ISLAMIC FINANCE: Incentives for Growth

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At the recent Global Islamic Financial Conference, Prime Minister, Dato' Seri Abdullah Haji Ahmad Badawi's announced additional incentives and support to strengthen Malaysia's position as an international Islamic financial hub ("New Incentives").

Various incentives and plans have been introduced to promote the growth of Islamic finance e.g. general stamp duty exemptions have been given as early as 1987. However, it was the launch of the initiative known as the Malaysian International Islamic Financial Centre ("MIFC") on 14 August 2006 that there has been concerted efforts to spur the growth of the Islamic Financial Market. These efforts are taken collectively by a diversified range of financial institutions (offering Islamic financial products and services out of Malaysia) and the market regulators, including Bank Negara Malaysia ("BNM"), Securities Commission ("SC"), Labuan Offshore Financial Services Authority ("LOFSA") and Bursa Malaysia Securities Berhad ("Bursa Malaysia").

This article summarises the key measures and incentives that have been announced thus far to position Malaysia as an international Islamic financial centre.

The New Incentives announced by the Prime Minister on 27 March 2007 are:

i) the Foreign Investment Committee ("FIC") rules, have been relaxed to allow 100% foreign equity ownership (currently, limited to 49%) in Islamic financial institutions conducting business in international currencies in Malaysia and such foreign institutions will be allowed to acquire properties for their own use, while the acquisition of properties and land for commercial purposes, as part of Islamic financing activities, will only be subject to a one-time approval;

ii) full stamp duty exemption for ten years on foreign currency instruments executed and on Ringgit as well as foreign currency instruments relating to Islamic securities issued by Islamic financial institutions conducting business in international currencies in Malaysia;

iii) full exemption from withholding any tax profits or income on non-residents’ investments in non-ringgit Islamic securities, including Sukuks issued in Malaysia; and

iv) BNM, as the one-stop liaison body and contact point for licence application for Islamic financial services has been accorded an ‘executive green lane’ to expedite applications by expatriates for long-term employment passes to facilitate the greater movement of talent and expertise in the Islamic finance sector in Malaysia.

Some of the other key measures and incentives that have been announced are set out below.

i) Malaysian Islamic banks and Takaful operators that are offering Islamic financial services in international currencies may apply for approval under their existing licences to set up an International Currency Business Units ("ICBU") within the institutions to conduct non-Ringgit Islamic banking or Takaful and re-Takaful businesses, as the case may be. The income arising from the transactions of the ICBU will be fully tax exempt for ten years effective from the year of assessment 2007.

ii) Qualified foreign and Malaysian financial institutions/insurance companies may apply for new licenses under the Islamic Banking Act 1983 or the Takaful Act 1984 to conduct a wide range of Islamic banking/Takaful business in international currencies (International Islamic Bank ("IIB")/International Takaful Operator ("ITO")). The IIB/ITO will be considered as a resident for foreign exchange administration policies and will enjoy full tax exemption for ten years effective from the year of assessment 2007.

iii) Existing and new offshore financial institutions licensed to conduct Islamic financial business by LOFSA, are allowed to open operational offices anywhere in Malaysia to conduct non-Ringgit business without having the need to maintain physical presence in Labuan. These entities will continue to enjoy the preferential tax rate of 3% or RM20,000 accorded under the Labuan Offshore Business Activity Tax Act 1990.

iv) All existing and new fund managers licensed under the Securities Industry Act 1983 are given full income tax exemption on management fees for ten years for managing funds of foreign investors based on Shariah principles.
There has been concerted efforts by financial institutions and the market regulators to spur the growth of the Islamic financial market

vi) The establishment expenses of an Islamic stock broking business are allowed as tax deduction so long as the application for approval for the Islamic stock broking business is made to Bursa Malaysia from 2 September 2006 until 31 December 2009.

vii) Stamp duty exemption on all agreements for the sale and lease of assets relating to the restructuring and rescheduling of outstanding balance under existing Islamic financing and on all sale/purchase or sale/lease of assets for the renewal of Islamic revolving financing facility.

viii) All associations established pursuant to a schemes of financing under the principles of Shariah are specifically excluded under the definition of partnership under Section 2(1) of the Income Tax Act, 1976 (“Income Tax Act”) so that financing structures such as Musharakah and Mudharabah need not file partnership tax returns effective from year of assessment 2007.

ix) Stamp duty remission of 20% on the principal or primary instruments used in Islamic financing products approved by the Shariah Advisory Council of BNM or the SC and full exemption on any instruments used in a Syariah compliant financing scheme which are additional to what would be required in a comparative conventional scheme of financing.

x) Profit or interest income received by non-residents from financial institutions established under the Islamic Banking Act 1983 are tax exempt.

xi) Special Purpose Vehicles (“SPV”) created specifically to facilitate the Islamic funding approved by the SC are not subject to income tax with effect from year of assessment 2007.

As more and more countries are realising the potential of Islamic finance and joining the bandwagon, these incentives are opportune to ensure that Malaysia remains as a significant player in the international Islamic market and continue to attract an influx of investments into Shariah compliant financial products.