New tax measures aimed at facilitating Islamic Bond issuance

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Speedread

The Japanese government has announced its intention to facilitate *Sukuk* (bonds) issuance by Japanese domestic corporations.

The Japanese government continues to remain keen to facilitate the conduct of Islamic finance business in Japan. In December 2008, the Ordinance for Enforcement of the Banking Law/Insurance Business Law was amended to allow subsidiaries of Japanese banks/insurance companies to conduct business in certain Islamic finance products such as *Murabahah* (cost-plus sale) or *Ijarah* (leasing).

Recently, the government has announced its intention to facilitate *Sukuk* (bonds) issuance by Japanese domestic corporations by extending to them the benefits of certain tax reforms regarding non-taxability of interest on bonds paid to offshore investors that formed part of government's tax reform package in 2010.

Under the abovementioned tax reforms, interest paid on book-entry bonds paid to non-residents and foreign entities are fully tax-deductable. The Financial Services Agency of Japan (FSAJ) proposed to improve the tax treatment of Islamic finance by treating the dividends payable on Sukuk in the same manner as interest on bonds. The Japanese Tax Commission accepted the above proposal in its Tax Reform Outline 2011 in relation to structures where a Japanese originator:

> Entrusts assets (such as real estate, the "Underlying Assets") to a trustee of a specified purpose trust (SPT) established pursuant to the Asset Liquidation Act.
>
> Acquires a bond-type beneficial interest (for example, a beneficial interest in relation to which fixed distributions are payable which resemble interest payments on bonds, the "Bond-Type Beneficial Interest").
>
> Issues the Bond-type Beneficial Interest as *Sukuk* to investors.
>
> Enters into a *Ijarah* lease agreement with the trustee in respect of the Underlying Assets and makes periodic lease payments to the trustee.
>
> Repurchases the Underlying Assets at maturity, and the trustee makes periodic distributions of dividends to the investors during the trust period, redeeming the Bond-Type Beneficial Interest

by using the amount it receives on repurchase of the Underlying Assets from the originator at maturity.

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Under the proposed amendments:

Distributions of dividends on book-entry Bond-Type Beneficial Interests (that do not carry voting rights other than in relation to significant matters) payable to non-resident investors shall not constitute taxable income.

In relation to the sale of Bond-Type Beneficial Interests, the requirement that more than 50 percent must be offered domestically shall be excluded from the conditions for tax-deductibility of dividends paid by the SPT.

In relation to the Bond-Type Beneficial Interests, the repurchase of the Underlying Assets from the SPT by the originator (settlor of the SPT) at maturity shall be excluded from registration license taxes and real estate acquisition taxes.

The JFSA stated in its Action Plan for Japan's New Growth Strategy in December 2010 that the taxation of cross-border transactions (including this reform) constitutes one of the core items in its agenda to improve the status of Japan in the Asian market. As such, it is expected that this reform will take effect within 2011.

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