



Update on Islamic finance in Hong Kong

The Financial Secretary, Mr John Tsang Chun-wah, in delivering the 2012-13 Hong Kong Budget, announced that the Hong Kong Government is currently finalising legislative amendments to promote Islamic finance.

The Government intends to provide a level playing field for common types of Islamic bonds (such as Sukuk) in respect of Profits Tax, Property Tax and Stamp Duty in comparison to conventional financing.

Islamic financial instruments typically avoid the payment of prohibited interest by structuring returns in the form of distributions, profits or rental in respect of property. Specifically, Sukuk are structured such that interest income is replaced by a share of the rental income derived from beneficial ownership in a tangible asset.

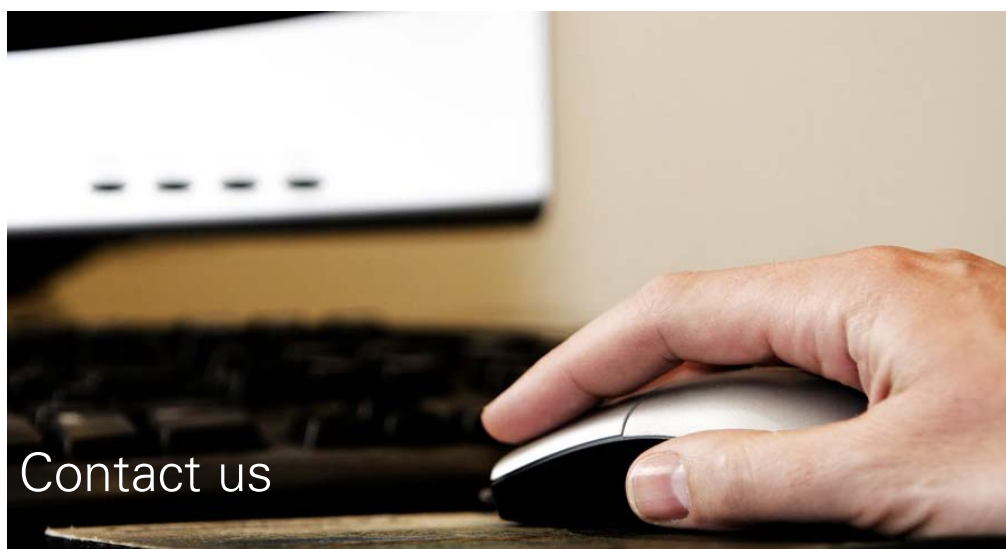
These differences in the legal form of the transaction can result in a less favourable or unexpected tax treatments. In particular:

- Whereas interest expense is generally deductible, dividends are usually paid out of post tax profits
- Islamic finance frequently involves the transfer of assets. This can give rise to taxes on gains, Stamp Duty and a transfer of capital allowances
- An SPV is frequently needed to issue the Sukuk. This can result in extra filing obligations. If the SPV is not treated as transparent for tax purposes, or the issues outlined above are addressed, additional tax leakage can also result.

In order for Hong Kong to attract Islamic financing, it will be necessary to ensure that these disadvantages are removed and that the tax treatment for Islamic financing is placed on the same footing as conventional bonds.

Plans to make necessary changes or clarifications to the tax legislation in respect of Islamic finance were first announced in the 2009-2010 Hong Kong Budget. The Government proposes to conduct market consultation in the first quarter of this year and introduce the amendment bill into Council in the next legislative session. Further background on the tax issues affecting Islamic bonds in Hong Kong can be found in the attached publication:

<http://kpmg.com/cn/en/IssuesAndInsights/ArticlesPublications/Pages/islamic-bond-hk-200903.aspx>



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