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Islamic finance finally has a place in the Australian economy

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Islamic finance finally has a place in the Australian economy

Abstract

In its executive summary, the board makes it very clear at the outset that the review was conducted on the basis of “its understanding of common Islamic finance structures, and that nothing in the report should be taken to suggest that a particular product or case study described is compliant with Shariah law”.

Keywords

has, place, australian, economy, islamic, finally, finance

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Islamic Finance *finally* has a place in the Australian Economy

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The Australian Government has *finally* released the much anticipated final report of the Board of Taxation Review of the Taxation Treatment of Islamic Finance from 2011, with its budget papers on the 3rd of May 2016.

In its executive summary, the Board makes it very clear at the outset that the review was conducted on the basis of “its *understanding* of common Islamic finance structures, and that *nothing* in the report should be taken to suggest that a particular product or case study described is *compliant* with Shariah law.”

The report recognises Australia as a net capital importer and therefore requires access to diverse sources of offshore capital, such as Islamic Finance, particularly for infrastructure projects. Islamic finance transactions are often asset based, and a transaction may involve multiple transfers of an underlying asset. These transactions give rise to additional dutiable transactions, such as: interest withholding tax and stamp duty, which makes it cost prohibitive to fund infrastructure projects by comparison to conventional financing such as loans.

Accordingly, three main impediments to Islamic Finance were identified: “(a) access to interest withholding tax exemptions; (b) stamp duty on asset backed finance products if the asset is dutiable property; and (c) uncertainty in relation to the application of general income tax provisions.”

In its recommendations, the Board of Taxation wanted to provide certainty in relation to the application of the general income tax provisions to Islamic finance products. The recommendations were specific to a number of issues:

1. The deferred payment arrangements or Murabahah.
2. The hire-purchase arrangements relating to all assets or Ijarah Muntahiah Bi Tamlik.
3. The returns on a deferred payment arrangement or Murabahah.
4. The interest withholding tax exemptions on Islamic finance products with similar economic characteristics to debentures.
5. Islamic finance products that may be defined as an offshore banking activity.
6. Investments in Sukuk.
7. Islamic finance products that would come within the definition of partnerships and joint ventures.
8. Profits under a deferred payment arrangements or Murabahah.
9. The current reduced input tax credits (RITC) regime for financial supplies.

Amendments to the income tax law were proposed in recommendations 1, 2 and 4. Meanwhile, recommendations 3, 5, 6 and 7 stated that, “If in the course of providing ATO guidance an impediment to Islamic finance is revealed that cannot be addressed under the current law, the Government should consider legislative options to address it.” In recommendation 8, the ATO is required to clarify the characteristic of

the profit component under a deferred payment arrangement for Goods and Services Tax (GST) purposes. Whereas, the last recommendation 9, stipulated that the current reduced input tax credits (RITC) regime for financial supplies was to be maintained without extending it to any other input taxed supplies.

In its findings, the Board of Taxation focused on Stamp duty and Land Tax that specifically affect asset based Islamic finance transactions (where each transaction may involve multiple transfers of an underlying asset, and thus incur multiple “redundant” stamp duty and land taxes on the asset).

Stamp Duty was found to be

- a significant impediment to the development and provision of Islamic finance products.
- prohibitive to certain asset backed Islamic finance arrangements making them uncompetitive, which reduces available funds and/or drive up the cost of capital acquisition.
- the responsibility of the States and Territories that need to consider providing relief based on substance of the arrangement or on a transaction by transaction basis.

Land tax was found to be

- in need of legislation amendment by the States and the Australian Capital Territory to ensure that land tax would be imposed on the ‘true owner’ of the land.

No doubt, the release of the Board of Taxation Review from 2011, with the recent budget papers, is a welcome change from the Australian Government ambiguous position over the past 5 years. However, it is inescapable that the timing of the release coincides with an upcoming election and a government mantra of “innovation, jobs and growth” as its election platform. Islamic finance fits nicely into the current political discourse, as a financial innovation that would create jobs and growth due to the demand by an ailing Chinese economy for Islamic finance partnerships (through the China-Australia Free Trade Agreement) to fund its new Silk (land and maritime) Road.