except private religious/ charitable trust .
- (61) Donation to Charitable/Religious Trust Donation to Rabatai Islami Project for printing copies of the Holy Quran .
- (65) Income from donation to welfare for research on Islamic history and culture .
- (66) Exemption of income of Islamic Trade Finance Corporation .
- (100) Any income not been income from trading activity of Modaraba .
- (107) Any income derived by the Islamic Development Bank or its subsidiary in Pakistan engaged in owning and leasing of tankers .
- (110) Any income charged under the Head Capital Gain being income from the sale of Modaraba .

Part-IV of 2nd Schedule

- 11 (xiii) Modaraba registered under the Modara Company and Modaraba Floating and Controlled Ordinance n 1980 , exempt from minimum tax .
- 11(xvi) A Modaraba bank or financial institution for the purpose of Islamic banking and finance , is exempt from minimum tax .
- 38(B) Islamic Development Bank is exempt from deduction of withholding tax on dividend .

A * T * A * I * ☾