



TAXATION OF SUKUK IN MALAYSIA

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By

Inland Revenue Board of Malaysia



Taxation of sukuk in Malaysia



Definition of sukuk

- * Securities Commission of Malaysia (SC) : Refer to certificates of equal value which evidence undivided ownership or investment in the assets using Syariah principles and concepts endorsed by the Syariah Advisory Council (SAC).
- * Inland Revenue Board of Malaysia (IRBM) : There is no specific definition of sukuk in Income Tax Act 1967 (ITA). For the purpose of section 60I - company that establish special purpose vehicle, Islamic securities means Islamic securities which adopt Syariah principle approved by SC or Labuan Financial Services Authority.



Taxation of sukuk in Malaysia



The tax legislation of sukuk

Act

- * Income Tax Act 1967 (ITA)
- * Real Property Gains Tax Act 1976 (RPGTA)
- * Stamp Act 1949

Regulation – Income Tax (Assets –Backed Securitization) Regulation 2014
[P.U. (A) 170]

Incentive

Deduction :

- * Income Tax (Deduction for Expenditure on Issuance of Islamic Securities) Rules 2007 [P.U. (A) 6]
- * Income Tax (Deduction on the Cost of Issuance of The Islamic Securities) Rules 2007 [P.U. (A) 176]



Taxation of sukuk in Malaysia



The tax legislation of sukuk

Exemption :

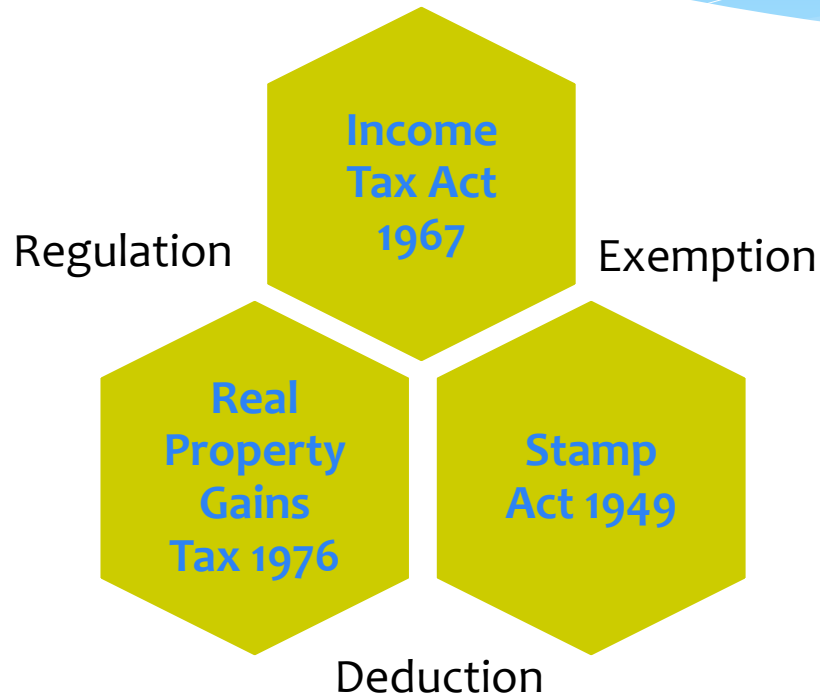
- * Income Tax (Exemption) (No.14) Order 2007 [P.U. (A) 180] - exempts a special purpose company resident in Malaysia from the payment of income tax.
- * Real Property Gains Tax (Exemption)(No.3) Order 2003 [P.U. (A) 450] – disposal of chargeable assets in relation to the issuance of private debt securities under Islamic principles.



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Recap :





Taxation of sukuk in Malaysia



The general legislation of sukuk

Sukuk also govern by :

- * Securities Commission Act 1993
- * Capital Market and Services (Amendment) Act 2012
- * Securities Industry (Central Depositories) Act 1991
- * Companies Act 1965



Taxation of sukuk in Malaysia



Structure of sukuk securitization in Malaysia

Assets Based Securitization Sukuk

- * The ownership of assets is not fully transfer, special purpose vehicle (SPV) hold the assets on behalf of the originator.
- * There is a recourse to the originator, particularly through put option.



Taxation of sukuk in Malaysia



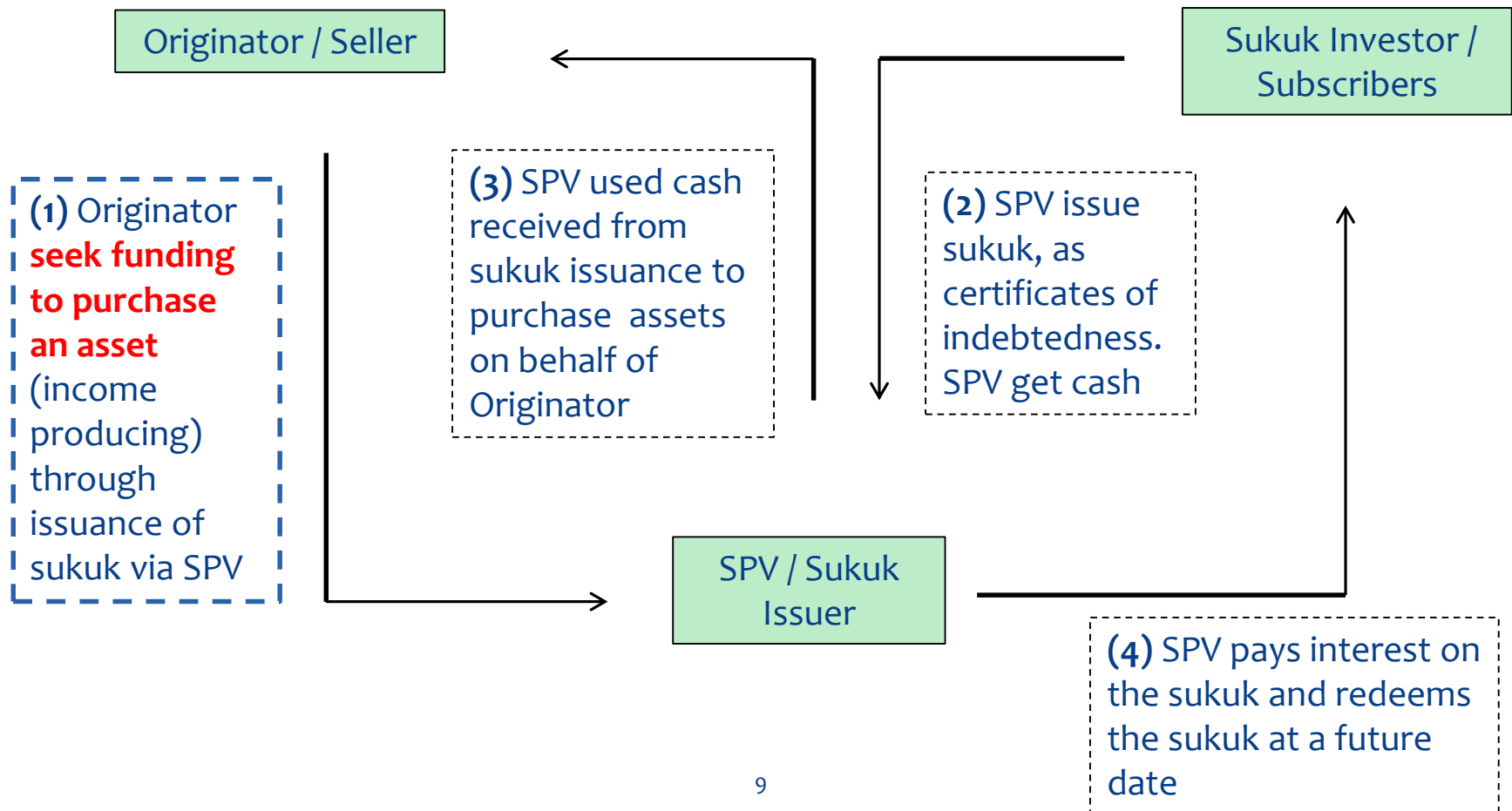
Structure of sukuk securitization in Malaysia

Assets Backed Securitization (ABS) Sukuk

- * ABS sukuk based on true sale, means the originator has to sell the assets to the SPV.
- * It is a way to prevent creditors or liquidator of the seller from claiming the asset from buyer. Thus it's creating 'bankruptcy remoteness' for the assets.

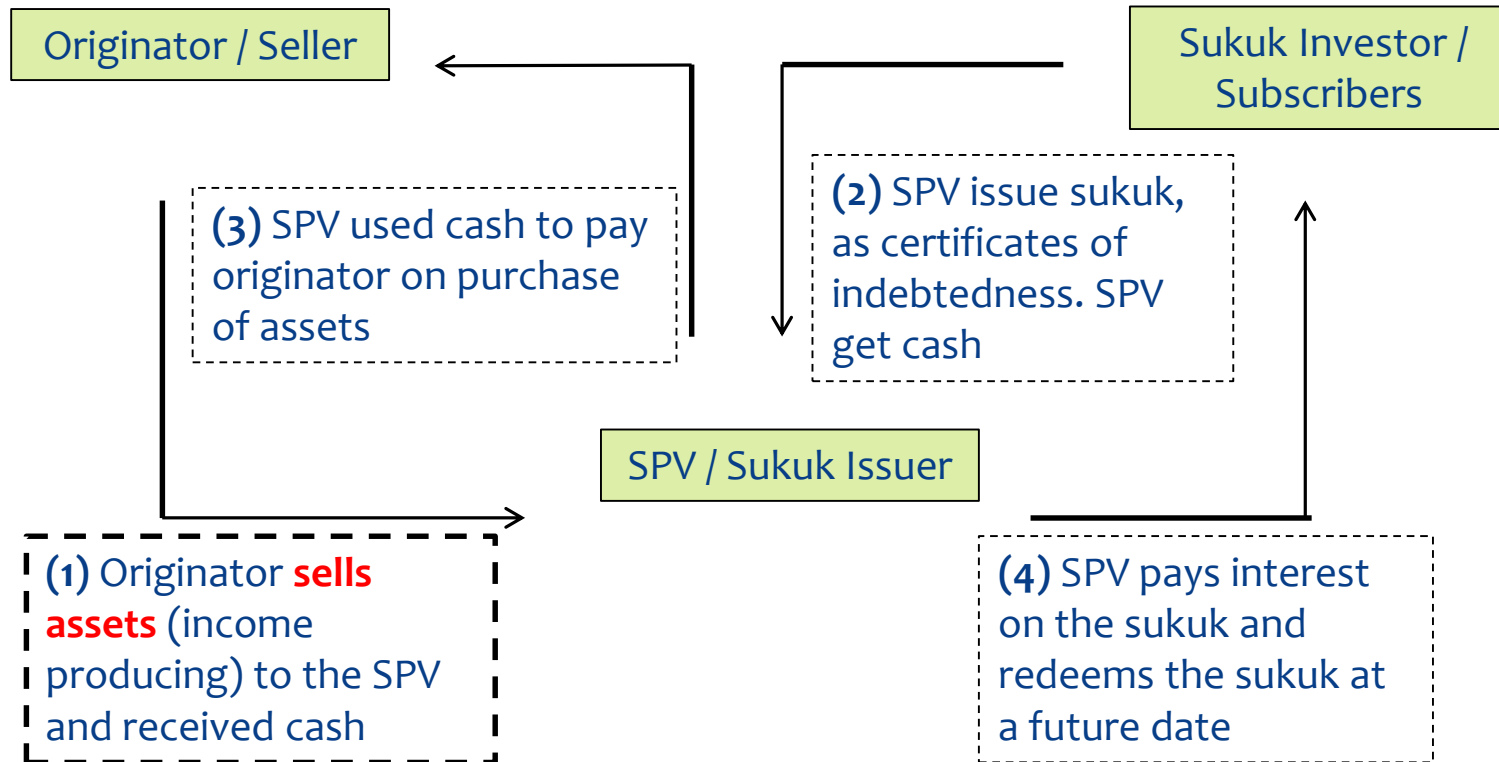
Structure of sukuk securitization in Malaysia

– Assets Based Securitization Sukuk



Structure of sukuk securitization in Malaysia

ABS Sukuk





Taxation of sukuk in Malaysia



Assets Based v Assets Backed General Perspective

Assets Based

- * Not a real sale – merely purchase undertaking that Originator give to the SPV
- * Sukuk holders have no recourse to underlying assets
- * Originator is the only possible purchaser
- * Redemption / outstanding value of sukuk
- * Sukuk holders have no benefit from rising assets value
- * Unsecured

Assets Backed (ABS)

- * True sale of assets to SPV
- * Sukuk holders have recourse to underlying assets
- * SPV can sell assets to third party
- * Market value of assets at maturity
- * Sukuk holder get upside potential from rising assets value
- * Collateralized



Taxation of sukuk in Malaysia



Tax treatment on structure of sukuk securitization in Malaysia

Assets Based Securitization Sukuk

- * Section 60I of the ITA applies to SPV which issues non asset-backed sukuk (asset-based/normal sukuk) in a securitization transaction.
- * Under subsection 60I(4) –
“SPV means a company incorporated under the Company Act 1965 or a company incorporated under the Offshore Companies Act 1990 which has made an election under section 3A of the Labuan Business Activity Tax Act 1990 and establish solely for the purpose of complying with the principles of Syariah in the issuance of Islamic securities **but excludes a company which issues asset-backed securities** in a securitization transaction approved by the Securities Commission or Labuan Financial Services Authority”.



Taxation of sukuk in Malaysia



Tax treatment on structure of sukuk securitization in Malaysia

Assets Based Securitization Sukuk

- * This provision seeks to provide that where a company establishes a SPV solely for the issuance of sukuk, any income of the SPV will be taxed as income of the authorised company and the SPV is not required to comply with any provision of the ITA.
- * The SPV is deemed a pass through entity / 'mirror' to the originator and any proceeds from issuance of sukuk will shift to the originator.



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Tax treatment on structure of sukuk securitization in Malaysia

ABS Sukuk

- * The tax treatment arising from a securitization transaction is provided under the Income Tax (Asset-Backed Securitization) Regulations 2014.
- * The Regulations apply to an originator and a SPV in an ABS transaction authorised by the SC.



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Tax treatment on structure of sukuk securitization in Malaysia

ABS Sukuk – Income Tax (Asset-Backed Securitization) Regulations 2014

- * To the originator, the Regulations address the tax treatments of –
 - i. proceeds or gains from disposal of trade receivables or stock in trade for originator
 - ii. loss from disposal of trade receivables or stock in trade
 - iii. call option to buy back
 - iv. disposal of fixed asset



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Tax treatment on structure of sukuk securitization in Malaysia

ABS Sukuk

- * To the SPV, the Regulations address the tax treatments of –
 - i. gross income of SPV
 - ii. adjusted income of SPV



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Assets Based v Assets Backed Tax Perspective

Assets Based

- * Section 60I, Income Tax Act 1967 applied.
- * SPV is not subject to tax or tax administrative procedures.
- * Any source of income of SPV and issuance of share treated as a source and income of the Originator.

Assets Backed (ABS)

- * Income Tax (Asset – Backed Securitization) Regulations 2014 [P.U. (A) 170] applied
- * Any income of SPV is treated as single source – business income (Regulation 10) and expenses incurred pursuant to securitization transaction is deductible (Regulation 11)



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Assets Based v Assets Backed Tax Perspective

Assets Based

- * No disposal / transfer of assets.
- * The Originator bear the responsibility under the act for the source and income from that source of the SPV.
- * No balancing allowances / charge deem as there is no transfer of assets occurred.

Assets Backed (ABS)

- * Disposal / transfer of assets to SPV occurred.
- * Any proceeds from disposal of source pursuant to a securitization transaction and recognized in the account of Originator, shall constitute as gross income of the Originator.
- * Any balancing allowances / charge deem have been made to the Originator.



Taxation of sukuk in Malaysia



Treatment of Profits – subsection 2(7) of the ITA

- * “Any reference in this Act to interest shall apply, mutatis mutandis, to gains or profits received and expenses incurred, in lieu of interest, in transactions conducted in accordance with the Syariah”
- * This new provision creates an equality of treatment on ‘interest’ in the bond to the ‘profit’ in the sukuk from the perspective of bondholders / sukuk holders.
- * The taxability or deductibility of profits would be similar to the treatment of interest in a conventional financing arrangement.



Taxation of sukuk in Malaysia



Tax Neutrality Provision – subsection 2(8) of the ITA

- * “Subject to subsection (7), 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, the Securities Commission, the Labuan Financial Services Authority or the Malaysia Co-operative Societies Commission, as a scheme which is in accordance with the principles of Syariah 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”



Taxation of sukuk in Malaysia



Tax Neutrality Provision – subsection 2(8) of the ITA

- * The transaction of underlying sale of assets is disregarded by virtue of this provision.
- * The objective of this subsection is to cater tax issues arising from additional transactions and additional documents that chargeable to real property gains tax (RPGT) and stamp duty.
- * Tax neutrality is important to facilitate the Islamic capital market and it helps in making Islamic capital products as attractive/cost-efficient as its conventional counterparts.



Taxation of sukuk in Malaysia



Treatment for discount and premium – section 34C and 27(1A) of the ITA

- * Section 34C applies in ascertaining the adjusted income of a company from discount or premium.
- * Any expenses in respect of the discount or premium incurred from the subscription or issuance of sukuk is deemed to accrue to the company over the whole period of the sukuk. The amount to be deducted from the gross income is determined by a specific formula.



Taxation of sukuk in Malaysia



Treatment for discount and premium – section 34C and 27(1A) of the ITA

- * Subsection 27(1A) applied that the amount of gross income of a company consists of discount or premium from the subscription or issuance of sukuk shall be deemed to accrue over the whole period of the sukuk. The gross income shall be a sum to be determined by a formula.



Taxation of sukuk in Malaysia



Stamp Act 1949 - Exemption

- * Paragraph 6 GENERAL EXEMPTIONS [Section 35] in the First Schedule to the Stamp Act 1949
- * “An instrument executed pursuant to a scheme of financing approved by the Central Bank, the Labuan Financial Services Authority, the Malaysia Co-operative Societies Commission or the Securities Commission as a scheme which is in accordance with the principles of Syariah, where such instrument is an additional instrument strictly required for the purpose of compliance with those principles but which will not be required for any other schemes of financing”.



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Real Property Gains Tax - Exemption

- * Subparagraph 3(g) Schedule 2, RPGTA - the disposal price shall be deemed to be equal to the acquisition price for the case of disposal of any chargeable asset pursuant to an approved scheme which is in accordance with the Syariah principles and Syariah compliance but not required for any other schemes of financing.
- * This implies that the Act allowed Islamic financing to continue without any tax issues relating to asset transfer or lease.



Taxation of sukuk in Malaysia



Tax Incentives

Tax Deduction

- * P.U. (A) 6, Income Tax (Deduction for Expenditure on Issuance of Islamic Securities) Rules 2007 - for the purpose of ascertaining the adjusted income of company from its business, a deduction of an amount equal to the expenditure incurred on the issuance of Islamic securities approved by the SC shall be allowed. The Islamic securities must be established under Securities Commission Act 1993 pursuant the principle of *mudharabah*, *musyarakah*, *ijarah and istisna'* or any other principle in accordance with Syariah principle approved by the Minister.



Taxation of sukuk in Malaysia



Tax Incentives

Tax Deduction

- * P.U. (A) 176, Income Tax (Deduction on the Cost of Issuance of The Islamic Securities), extended the deduction to the amount equivalent to the cost of issuance of Islamic securities incurred by the special purpose company.



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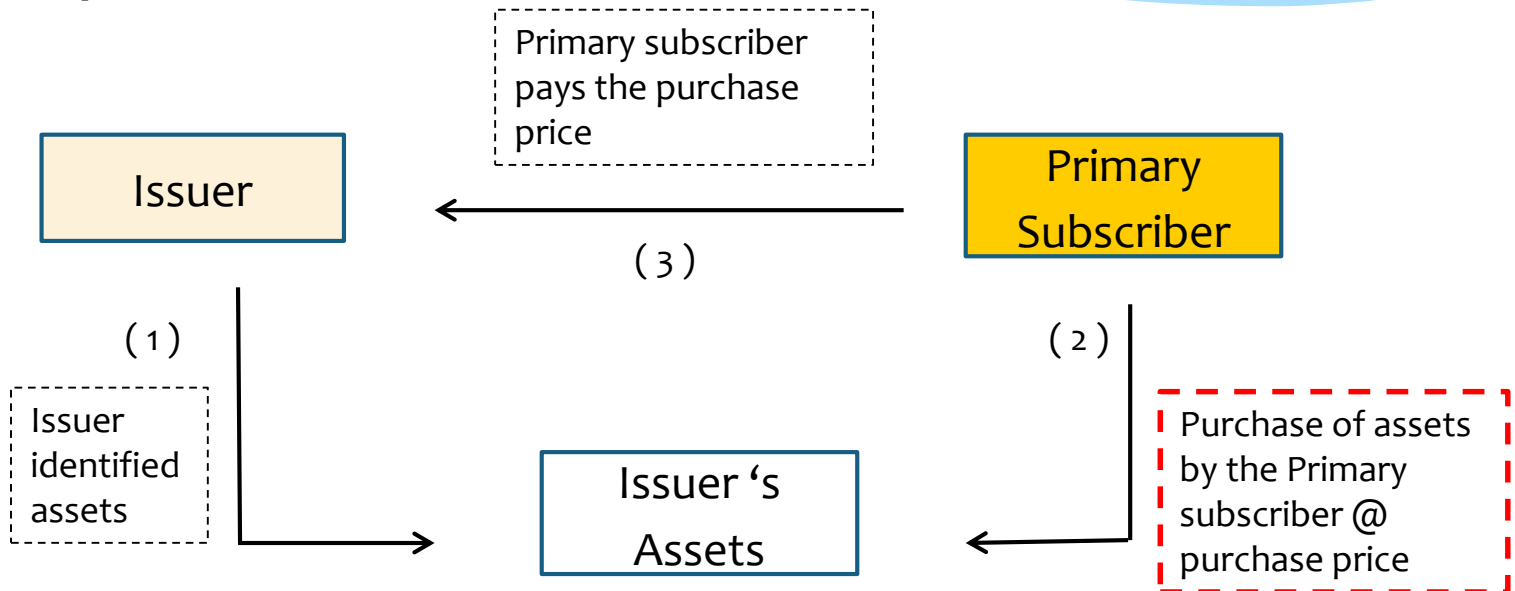
Tax Incentives

Tax Exemption

- * P.U. (A) 180, Income Tax (Exemption) (No.14) Order 2007, exempts a special purpose company resident in Malaysia from the payment of income tax in respect of statutory income derived from the issuance of Islamic securities.
- * Exemption for payment of RPGT in respect of chargeable gains accruing on disposal of any chargeable assets in relation to the issuance of Islamic securities or sukuk via P.U (A) 450, Real Property Gains Tax (Exemption) (No.3) Order 2003.

Basic Structure for BBA Islamic Debt Securities (Sukuk IDS)

Step 1 :





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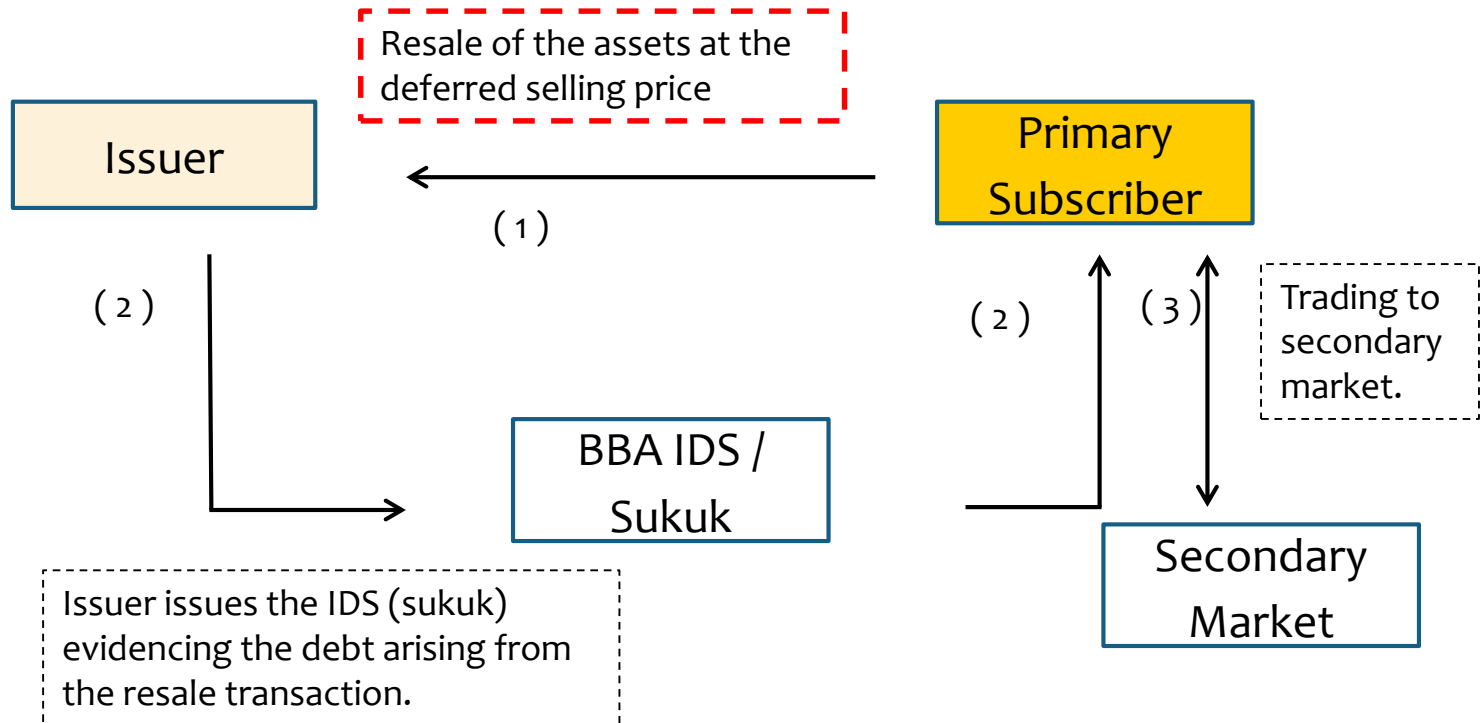
Basic Structure for BBA Islamic Debt Securities (Sukuk IDS)

Transaction Step 1 :

- (1) Issuer who need financing will identify the assets to be disposed to the primary subscriber.
- (2) The **assets then sold** to the primary subscriber.
Tax issue: RPGT? Stamp Duty?
- (3) The primary subscriber then pay, the issuer will receive cash proceed (purchase price) from the sale transaction above.

Basic Structure for BBA Islamic Debt Securities (Sukuk IDS)

Step 2 :





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Basic Structure for BBA Islamic Debt Securities (Sukuk IDS)

Transaction Step 2 :

- (1) Primary subscriber **sells the assets** back to the issuer **on mark – up price (cost plus profit)** for deferred payment basis.

*Tax issue: **RPGT? Stamp Duty?***

Profit assesses under paragraph 4(a) or 4(f) of ITA?

- (2) The issuer issues the BBA IDS sukuk as evidence / certificate of indebtedness to the primary subscriber.
- (3) The primary subscriber may then trade the BBA IDS to the secondary market as bai'dayn.



Taxation of sukuk in Malaysia Malaysian Practice



Tax issue on BBA Islamic Debt Securities (Sukuk IDS)

Remedy on tax issues – Originator viewpoint

- i. The disposal of asset will be disregarded for the purpose of income tax under provision in subsection 2(8) of the ITA.
- ii. In the case of disposal or transfer of assets, no RPGT will be imposed – exemption under subparagraph 3(g) Schedule 2 RPGTA.
- iii. Tax deduction on the issuance cost of sukuk for approved transaction by the SC .
- iv. Profit payment to the investor is regarded as ‘interest’ under subsection 2(7) of the ITA and allowed as a deduction under subsection 33(1) of the same Act.



Taxation of sukuk in Malaysia Malaysian Practice



Tax issue on BBA Islamic Debt Securities (Sukuk IDS)

Remedy on tax issues – Investor viewpoint

- i. Tax exemption up to YA 2015 on profits derived from the regulated activity of dealing in non-Ringggit sukuk.
- ii. Tax exemption on profit for approved sukuk by the SC.

