

LUXEMBOURG A EUROPEAN HUB FOR ISLAMIC FINANCE

Further to the Circular letter dated January 12, 2010 of the Luxembourg direct tax authorities clarifying the scope of certain Islamic financing arrangements and their treatment under Luxembourg direct tax laws, the Luxembourg indirect tax authorities, *Administration de l'Enregistrement et des Domaines*, issued a Circular on June 17, 2010 (the "New Circular") which aims at providing greater certainty on the indirect tax treatment of *Murabaha* and *Ijara*.

Based on the "substance over form approach", the New Circular defines *Murabaha* and *Ijara* arrangements as follows:

- *Murabaha*: A sale based transaction whereby an investor acquires an asset for resale to a client at a profit determined on a cost-plus basis. This is a financing arrangement whereby the cost-plus profit margin of the investor is determined in advance and may apply to all types of assets.
- *Ijara*: A lease based arrangement whereby an investor acquires an asset and grants a client the right to the use of such asset for a consideration payable over a certain timeframe. Generally, such arrangements involve an intermediary structure through a special purposes vehicle ("SPV") and, therefore, imply the application of indirect taxes such as transfer taxes and VAT in the hand of the SPV.

I. Transfer Taxes

- **Real Estate Transfer Taxes**

The New Circular indicates that, in principle, the sale of shares held in a company which holds real estate does not give rise to a proportional registration duty. However, the sale of interests held in a partnership or an economic interest grouping, i.e., *groupement d'intérêt économique* ("GIE"), the assets of which include real estate, is treated as a sale of the underlying real estate and is, therefore, subject to a proportional registration duty levied at the rate of 6%. In addition, when the purchaser explicitly states that the purchase of such interests is performed in view of their re-sale (which transaction is then deemed to be an acquisition of the underlying real estate in view of its re-sale), the acquisition agreement is subject to an increased registration duty levied at the rate of 7.2%.

However, the New Circular states that, in accordance with the Circular letter n°54, dated July 22, 1934 (concerning the interpretation of the law dated August 1935 relating to the stabilisation of some privileged or mortgage receivables), when an SPV, in the framework of a *Murabaha* or *Ijara* agreement, registers the acquisition agreement concomitantly to the re-sale agreement, the acquisition agreement would only be subject to a reduced 1.2% registration duty (and not 7.2%), whereas the resale agreement would be subject to the 6% proportional registration duty.

- **Taxable Basis for Real Estate Transfer Taxes**

The New Circular specifies that, for transfer tax purposes, the investor's profit margin as explicitly determined in a *Murabaha* agreement, which corresponds to the balance between the original acquisition price paid by the SPV and the price actually paid by the client to the SPV, has to be considered as interest and will, therefore, not be subject to transfer taxes under the following conditions:

- The client must enter into possession of the real estate immediately following the re-sale of the acquired real estate;
- The re-sale agreement enters into force no later than 10 days following the acquisition of the real estate;
- The acquisition agreement must specify that the acquisition is performed in the framework of a *Murabaha*, which must be enclosed alongside the acquisition agreement.

Therefore, assuming the above mentioned conditions are met, transfer taxes would only be levied on the price paid by the SPV in connection with the acquisition of the real estate, excluding the profit margin agreed upon in the *Murabaha* agreement.

II. VAT

The New Circular states that SPVs involved in the framework of *Murabaha* or *Ijara* arrangements are to be considered as taxable persons for VAT purposes and that, in particular, article 44 §1 f) and g) and article 45 of Luxembourg VAT law dated February 1979 ("**Luxembourg VAT Law**") are, therefore, applicable when the agreements relate to real estate. This does not, however, imply that the transactions will be liable to Luxembourg VAT.

In accordance with the above mentioned provision of Luxembourg VAT law, the supply of real estate is generally exempt from VAT but under certain conditions, taxable persons can opt out of this exemption and can elect to have their transactions subject to VAT.

As a conclusion, the New Circular can be considered as an additional step towards the clarification of real estate transactions involving *Sharia* compliant financial instruments in view of promoting Luxembourg as a key European hub for this type of investment.

An article authored by Oostvogels Pfister Feyten which details further specifics of Islamic Finance in Luxembourg can be found [here](#).



For further information, please contact:

Frédéric Feyten

Email: ffeyten@oostvogels.com

Chokri Bouzidi

Email: cbouzidi@oostvogels.com

Tel: +352 46 83 83