

Islamic Finance: A critical analysis of South African taxation legislation addressing Shariah compliant transactions

Z Mia



orcid.org/0000-0002-4691-0961

Mini-dissertation submitted in partial fulfilment of the
requirements for the degree [Master of Commerce](#) in [Taxation](#)
at the North-West University

Supervisor: Prof P van der Zwan

Graduation: May 2019

Student number: 16057600

ACKNOWLEDGEMENT

I thank The Almighty, Allah Ta'ala, for granting me the ability to complete this project.

ABSTRACT

The exponential growth of Islamic finance globally has caught the attention of governments in traditional western economies, with South Africa desiring to place itself as the gateway to Africa and at the forefront of this developing industry. Taxation considerations were identified as an impediment to advance such a strategy, which resulted in government enacting specific taxation legislation dealing with such Shariah compliant financing arrangements, with the objective of creating tax parity between Islamic finance and conventional finance. Section 24JA was thus introduced in the Income Tax Act with accommodating provisions in the VAT Act, the Transfer Duty Act and the Securities Transfer Tax Act.

The aim of this study was to analyse whether South African taxation legislation sufficiently addressed shariah compliant transactions. The analysis consisted of a qualitative comparison of the transactions as defined in the Act to their respective AAOIFI counterpart transaction, and thereafter, evaluating whether the deeming provisions of the Act sufficiently addressed the taxation aspects of such transactions.

This study found that the approach undertaken by government in dealing with Islamic finance transactions was to enact deeming provisions, which transformed the nature of these transactions to assimilate conventional financial transactions which treatment for taxation purposes was then aligned to reciprocate that of conventional transactions. This process of assimilation, where found to be incongruent, resulted in certain unintended consequences in the taxation treatment of these transactions. Recommendations are made to the legislature to reconsider certain aspects resulting to such anomalies and where deemed necessary legislation refined to address such issues.

Keywords: Islamic finance; Shariah compliant financing; *Mudaraba*; *Murabaha*; Diminishing *Musharaka*; *Sukuk*; Section 24JA

OPSOMMING

Die wêreldwye, eksponensiële groeiende Islamitiese finansiewese het die aandag getrek van regerings in westerse ekonomies met Suid-Afrika wat begeer om homself as die poort na Afrika te vestig asook om aan die voorpunt van hierdie ontwikkelende strategie te wees. Belasting oorwegings is geïdentifiseer as 'n belemmering van vooruitgang van so 'n strategie. Dit het tot gevolg dat die regering spesifieke belastingwetgewing ingestel het met betrekking tot "*sharia*-" toegewing finansieringsreëlins met die doelstelling om belasting gelykheid tussen Islamitiese finansieringswese en die gewone verbruikersfinansies te bewerkstellig. Artikel 24JA is dus ingebring as deel van die Inkomstebelasting Wet met tegemoetkomende voorsorg in die BTW Wet, die Oordragbelasting Wet en die Sekuriteite Oordrag Belasting Wet.

Die doel van hierdie studie was om krities ondersoek in te stel of die Suid-Afrikaanse belasting wetgewing voldoende die "*sharia*" toegewings-transaksies aangespreek het. Die ondersoek het bestaan uit kwalitatiewe vergelykbare standaarde van die transaksies soos beskryf in die Wet met hulle onderskeie AAOIFI ooreenstemmende transaksies en om daarna die waarde te bepaal of die Wet genoegsaam die belasting aspekte van sulke transaksies aanspreek.

Die studie het gevind dat die uitgangspunt van die regering met betrekking tot die Islamitiese finansiële transaksies was om voorsiening te tref om die wese van die transaksies te omskep en gelyk te maak met die gebruikelike gewone finansiële transaksies, welke onderhandeling vir belastingdoeleindes dan in lyn is. Daar is gevind dat hierdie proses van gelykstelling nie in ooreenstemming is met die belastingonderhandelings van hierdie transaksies is nie. Dit lei tot sekere onopsetlike gevolge. Aanbevelings word gemaak aan die wetgewer om die aspekte wat sulke onreëlmatighede tot gevolg het, te heroorweeg en waar nodig, wetgewing te verbeter om sulke gevolge aan te spreek.

Sleutelwoorde: Islamitiese finansiewese; Sharia toegewings-finansieringsreëlins; Mudaraba; Murabaha; Verminderde Musharaka; Sukuk; Artikel 24JA.

TABLE OF CONTENTS

ACKNOWLEDGEMENT	II
ABSTRACT	III
OPSOMMING	IV
ABBREVIATIONS	XI
CHAPTER 1 BACKGROUND AND OBJECTIVES OF THE STUDY	1
1.1 Background	1
1.2 Motivation for the study.....	3
1.3 Problem statement and research question	5
1.3.1 Main objective	5
1.3.2 Secondary objectives	5
1.3.2.1 <i>Islamic finance and conventional finance</i>	5
1.3.2.2 <i>Shariah compliant transactions – Banking context</i>	6
1.3.2.3 <i>Sukuk – Public sector context</i>	6
1.4 Research methodology.....	6
1.5 Overview.....	7
1.5.1 Chapter 1 – Background and objectives of the study.....	7
1.5.2 Chapter 2 – Shariah compliant transactions	7
1.5.3 Chapter 3 – Diminishing <i>Musharaka</i>	7
1.5.4 Chapter 4 – <i>Mudaraba</i>	8
1.5.5 Chapter 5 – <i>Murabaha</i>	8
1.5.6 Chapter 6 – <i>Sukuk</i>	8
1.5.7 Chapter 7 – Conclusion.....	8

CHAPTER 2 SHARIAH COMPLIANT TRANSACTIONS	9
2.1 Introduction	9
2.2 Islamic and Conventional finance	9
2.3 The doctrine of Substance over Form	12
2.4 The taxation concept of Capital versus Revenue	15
2.5 Section 24JA of the Income Tax Act	16
2.6 Accounting and Auditing Organisation of Islamic Financial Institutions (AAOIFI)	17
2.7 Approach followed in ensuing chapters.....	18
2.8 Conclusion	21
 CHAPTER 3 DIMINISHING MUSHARAKA	 23
3.1 Diminishing <i>Musharaka</i> as defined.....	23
3.1.1 AAOIFI definition of diminishing <i>musharaka</i>	24
3.1.2 Section 24JA definition of diminishing <i>musharaka</i>	25
3.1.3 Comparative analysis of the definition of a diminishing <i>musharaka</i>	26
3.1.4 Conclusion	28
3.2 Critical analysis of the deeming provisions of the Act.....	29
3.2.1 Deeming provisions of the Act.....	29
3.2.2 Analysis of the deeming provisions	30
3.2.2.1 <i>Capital nature and allowances</i>	31
3.2.2.2 <i>Maintenance and insurance</i>	31
3.2.2.3 <i>Acquisition of the bank's share by the client</i>	32
3.2.2.4 <i>General considerations</i>	33

3.3	Amendments to other legislation.....	34
3.4	Findings relating to a diminishing <i>musharaka</i>.....	35
3.4.1	Aspects of a diminishing <i>musharaka</i> to be considered by the Legislature	35
3.4.2	Conclusion	36
CHAPTER 4	MUDARABA.....	38
4.1	<i>Mudaraba</i> as defined.....	38
4.1.1	AAOIFI definition of <i>mudaraba</i>	39
4.1.2	Section 24JA definition of a <i>mudaraba</i>	40
4.1.3	Comparative analysis of the definition of a <i>mudaraba</i>	40
4.1.4	Conclusion	42
4.2	Critical analysis of the deeming provisons of the Act.....	42
4.2.1	Deeming provisions of the Act.....	42
4.2.2	Analysis of the deeming provisions	43
4.2.2.1	<i>The form of the transaction</i>	43
4.2.2.2	<i>The risk of loss</i>	44
4.2.2.3	<i>General considerations</i>	44
4.3	Amendments to other legislation.....	45
4.4	Findings relating to a <i>mudaraba</i>	45
4.4.1	Aspects of a <i>mudaraba</i> to be considered by the Legislature.....	45
4.4.2	Conclusion	46

CHAPTER 5 MURABAHA.....	47
5.1 <i>Murabaha</i> as defined.....	47
5.1.1 AAOIFI definition of <i>murabaha</i>	47
5.1.2 Section 24JA definition of a <i>murabaha</i>	49
5.1.3 Comparative analysis of the respective definitions of a <i>murabaha</i>	50
5.1.4 Conclusion	52
5.2 Critical analysis of the deeming provisions of the Act.....	52
5.2.1 Deeming provisions of the Act.....	52
5.2.2 Analysis of the deeming provisions	54
5.2.2.1 <i>Holding costs</i>	54
5.2.2.2 <i>Default penalties and donations</i>	54
5.2.2.3 <i>Amounts other than in cash</i>	55
5.3 Amendments to other legislation.....	56
5.4 Findings relating to a <i>murabaha</i>	57
5.4.1 Aspects of a <i>murabaha</i> to be considered by the Legislature.....	57
5.4.2 Conclusion	57
CHAPTER 6 SUKUK.....	58
6.1 Theory and background	58
6.1.1 AAOIFI definition of a <i>sukuk</i>	59
6.1.2 Section 24JA definition of a <i>sukuk</i>	60
6.1.3 Comparative analysis of the definition of a <i>sukuk</i>	60
6.1.4 Conclusion	61
6.2 Critical analysis of the deeming provision of a <i>sukuk</i>	61

6.2.1	Analysis of the provisions of the Act	63
6.3	The ‘enabling transaction’	64
6.4	Amendments to other legislation.....	65
6.5	Findings relating to a <i>sukuk</i>.....	66
6.5.1	Aspects of a <i>sukuk</i> to be considered by the Legislature	66
6.5.2	Conclusion	67
CHAPTER 7	CONCLUSION.....	68
7.1	Summary of findings.....	68
7.1.1	Contextualising section 24JA	68
7.1.2	Diminishing <i>musharaka</i>	69
7.1.3	<i>Mudaraba</i>	70
7.1.4	<i>Murabaha</i>	71
7.1.5	<i>Sukuk</i>	72
7.1.6	General conclusion	72
7.2	Limitations of this study	73
7.3	Areas for further research	73
	LIST OF REFERENCES.....	75

LIST OF TABLES

Table 3.1:	Comparison between an 'Islamic' diminishing <i>musharaka</i> and section 24JA(1) defined diminishing <i>musharaka</i>	28
Table 4.1:	Comparison between 'Islamic' <i>mudaraba</i> and section 24JA(1) defined <i>mudaraba</i>	42
Table 5.1:	Comparison between the definition of an 'Islamic' <i>murabaha</i> and the section 24JA(1) defined <i>murabaha</i>	51
Table 6.1:	Comparison between 'Islamic' <i>sukuk</i> definition and section 24JA(1) defined <i>sukuk</i>	61

ABBREVIATIONS

AAOIFI: Accounting and Auditing Organization for Islamic Financial Institutions

CIR: Commissioner for Inland Revenue

GCC: Gulf Cooperation Council

IFSB: Islamic Financial Services Board

ITA: Income Tax Act

ITA Act: Income Tax Act no.58 of 1962

OECD: Organisation for Economic Co-operation and Development

RSA: Republic of South Africa

SARS: South African Revenue Services

SPV: Special Purpose Vehicle

STT: Securities Transfer Tax

STT Act: Securities Transfer Tax Act no.25 of 2007

TDA: Transfer Duty Act

TDA: Transfer Duty Act no.40 of 1949

UK: United Kingdom

USA: United States of America

VAT: Value Added Tax

VAT Act: Value Added Tax Act no.89 of 1991

CHAPTER 1 BACKGROUND AND OBJECTIVES OF THE STUDY

1.1 Background

Islamic finance is a distinctive financial arrangement that follows Shariah (Islamic laws) as the core value system (Harrison & Ibrahim, 2016:1). Islam prohibits the charging and payment of interest on financial transactions and advocates social justice and equality through distribution of wealth within the society (Rammal, 2010). The parties must share the risks and rewards of a business transaction and the transaction should have a real economic purpose without undue speculation, and not involve any exploitation of either party (IMF, 2017). According to the International Monetary Fund, Islamic banking differs from conventional banking in several ways. Unlike conventional banks that operate on the basis of borrowing and lending with pre-specified interest rates, Islamic banks are funded by current accounts that do not attract interest or by profit-sharing investment accounts (PSIA) where the account holder receives a return that is determined ex-post by the profitability of the banks. All banking business based on sale or lease must have an underlying asset. This is in contrast to conventional banking, where the asset's importance lies only in terms of collateral security but the asset is not necessarily part of the loan transaction.

The Islamic banking sector is the dominant component of the Islamic finance industry. It has grown exponentially in the last two decades, accumulating nearly \$1.9 trillion in assets, and spans across at least 50 Muslim and non-Muslim countries around the world (World Bank Group, 2016). Islamic finance covers a wide-ranging market of 1.6 billion Muslims that are interested in participative Islamic banks and services (Huet & Cherqaoui, 2015:77). Key centres are concentrated in Malaysia and the Middle East, including Iran, Saudi Arabia, Kuwait, UAE and Bahrain. Islamic finance is also developing in Asian countries, such as Bangladesh, Pakistan and Indonesia, as well as North African countries, such as Sudan and Egypt (McKenzie, 2010:1).

The exposure of global banks, often from the UK and USA, with Islamic operations indicates that the growth of Islamic finance and its products are also co-ordinated through firms and elites operating from world cities beyond the Muslim world, such as Geneva, London and New York. A number of Asian financial centres such as Brunei, Singapore, Hong Kong and Jakarta are also turning their attention to the IFS markets, under the shadow of the Malaysian Islamic financial market (Hasan, 2015:6). According to Mohamed and Goni (2017:11), Islamic finance assets are primarily distributed in the categories of Islamic Banking (73%) and *Sukuk* (16%), which together, represent almost 90% of the market. Islamic financial instruments consist primarily of profit-sharing (*mudaraba*), cost-plus financing (*murabaha*), leasing (*ijara*), partnership (*musharaka*) and bonds (*sukuk*). *Sukuk* issuance has also increased rapidly. Global *sukuk* issuance has grown significantly since 2006, reaching US\$345 billion in 2016 (Mohamed and Goni, 2017:11). Issuance is still

concentrated in Malaysia and the GCC countries, although diversification is ongoing with new issuance in Africa, East Asia and Europe (Kammer *et al.*, 2015:15). Islamic finance is also represented in more than 300 Islamic banks and windows, which are present in at least 60 countries (Deloitte, 2016:5). Buoyed by the perception of more tranquil market conditions and an improving regulatory backdrop, issuance of Islamic debt by non-Muslim countries is set to climb to a 3-year high in 2017 (Lee, 2017). In 2014, South Africa concluded its debut \$500 million *Sukuk* issuance in the capital markets, which was four times oversubscribed (RSA National Treasury, 2014).

Any innovation and product brings with it new challenges, especially in a taxation context. Similarly, Islamic financial products and offerings bring about their own unique challenges to taxing authorities globally, as taxing systems have been designed chiefly to accommodate conventional financial transactions. From a tax perspective, the nexus of a transaction is its substance over its legal form (ITC 1618 (59 SATC 290). The doctrine is based on a principle that Innes CJ expressed in *Dadoo* (at 547) as a 'branch of the fundamental doctrine that the law regards the substance rather than the form of things'.

To provide for certainty and clarity, various jurisdictions have specifically introduced legislation to deal with Islamic financial transactions. In a tax circular released on 12 January 2010 (Circular L.G.-A No.55 of 12 January 2010), Luxembourg considers the tax treatment of *Sukuks* as debt for Luxembourg tax purposes. Islamic finance transactions hence benefit the same as conventional products from a taxation perspective. In Ireland, the Specified Financial Transactions section of the Taxes Consolidation Act 1997 read with the Finance Act 2016, creates an enabling environment to tax certain Islamic financial transactions in the same way as conventional finance transactions.

London has become the largest international centre for Islamic finance outside of the Muslim World, largely because of the City's role as a centre for Middle Eastern and Asian banking (Ahmad & Hassan, 2006:42). The Finance Act 2003 provided relief from double Stamp Duty Land Tax 'SDLT' on Home Finance *Murabaha* and *Ijara* Products (Raza, 2010). The Finance Act 2007 introduced legislation, which provided for *sukuk* to be taxed similar to conventional bonds (Raza, 2010). The approach undertaken by the UK, and as reinforced in their relevant legislation, is that of treating Islamic finance within the context and as part of the broader conventional finance framework. By adopting this approach and levelling the playing field, the Islamic finance industry will be held to the same standards as the conventional finance industry, and contracting parties should expect to be subject to the same levels of scrutiny from the regulators and courts (Dewar & Hussain, 2017:92). Back in April 2010, the Federal Government of Australia announced that the Board of Taxation would undertake a comprehensive review of Australia's tax laws to ensure they do not inhibit the expansion of Islamic finance, banking and insurance products in Australia. The

changes would place transactions structured in a Shariah compliant manner on a similar footing to conventional financing so far as the tax consequences are concerned (Rayner & Falkner, 2016). In the 2016-17 Budget the Australian Government announced it would amend the tax laws to give asset backed financing arrangements consistent tax treatment with arrangements based on interest bearing loans or investments. These changes will apply from 1 July 2018. These measures incorporate the Board of Taxation's recommendations as outlined in their final report to the Australian Government (Australia, Board of taxation). The Australian approach is similar to the United Kingdom (Norton Rose Fulbright, 2016).

Malaysia has developed a sophisticated Islamic finance sector over the past 30 years, which in turn has generated a vibrant business environment for financial institutions, intermediaries, investors, issuers and service providers alike. In the course of this development, Malaysia successfully established a mature and robust Islamic finance regulatory framework and pioneered the dual banking system, wherein both Islamic and conventional financial systems operate and co-exist within a single regulatory framework (D'Cruz & Aziz, explained by Dewar & Hussain, 2017:35). Malaysia has introduced a new single legislative framework for the conventional and Islamic financial services (FS) sectors. The Malaysian Financial Services Act 2013 (FSA) and Islamic Financial Services Act 2013 (IFSA) came into effect in July 2013 (bobsguide, 2013). The Malaysian tax legislation has tax neutrality provisions so that Islamic finance transactions are treated similarly to conventional financing transactions for tax purposes (PWC, 2009:22).

1.2 Motivation for the study

In South Africa, The Taxation Laws Amendment Act, 2010 first introduced provisions relating to Islamic finance, recognising the adoption of the principle of substance over form as the basis for regulating Shariah compliant financing arrangements. These are contained in section 24JA of the Income Tax Act No.58 of 1962. Three broad categories of Islamic financial transactions were initially addressed, these being *Mudaraba*, *Murabaha* and Diminishing *Musharaka*, which required compulsory participation by a bank (as defined) to be a party to the transaction. Their associated VAT, transfer duty and securities transfer tax implications were also dealt with in the respective legislation. Subsequently, changes were made to accommodate the issuance of *sukuk* by the Government and state owned companies and later by extending the scope of *murabaha* and *sukuk* to listed companies as well.

"Islamic finance has the potential to contribute to higher and more inclusive economic growth. However, Islamic finance faces a number of other constraints that may be impeding its development. Although Islamic regulatory bodies and standard setters have created principles and detailed technical standards, there is further scope for their implementation by national authorities,

who are often more focused on global conventional banking standards.” This argument is supported by Kammer *et al.* (2015:15).

With the development of the global Islamic finance market, some issues relating to these transactions will require international co-operation and uniform standards of classification. Of primary concern is the notion of debt and equity between conventional and Islamic finance, and the associated tax treatment thereof. Conventional tax systems recognise the return to debt (but not equity) as a deductible expense for income tax purposes. This so-called debt bias can, in principle, disadvantage Islamic finance, since Shariah does not recognize interest. This apparent anomaly is overcome by treating the economic substance of Islamic financial instruments similar to conventional financial instruments. As such, in certain instances, it may not be a necessity that specific provisions be enacted to cover Islamic finance transactions, provided that the general framework makes a clear reference to the treatment of simulated transactions. However, specific changes to tax law may provide transparency and certainty regarding the tax treatment of the main Islamic finance instruments.

There is also the risk that, if unchecked, differences in the treatment of Islamic and conventional finance across jurisdictions can create international tax arbitrage opportunities. Multinational enterprises exploit differences in tax systems in many different forms, one of which is to treat a transaction as debt in one country and equity in another. Double Taxation Agreements between countries can, to a certain extent, address this tax leakage. International standards can also facilitate tax reforms toward levelling the playing field between Islamic and conventional finance. Accounting and auditing standards for Islamic finance are particularly important, especially for ensuring Shariah consistency within and across jurisdictions (Hurcan, Mansour, & Olden, 2015). To help unlock the full potential of Islamic banking, it will be important to reduce the tax and regulatory impediments to Islamic bank financing, and enhance the financial infrastructure (Kammer *et al.*, 2015:7). There is uncertainty as to whether the current tax provisions fully appreciate the underlying Shariah principles.

The exponential growth in the Islamic financial markets coupled with the diversity in product offerings, poses unique challenges as the market is in a constant state of flux. As such, taxation systems are challenged to keep pace with such developments. South African taxation legislation primarily addresses Shariah compliant transactions in section 24JA. Although a progressive step, the position of National Treasury and SARS can be said to be reactive as opposed to proactive in the field of Islamic finance as the proposed legislation was based on current practices existing among financial institutions (SCOF, 2010:13). Government has thus far only issued one maiden *Sukuk* in 2014, with state owned companies expressing an interest but not yet having offered any

sukuk as yet. As these practices evolve, so too will the need for specific legislation to be introduced or amended.

1.3 Problem statement and research question

The provisions in section 24JA of the Act are based on the presumption that the substance of Islamic finance and conventional finance are largely the same (South Africa, 2010:50). This study was undertaken to comparatively analyse these transactions within their respective context of application, with our research question thus being:

Does South African taxation legislation, when measured against AAOIFI principles contained within the definition of the respective 'Islamic' transaction counterpart, sufficiently address the taxation considerations of such Sharia compliant financing arrangements?

1.3.1 Main objective

The introduction of legislation dealing with Islamic finance specifies the tax treatment of certain specific Sharia compliant financing arrangements. These are contained within section 24JA of the Income Tax Act no 58 of 1962 (ITA) with corresponding amendments made to the Value Added Tax (VAT) Act no. 89 of 1991, the Securities Transfer Tax (STT) Act no. 25 of 2007 and the Transfer Duty Act (TDA) no. 40 of 1949.

The main objective of the research is to determine whether the taxation aspects of Sharia compliant financing arrangements as dealt with in the South African taxation legislation (as mentioned above), are sufficiently addressed.

1.3.2 Secondary objectives

Section 24JA of the Income Tax Act deals with selected Islamic finance transactions under the heading called 'Sharia compliant financing arrangements'. The respective arrangements dealt with are diminishing *musharaka*, *mudaraba*, *murabaha* and *sukuk*. These are accordingly discussed individually.

1.3.2.1 Islamic finance and conventional finance

To evaluate the basic application of Islamic finance and conventional finance within the broader context of substance over form and capital versus revenue, and to contextualise section 24JA within this perspective.

1.3.2.2 *Shariah compliant transactions – Banking context*

To analyse whether the aspects of Shariah compliant financing arrangements, v.i.z. *Murabaha*, *Mudaraba* and Diminishing *Musharakah*, which are open for participation by banks, are sufficiently addressed by section 24JA(2) – 24JA(6) by comparing these provisions against the ‘Islamic’ transaction counterpart.

1.3.2.3 *Sukuk – public sector context*

To analyse whether the aspects of Shariah compliant ‘bond’ type transactions, v.i.z. *Sukuk*, which are originated by the public sector, are sufficiently addressed by section 24JA(7) by comparing these provisions against the ‘Islamic’ transaction counterpart.

1.4 **Research methodology**

The inherent nature of taxation is that it is multidisciplinary, primarily cutting across accounting, finance and economic fields. Maydew (2001) and Hanlon & Heitzman (2010:1) are of the view that researchers in accounting should not be restrictive to accounting but rather encouraged to incorporate more theory and evidence from economics and finance. The Pearce Committee classified legal research as either doctrinal or non doctrinal, and further segmented non doctrinal to contain reform-orientated research, which it described as, “Research which intensively evaluates the adequacy of existing rules and which recommends changes to any rules found wanting (Pearce *et al.*, 1987). Research methodology is not an exact science and as such, it may be difficult to identify philosophical variations between the methods (McKerchar, 2008:19). Bentley (2006:6) uses theoretical research to understand and formulate the basis of legal rules, then employs doctrinal research to analyse these legal rules and finally proposes reforms based on critical examination. When the practice of a discipline is based on principles and rules, ‘the doctrines’, which are developed through a process of consensus, then a very important research approach that could be followed is doctrinal research (Coetsee & Buys, 2018:86).

The approach followed in this study was aligned to the doctrinal methodology in gaining an understanding of the current law and the analysis of the relevant legal doctrine, followed by reform-orientated proposed recommendations stemming from a critical analysis of the law.

The research source is primarily literature review based. These include books by reputable authors, articles in industry specific journals, other scholarly works dealing with similar matters and reputable websites. The focus was on defining those Islamic finance transactions that are contained in section 24JA, together with a reading of the background leading to these changes and

their rationale as expunged by government authorities. The salient characteristics of these categories of Islamic finance transactions were summarised based on the Shari'ah Standards and definitions issued by The Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), and this applied as a 'benchmark' to evaluate whether section 24JA sufficiently addresses these transactions. The introductory explanatory memorandum to the Income Tax Act dealing with section 24JA, together with their respective subsequent amendments were analysed and compared against this 'benchmark' to assess which components of the Shariah compliant transactions, as contained therein, have been addressed and to what extent. The amendments to other taxation legislation as a result of Shariah compliant alignment are briefly discussed on a high level. (Value Added Tax Act, Transfer Duty Act, Securities Transfer Tax Act)

1.5 Overview

1.5.1 Chapter 1 – Background and objectives of the study

This Chapter deals with the introduction to the topic and contextualising the issues within the broader context. It discusses the comparability of Islamic finance to conventional finance. It sets the tone for the study and defines the research objectives and thus the research methodology followed.

1.5.2 Chapter 2 – Shariah compliant transactions

In this Chapter, a literature review is conducted of the salient features of Islamic finance transactions. These transactions are looked at from an academic view – specifically from a taxation perspective. The principles of substance over form and capital versus revenue are discussed, as they apply to the taxation discipline. The unique characteristics of these transactions are used in the subsequent Chapters to benchmark and assess them against the taxation provisions, to determine whether they have been sufficiently addressed by legislation.

1.5.3 Chapter 3 – Diminishing *Musharaka*

This Chapter focuses on Diminishing *Musharaka*. This Chapter begins with an introduction of this type of transaction with reference to AAOIFI Shari'ah Standards, and the features of the 'Islamic' transaction are stated with a view to be used for comparative purposes. This 'Islamic' transaction is used as a benchmark to compare to the definition as contained in section 24JA of the Act of a similar named transaction. The provisions contained in the Act are analysed to determine whether they sufficiently address this type of transaction and a conclusion is drawn. This is followed by a cursory discussion of The VAT Act, TD Act and STT Act (where applicable).

1.5.4 Chapter 4 – *Mudaraba*

This Chapter focuses on *Mudaraba*. This Chapter begins with an introduction of this type of transaction with reference to AAOIFI Shari'ah Standards and the features of the 'Islamic' transaction are stated, with a view to be used for comparative purposes. This 'Islamic' transaction is used as a benchmark to compare to the definition as contained in section 24JA of the Act of a similar named transaction. The provisions contained in the Act are analysed to determine whether they sufficiently address this type of transaction and a conclusion is drawn. This is followed by a cursory discussion of the VAT Act, TD Act and STT Act (where applicable).

1.5.5 Chapter 5 – *Murabaha*

This Chapter focuses on *Murabaha*. This Chapter begins with an introduction of this type of transaction with reference to AAOIFI Shari'ah Standards and the features of the 'Islamic' transaction are stated, with a view to be used for comparative purposes. This 'Islamic' transaction is used as a benchmark to compare to the definition as contained in section 24JA of the Act of a similar named transaction. The provisions contained in the Act are analysed to determine whether they sufficiently address this type of transaction and a conclusion is drawn. This is followed by a cursory discussion of the VAT Act, TD Act and STT Act (where applicable).

1.5.6 Chapter 6 – *Sukuk*

This Chapter focuses on *Sukuk*. This Chapter begins with an introduction of this type of transaction with reference to AAOIFI Shari'ah Standards and the features of the 'Islamic' transaction are stated, with a view to be used for comparative purposes. This 'Islamic' transaction is used as a benchmark to compare to the definition as contained in section 24JA of the Act of a similar named transaction. The provisions contained in the Act are analysed to determine whether they sufficiently address this type of transaction and a conclusion is drawn. This is followed by a cursory discussion of the VAT Act, TD Act and STT Act (where applicable).

1.5.7 Chapter 7 – Conclusion

Based on the findings above, a conclusion is drawn as to whether the taxation considerations relating to Shariah compliant transactions as discussed in the previous chapters are sufficiently addressed by the South African taxation legislation and, where applicable, a summary of recommendations are stated.

CHAPTER 2 SHARIAH COMPLIANT TRANSACTIONS

2.1 Introduction

Adam Smith (1776:347), in his magnum opus, 'An Inquiry into the Nature and Causes of The Wealth of Nations', lists four maxims as the cornerstones upon which a taxation system should be based. These are equity, certainty, convenience and economic collectability. In the context of certainty he states, "The tax which each individual is bound to pay ought to be certain and not arbitrary. The time of payment, the manner of payment, the quantity to be paid all ought to be clear and plain to the contributor and to every other person". This implies that the quantum to be paid and the timing of such dues should be certain.

The modern global economic landscape transforms rapidly and in order to keep up with such developments, taxation systems should be structured so as to be geared to adapt to this environment, if not to anticipate these changes. In the designing of a tax system, the actual economy and the population that is affected should be considered as it is, and not how we may wish it to be (Mirrlees et al., 2011:2). The objectives of governments are reflected in the taxes imposed (Scottish Government, 2013:58). In 2010, the South African government, recognised the importance of Islamic finance and has enacted certain provisions in subsequent years to cater for such transactions.

The Islamic and conventional financial systems are based on their own set of principles and as such, any meaningful comparison between these transactions should take cognisance of their respective application environments. As mentioned in Chapter 1, the basis to be applied for the comparison of Islamic finance transactions is their definition as contained in the Accounting and Auditing Organization for Islamic Financial Institutions' (AAOIFI) standards. This chapter evaluates the contextual framework of Islamic and conventional finance, with Chapter 3 to 6 analyzing whether the provisions of sharia compliant financing arrangements, as contained in the Act, sufficiently addresses these transactions from a taxation perspective. To contextualise these arrangements within this framework, an understanding of Islamic and conventional finance environments are essential, which are thus discussed in the next section, followed by certain important taxation principles, namely substance over form and capital versus revenue.

2.2 Islamic and Conventional Finance

The prescripts of the substance versus form and capital versus revenue principles are interdisciplinary, with both Islamic and conventional finance transactions being subjected thereto. This also holds true from a taxation perspective. Having outlined a high-level overview of these

principles, their impact within the Islamic and conventional finance environments are further explored.

Islamic finance, as the name suggests, has a moral dimension founded in religion. A variety of Islamic finance definitions can be found in the literature from relatively simple concepts to more complex ones. Warde (2000:5) defines Islamic finances as follows, “Islamic financial institutions are those that are based, in their objectives and operations on Islamic law (the Shariah). They are thus set apart from ‘conventional’ institutions, which have no such preoccupations.” El Gamal (2006:2) argues that the ‘Islamic’ distinction is often mainly preserved at a cost, which cost when driven by competitive pressures, may render such distinction only in form without any substance. The crux of an Islamic economic system is based upon a body of immutable rules laid down by the principles of Shariah (Iqbal & Mirakhor, 2011:40).

Shariah is the codified body of Islamic law. The principles of Shar’iah are embodied in a comprehensive code, covering a Muslims private and public life (Millar, 2008:3). Shari’a is derived from the Quran, which is the revealed word from Allah (The Almighty) and the Sunnah, which comprises the sayings and practices of Prophet Mohammed (Peace be upon him) (Ayub, 2007:22). Fiqh is Islamic jurisprudence, with a branch thereof being fiqh ul muamalat, which covers economic transactions (Kamali, 2008:14). Islamic finance is governed under this branch of Islamic law.

In Islam, ‘riba’ (interest), in whatever form, is strictly prohibited. Iqbal and Molyneux (2005:9) define riba as follows, “In its basic meaning, Riba can be defined as anything (big or small), pecuniary or non-pecuniary, in excess of the principal in a loan that must be paid by the borrower to the lender along with the principal as a condition (stipulated or by custom) of the loan for an extension in its maturity. According to a consensus of Islamic jurists, it has the same meaning and import as the contemporary concept of interest.” Since the advent of Islam fourteen centuries ago, the fundamental rules and basis for an Islamic financial system has been laid down, and as the Quran has not and cannot change, these principles are enshrined and cast in stone (Ayub, 2007:21). In the prohibition of interest and its dissimilarity to commerce, the Holy Quran respectively states:

“O ye who believe! Devour not usury, doubling and quadrupling (the sum lent). Observe your duty to Allah, that ye may be successful” (Qur’aan, 3:130).

“...That is because they say: Trade is just like usury; whereas Allah permitteth trading and forbiddeth usury...” (Qur’aan, 2:275)

Together with the prohibition of interest, Shariah also prohibits ‘gharar’ (uncertainty) and ‘maysir’ (gambling, chance transactions), whilst promoting the quest for justice with an ethical and social

dimension. Gharar incorporates uncertainty regarding future events, which may also be the result of an incompleteness of information (El Gamal, 2006:60). Maysir is regarded by most Islamic scholars as gambling with a desire for obtaining a return through deliberate intentional risk-taking (Gait & Worthington, 2007:11).

A distinctive feature of an Islamic financial system is that the lending or borrowing of financial assets cannot be used for the creation of debts (Kyeong et al., 2012:48). Debt-based financing, which is found in conventional finance does not exist in Islamic finance (Aljifri & Khandelwal, 2013:81). Financial transactions are to be underpinned by a productive economic activity, and the basis for profit sharing is proportional to the risks assumed by the parties (Abdul Wahab et al., 2014:17). Islamic finance is thus grounded by two fundamental ideologies; firstly, the sharing of risk philosophy between lender and borrower, and secondly, the promotion of social development through ethical business practice (Warde, 2000:5). Islamic finance is immune from unethical business practices and not necessarily exclusive to the adherents of the Muslim faith, with many non-Muslims participating in Islamic financial transactions in various capacities (Hayat & Malik, 2014:2).

The commercial market, influenced by multi national corporates and governments across various jurisdictions, sets the pace at which the global economy develops and adapts. Conventional financial institutions exist to serve this market without the prejudice of subscribing to a higher religious authority, and as these markets demand, so too will these institutions evolve. In theory at least, Islamic financial institutions are based on socio-economic values, whereas conventional financial institutions are based on capitalistic ones (Ahmad & Hassan, 2007:27). The most impressive argument in favour of Islamic finance is that it integrates the financial with the real sector, which conventional finance fails to do (Siddiqi, 2006:6). There is an overwhelming consensual view amongst scholars that the two fundamental core principles that lie at the very heart of an Islamic financial system, and as proposed by Iqbal and Mirakhor (2011:10), is the prohibition of interest and risk sharing. This view is corroborated by Kyeong et al. (2012:53); Jobst (2007:1); Beck et al. (2010:5); Aljifri and Khandelwal (2013:81) and Abdul Wahab et al. (2014:16).

On the similarities of these two institutions, Hanif (2011:166) argues that Islamic banking is practiced very much like conventional banking; hence, perceiving it as foreign to the business world is not entirely correct. He further argues that although the profit rate charged in Islamic banking may be similar to conventional banking, the risks associated with the respective contracts are different and the philosophies on the operational side contrast each other. Hayat and Malik (2014:5) point out that instead of finding Islamic and conventional finance, different critics question its Islamic credentials and socioeconomic value add because of their unusual similarities. Honohan (2001:4) argues that there is an overlap between Islamic and conventional finance, with the Islamic

financial instruments on that are offer representing only a subset of their conventional counterparts, which similarities may mask fundamental important differences, rendering the impact of these instruments weaker to sustain and boost economic growth.

The primary difference in principle between Islamic financial institutions and conventional financial institutions is that the former is based on the total elimination of the payment and receipt of interest in all its forms, whereas in the case of the latter it is not (Lewis, 2008:9). Shafi Alam (2011:39) argues that the primary and major source of profit in conventional systems is the interest that banks earn, where the repayment of the said loans with interest is generally guaranteed, in that the bank assumes that the quality of the collateral may buffer any default. These practices may promote reckless lending and unbridled credit expansion, which may contribute to an inability to recover these loans with their associated interest repayments, resulting in losses accruing to conventional financial institutions (Bartmann, 2017:9). This is in contrast to a 'profit and loss' sharing model in which the risks are shared by the parties.

While the theory of Islamic finance aspired to prove that it was different to conventional finance, the rapid developments of late were aspired by practitioners searching for ways to make them similar (Siddiqi, 2006:8). El Gamal (2006:20) has aptly coined a term, 'Shari'a arbitrage', which refers to a "perculiar form of regulatory arbitrage" that is widely practiced in Islamic finance today. 'Shari'a arbitrage' is the process whereby a conventional financial product that is deemed contrary to Shariah is identified, which is then re-engineered to form an 'Islamic analog', labeled and packaged with an Arabic name, having kept the conventional structure intact thereby ensuring that this new product is consistent with secular legal and regulatory frameworks (El Gamal, 2006:20). The currently practiced Islamic finance and conventional finance are very similar in nature, thereby resulting in similar forms of transactions (Beck *et al.*, 2010:6), whereas their ideological philosophy is so contrasting that it is irreconcilable, hence resulting in a disconnect between the substance and the form of a transaction. The degree of 'Shari'a arbitrage' will often result in an evolution from a capital to a revenue nature (or vice versa) or from an exempt to a taxable nature (or vice versa), primarily dependant upon the extent to which the 'islamic analog' has been re-engineered. The taxation treatment of Shariah compliant arrangements are covered by section 24JA of the Act, which are to be interpreted within the broader doctrine of substance versus form, which form the basis of any anti-avoidance measures in taxation-related determinations.

2.3 The doctrine of substance over form

The dichotomy between substance and form is so prominently exhibited in an Islamic finance transaction, that it is the norm as opposed to the exception in conventional parlance. According to

Kholvadia (2016:53), the level of cognitive dissonance in Islamic banking in South Africa is so prevalent that it affects all transactions.

The doctrine of substance versus form is an international legal concept encountered across various jurisdictions. In the United States of America, courts repeatedly state that substance, as opposed to form, characterises a transaction (Maloof, 1956:269). In the case of *Weiss v Stearn* (1924), in dealing with substance versus form, the Supreme Court of the United States stated, "Questions of taxation must be determined by viewing what was actually done rather than the declared purpose of the participants." In a British case of the House of Lords, Lord Tomlin in *Duke of Westminster v CIR* (1936), on the issue of substance and form stated, "there is a doctrine that the court may ignore the legal position and regard what is called 'the substance of the matter'." (Durack, 1979:604) In South Africa, the courts have given English decisions persuasive authority.

The legislative intent is generally reflected in the substance of a transaction with the words being the form expressing such intent (Durack, 1979:607). A limitation of the substance doctrine is that in theory there may exist a scenario where the law was intended to provide for a certain provision to apply to a range of transactions; whereas another transaction not falling within this range, but nonetheless, which comports with the text, intent and purpose of the said legislation, will avail itself of the benefits of such a provision, however, that has not proven to be the case in general practice (Bankman, 2000:15). In Islamic finance, an element of the substance of the transaction from the client's perspective is the purchase of an asset, whereas the legislation provides for a portion of the purchase price to be deemed interest. An important distinction needs to be made between a fraudulent transaction and one where a taxpayer orders his affairs in such a manner so as to attract the least possible tax. In South Africa, courts have given due consideration to the intent of the parties, and where this stated intent, the *ipse dixit*, differs from the form of the transaction or vice versa, these transactions are further scrutinised, and where appropriate, modified to give effect to the purpose of the transaction. A further and important distinction to be made is where the intent of the parties is more apparent and common knowledge, and their rationale for entering a transaction is clear, in which case the enquiry as to the purpose or intent of the parties is fairly straightforward.

Dealing with the doctrine of substance over form by the courts in South Africa spans back almost a century, when it was applied in *Dadoo Ltd v Krugersdorp Municipal Council* (1920). Here Innes CJ remarked that the doctrine is based on principle of law, a "branch of the fundamental doctrine that the law regards the substance rather than the form of things – a doctrine common, one would think, to every system of jurisprudence and conveniently expressed in the maxim *plus valet quod agitur quam quod simulate concipitur*", which means that what is actually done is more important than that which seems to have been done. In the principles laid down by *CIR v Estate Kohler*

(1952), *Commr for IR v Berold* (1962) and *Estate Dempers v SIR* (1977), which substitutes the legalistic approach in favour of the substantive interpretation (Durack, 1979:605).

Usually, when the courts have been called upon to give effect and interpretation on the substance over the form of a transaction, it involved a certain degree of a simulated or sham transaction. This differentiation between a genuine transaction and a simulated one is evident from the various cases, as stated by Watermeyer CJ (quoting Innes CJ in *Zandberg v Van Zyl* [1910]) in *Randles, Brothers & Hudson Ltd v Commissioner of Customs* (1941), "I wish to draw particular attention to the words 'a real intention, definitely ascertainable, which differs from the simulated intention' and more recently in the *SARS v NWK Ltd* (2011) case, where Lewis JA emphasising the purpose of the transaction stated, 'If the purpose of the transaction is only to achieve an object that allows the evasion of tax, or of a peremptory law, then it will be regarded as simulated'."

The OECD Model Tax treaty and its commentary also acknowledge the doctrine of substance versus form. In the context of an employment relationship the commentary states, "In many States, however, various legislative or jurisprudential rules and criteria (e.g. substance over form rules) have been developed for the purpose of distinguishing cases where services rendered by an individual to an enterprise should be considered to be rendered in an employment relationship (contract of service) from cases where such services should be considered to be rendered under a contract for the provision of services between two separate enterprises (contract for services)" (OECD, 2010:256). The International Bureau of Fiscal Documentation (IBFD) provides that substance over form is an anti avoidance rule under which the legal form of an arrangement is ignored and tax is thus levied on its economic substance (Rodgers-Glabush, 2015:406).

The initial enactment of taxation legislation addressing Shariah compliant financing arrangements was to accommodate the banking industry as it was made compulsory that an Islamic finance transaction would only be recognised if one of the parties was a bank. Mahmoud El-Gamal (2006:190) has argued persuasively for an Islamic banking system that focuses on substance rather than form. As he writes, "The form-over-substance juristic approach to Shariah arbitrage has also been shown to squander the prudential regulatory content of pre-modern Islamic jurisprudence, while reducing economic efficiency for customers through spurious transactions, not to mention legal and jurist fees".

The implication for Islamic finance transactions, from a taxation perspective, is that the substantive interpretation results in a transformation in the nature of the transaction, which could lead to an amount that would ordinarily have formed part of the capital cost of an asset and capitalised to being transformed to that of a revenue nature and expense.

2.4 The taxation concept of capital versus revenue

In taxation, whether an amount is of a capital or revenue nature is of decisive importance. These two (i.e. capital and revenue) are mutually exclusive concepts and an amount that is one would not be the other. In *Pyott Ltd vs CIR* (1945), Davis AJA in commenting on capital and revenue nature stated, “This is a half-way house of which I have no knowledge.” *Visser v CIR* (1937) states that, “‘Income’ is what ‘capital’ produces, or is something in the nature of interest or fruit as opposed to principal or tree. This economic distinction is a useful guide in matters of income tax, but its application is very often a matter of great difficulty, for what is principle or tree in the hands of one man may be interest or fruit in the hands of another. Law books in the hands of a lawyer are a capital asset; in the hands of a bookseller they are a trade asset.”

In determining the capital nature or otherwise of an amount, the courts have followed the approach as formulated in *George Forest Timber* (1924), amplified in the *New State Areas* (1946) and applied in *Cadac* (1965) cases. The test essentially entails an enquiry into the close connection of the amount to the income earning operations, (in which case it would be revenue) or to the income earning structure (in which case it would be capital). The metaphor of the trees and fruit in differentiating between revenue and capital may be helpful in understanding their salient characteristics as referred to in *Visser v CIR* (1937), however, caution needs to be exercised so as not to over simplify these concepts. Cardoso J, in *Berkey v Third Ave Railway Co* (1926), warned, “[m]etaphors in law are to be narrowly watched, for starting as devices to liberate thought, they end often by enslaving it”.

In *New State Areas Ltd v Commissioner for Inland Revenue* (1946), Watermeyer CJ, after discussing numerous English cases remarked, “The conclusion to be drawn from all of these cases seems to be that the true nature of each transaction must be enquired into in order to determine whether the expenditure attached to it is capital or revenue expenditure. Its true nature is a matter of fact and the purpose of the expenditure is an important factor.” Hefer AP, in *Samril Investments (Pty) Ltd v Commissioner, South African Revenue Service* (2002), expressed a similar view that each case must be decided on its own facts. In *Commissioner for the South African Revenue Service v Capstone 556 (Pty) Ltd* (2016), the Supreme Court of Appeal stated that the transaction must be considered in its entirety from a commercial perspective and not be broken into component parts or subjected to narrow legalistic scrutiny

Despite the myriad of court decisions and literature in determining whether an amount is of a capital or revenue nature, there are no set rules that can be applied to make this determination (Botha & Kotze, 2018:online). The enquiry as to the capital or revenue nature of a transaction will revolve around the true nature of the transaction and hence can only be ascertained by reference

to the facts and circumstances of the particular transaction. Islamic finance transactions have an inherent dimension, which is grounded in religion (DeLorenzo, 2000:140). Where there is a disconnect between the form and the substance of a Shariah compliant transaction from a capital versus revenue perspective, the true nature of the transaction needs to be enquired into. Apart from evidence to the contrary, it would be irrational for this enquiry to aver, from the perspective of a Muslim who is subjected to the demands of his beliefs, that the form of the transaction does not reflect his true intent. Hence, the capital or revenue nature of the transaction will be interpreted with reference to the form of the transaction. Shariah compliant financing arrangements are contained within section 24JA of the Act.

2.5 Section 24JA of the Income Tax Act

In his budget speech to parliament on 17 February 2010, the Finance Minister at the time, Mr. Pravin Gordhan, indicated that as part of enhancing South Africa's attractiveness as a base for entering the African economy, government would review the tax treatment of financial instruments so as to accommodate Islamic compliant financing (South Africa, 2010:14). National treasury has recognised the prohibition of interest and the sharing of risk (of profit or loss) amongst the principles of Islamic finance that impact transactional form (South Africa, 2010:48). This was necessitated because the tax system lacked the recognition of Islamic finance, as it mainly focused on conventional finance and as such, there was a need to level the playing field (South Africa, 2010:3). In order to eliminate taxation related anomalies, the approach was to treat Shariah-compliant financing as comparable to conventional debt instruments, by deeming Islamic finance amounts to be interest for Income tax purposes (South Africa, 2011:73).

The development of provisions addressing Islamic financial transactions was undertaken in a phased approach, commencing with current practices among financial institutions at the time (South Africa, 2010:13). The provisions first introduced in 2010 initially covered diminishing musharaka, mudaraba and murabaha. As an anti-avoidance measure, it was made obligatory that a bank, as defined in the Act, be a participant in these transactions. Subsequently, the scope of a murabaha was extended to include a listed company. To further the objective of Government in creating a broader enabling framework for Islamic finance, which lacked a 'risk-free' standard against which to price Islamic bonds, legislation was introduced in 2011 to provide for a *sukuk* (South Africa, 2011:70). The conventional counterparts of these transactions are:

- Diminishing *Musharaka* – Project financing transactions.
- *Mudaraba* – Investment or transactional accounts.
- *Murabaha* – Asset acquisition finance. (South Africa, 2010:49).
- *Sukuk* – Bonds (South Africa, 2011:70).

The approach, followed by legislature, was to firstly define these transactions primarily as to their form, thereby bringing them within the scope of the Act and thereafter providing for deeming provisions, which aligned these transactions to their respective conventional counterparts. This approach thus deemed certain amounts to be regarded as interest.

Section 24 JA was thus introduced into the Income Tax Act no 58 of 1962 (Act) by section 48 of the Taxation laws Amendment Act, 2010. These included various provisions, which were subsequently refined, and grouped under the heading Sharia-compliant financing arrangements. The Shariah compliant transactions covered by the section 24JA legislation (i.e. (i) diminishing musharaka (ii) mudarabah (iii) marabaha and (iv) sukuk), are considered in more detail in the following chapters. This study refers to the definitions of these transactions as contained in the AAOIFI Shari'ah standards.

2.6 Accounting and Auditing Organisation of Islamic Financial Institutions (AAOIFI)

Because of the differing schools of thought in Islamic jurisprudence, there is no single globally recognised authority on Shariah law (Gooden, 2011:44). Two of the most prominent standard setting bodies serving the Islamic financial industry are the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB). These two organisations address issues of harmonising best practice in the industry, each within their respective niche focal areas (Abdel Karim, s.a.:6). AAOIFI is based in Bahrain, in the Middle East, with IFSB based in Malaysia, in Asia.

Historically, in 1990 various international Islamic financial institutions signed an agreement to establish a body, which was subsequently registered in 1991 in the form of AAOIFI, with the primary objective of developing and issuing global accounting and auditing standards for the Islamic finance industry (AAOIFI, 2017:22). AAOIFI is a non-profit organisation with its organisational structure comprising of a General Assembly, a Board of Trustees, an Accounting and Auditing Standards Board, an Executive Committee, a Shariah Board and a General Secretariat headed by a Secretary-General. The development of the standards issued by AAOIFI comprise more than ten stages, commencing with the preparation of exposure drafts, public hearings, reviews, input from the various sub-committees and industry role players, and then finally, being approved and issued by the Board (AAOIFI, 2017:8). Thus far, AAOIFI has issued approximately 100 standards, covering a range of Shariah, accounting and auditing governance standards, as well as the issuance of certain guidance relating to ethical issues. These standards are regarded as the most outstanding reference for Shariah within the global Islamic finance industry (AAOIFI, 2017:7). AAOIFI has recently launched a peer reviewed 'Journal of Islamic

Finance Accountancy' as the first of its kind in the field of Islamic finance accountancy (AAOIFI: online). Whilst the AAOIFI standards are not binding on its approximately 200 members, which include, 45 countries, certain central banks and Islamic financial institutions. Many have adopted these AAOIFI standards as mandatory, with others issuing tailored guidelines based on these standards (Thomson Reuters: online).

The Islamic Financial Services Board (IFSB) was founded in 2002 and started operating in 2003, with the primary objective of providing guidance for the effective supervision and regulation of institutions that offer Islamic financial products (Aljudaibi et al., 2017:online). The IFSB complements the work of the Basel committee on Banking Supervision. The IFSB has 178 members comprising primarily of regulatory and supervisory bodies, as well as the respective industry and market players across 57 jurisdictions. The IFSB is essentially an association of central banks and authorities responsible for the regulation and supervision of the Islamic financial services industry.

Whilst there may be an overlap between membership of the two bodies and certain fundamental governance and Shariah concept issues, their operational methodology differs and their focus is on specific areas. AAOIFI focuses on the issuance of standards regarding product offerings by financial institutions, whereas IFSB focuses of the issuance of standards regarding the supervision of these institutions. The issuance of Shariah standards is beyond the scope of the IFSB and is an area that it has chosen not to enter (IFSB, 2016:19). It is thus imperative for institutions, especially conventional financial institutions that have an Islamic finance window whereby they seek to gain access to the Islamic banking consumer market, to comply with AAOIFI standards. Most Muslim countries around the world consider AAOIFI as the most authoritative institution regarding issuance of Islamic banking and finance standards (Taner, 2011:55). South Africa lacks an Islamic finance Shariah standard setting authority, whereas AAOIFI is internationally recognised as pioneer in the field of setting standards for Islamic finance transactions, hence this study applies the guidance as contained within these AAOIFI standards in defining Islamic finance transactions as a basis to conduct a comparative analysis. This approach is followed in Chapter 3 to Chapter 6.

2.7 Approach followed in ensuing Chapters

The basis for comparability of similar transactions should be consistent in their nature and context of application. This study is based on a comparative analysis of Islamic finance transactions. Transactions are often analysed for comparability in transfer pricing determinations for taxation purposes. In this regard, the OECD guidelines describe two key aspects. Firstly, in delineating the transaction that is the subject of the comparability analysis, one has to identify the commercial and financial relationship between the parties and the context within which the conditions and

economically relevant circumstances exist and secondly, comparing the conditions and economically relevant circumstances of relationship between the two transactions in the search for comparables (OECD, 2015). Similarly, in the comparative analysis undertaken in this study, these transactions should be contextualised as being within the broader fundamental principles of Islamic finance transactions and hence subjected to the broader concept of interest free banking, and profit and loss sharing ventures. The approach by the legislature was to provide for provisions in the Income Tax Act, recognising Shariah compliant financing arrangements and provide for certain deeming provisions that apply to such transactions. The ancillary taxation legislation (i.e. VAT, TD and STT) was amended where deemed necessary, in order to accommodate the deeming provisions of the ITA and as such it is important to understand these deeming provisions in order to assess their accommodation in the ancillary legislation.

In evaluating whether taxation legislation sufficiently addresses Islamic finance transactions, the analysis is primarily based on the provisions as contained in the Income Tax Act. The stepwise approach followed in the ensuing chapters entail a comparative analysis of the taxation aspects of Islamic finance transactions and their application within a conventional finance framework, which can be summarised as follows:

1. State the 'Islamic' transaction definition with reference to AAOIFI.
2. Compare this definition to the Act's definition.
3. Critically evaluate whether the provisions of the Act sufficiently address these transactions.
4. Analyse the impact of these provisions on ancillary taxing statutes, namely VAT, STT and TDA.
5. Conclude.

The 'Islamic' transaction definition is stated with the objective of comparability and is thus focused on the salient features that the particular type of transaction should constitute. This is done by providing a brief background of the transaction, whereafter the AAOIFI-defined transaction is discussed, and thus, the 'Islamic' transaction definition to be used for comparison purposes is stated. The approach then followed is to compare the taxation-specific characteristics of the 'Islamic' transaction to the respective similar transaction as defined in the Act. The benchmark for comparison is the 'Islamic' transaction. In the case where the compared transaction (the transaction defined in the Act) differs, it is evaluated with a view to conclude as to whether the respective definitions are consistent with each other. After comparing the definitions of these transactions, the taxation-specific issues relating to such transactions are critically evaluated against the provisions as contained in the legislation in order to determine whether they are sufficiently addressed. The approach followed by legislature was to contain the deeming provisions within the ITA, and flowing from these provisions, the VAT Act, STT Act and TDA were amended to

accommodate such deeming provisions. As such, the impact of the amendments to other legislation follows the analysis of these deeming provisions and finally a conclusion is drawn.

The conditions and economically relevant circumstances of the transactions within their broader context of application in the Islamic finance realm, although mentioned where appropriate, is not taken into account as this is beyond the scope of this study. The definition in the Act of the transactions covered in Chapters 3 to Chapters 5 contains a limitation in that within each of them, one of the parties to the transaction must be a bank and in the case of a *murabaha* (Chapter 5), may also either be a listed company. The limitation in *Sukuk* (Chapter 6) is that the originator has to either be the Government, a state-owned company or a listed company, and thus a bank is not recognised as an originator of a *sukuk* transaction. These limitations are a restriction on the scope of participants and do not have a direct bearing on the characteristics of the respective Islamic finance transactions and their application regarding the taxation provisions of the Act. As to the participants in a Shariah compliant financing arrangement, the Act does not specifically define a 'client', and a state-owned company is referred to as any public entity listed in Schedule 2 of the Public Finance Management Act. Section 24JA(1) does, however, specifically define a 'bank' and a 'listed company' as follows:

“‘bank’ means any –

- (a) bank as defined in section 1 of the Banks Act;
- (b) mutual bank as defined in section 1 of the Mutual Banks Act, 1993 (Act No. 124 of 1993); or
- (c) co-operative bank as defined in section 1 of the Co-operative Banks Act, 2007 (Act No. 40 of 2007);”

“‘listed company’ means a listed company as contemplated in paragraph (a) of the definition of “‘listed company’ in section 1(1)”

The legislature did not encroach on religious issues dealing with the Shariah compliancy of these transactions, leaving such considerations to be dealt with by institutions offering such products, resulting in them assuming any reputational risk that may arise as a result of non-compliance to religious prescripts. As such, the Act defines a sharia arrangement to be as follows:

“sharia arrangement” means an arrangement that is –

- (a) open for participation by members of the general public; and
- (b) presented as compliant with sharia law when the members of the general public are invited to participate therein.”

2.8 Conclusion

The Islamic investor prefers to satisfy his ethical criteria and is not necessarily interested in traditional risk-return trade off (Renneboog et al., 2008:308). Under the broader principles of Islamic finance, each financial transaction must be tied to a tangible identifiable underlying asset, sanctity of contracts, profit and risk sharing, and other Shariah compliant principles (Djebbar, 2011:162-164). The tailoring of conventional financial products to assimilate a Shariah compliant one “entails taking an existing instrument in the conventional system and evaluating each component to find the closest substitute from the basic set of Islamic instruments” (Iqbal, 1999:547).

The debate as to whether a product is Shariah compliant or not will rage on and it is beyond the scope of this paper. The focal point of our analysis being the taxation implications of Islamic financial transactions as defined in the legislation. The substance of a transaction should be consistent with its form, and in cases where these differ, the courts would invariably give preference to the substance of the transaction in the interpretation of its true identity. The uniqueness of an Islamic financial transaction is that, relative to conventional finance, the enquiry into the substance of the transaction is more easily determined as the transaction is based upon principles that are public knowledge. It can invariably be said that the form of an Islamic finance transaction could reflect Islamic financial principles, whilst the substance could possibly be far from it. For example, a contract reflecting an interest return could never be an acceptable Islamic finance contract, as interest in all its forms is specifically prohibited, however, a sugar coating of the contract – substituting the word ‘profit’ for ‘interest’ – may appear to be acceptable. This acceptability is in form only, whereas the underlying substance is still grounded in interest.

The rationale advocated for tax parity between conventional finance and Islamic finance is that whilst the contracts may differ in form, their economic substance is the same and as such, their tax treatment should be the same. Whilst the consistent treatment of similar transactions cannot be disputed, it begs the question as to why the need exists to introduce specific tax legislation, trivialising the form and accommodating the substance of the transaction. Whilst it is principally correct, at least from a taxation perspective, that transactions are taxed according to their

substance, it begs the further question as to why the substance and the form differs in an Islamic finance transaction. Should the untenable assertion that the economic substance of an interest transaction and a profit transaction being equivalent be put forward as the basis for the introduction of specific legislation, this absurdity would then demand a re-write of the entire taxation legislation, unless it is held that the form is of no significance and a sham from a taxation vantage point.

The economic reality of Islamic finance transactions on offer in South Africa is significantly different from its legal form and economically replicate conventional banking transactions (Kholvadia, 2016:8). The *raison d'être* of a person of the Islamic faith that transacts in an Islamic finance transaction is ethically based and hence, if the substance of such a transaction can be held to be contradictory to its form, the entire rationale for entering into the transaction may be compromised. From a tax perspective, in the absence of legislation to the contrary, there would be grounds to assert that the form of the transaction is its substance.

The emphasis in the chapters that follow is an analysis of the Islamic finance transactions, namely (i) Diminishing *Musharaka* (ii) *Mudaraba* (iii) *Murabaha* and (iv) *Sukuk* as they are contained in section 24JA of the Act.

CHAPTER 3 DIMINISHING *MUSHARAKA*

Section 24JA defines four types of Shariah compliant financing arrangements, namely diminishing *musharaka*, *mudaraba*, *murabaha* and *sukuk*. This chapter deals with diminishing *musharaka*, and the following Chapters each deal with *mudaraba*, *murabaha* and *sukuk* individually.

The main aim of this Chapter is to define a diminishing *musharaka*, thereby gaining an understanding of the transaction, and then to analyse whether the deeming provisions of the Act sufficiently address the taxation aspects of such a transaction, and hence where deemed necessary, recommendations are made for consideration by The legislature to refine legislative provisions relating to diminishing *musharaka* transactions.

3.1 Diminishing *Musharaka* as defined

Musharaka is an Arabic word derived from the root verb *Shirka*, and commonly refers to a partnership between two or more persons (Shah, 2009:11). In Islamic jurisprudence, *shirka* means sharing, with *musharaka* being developed in modern terminology to refer to a limited form of *shirka*, which falls within *shirkat-ul-aqd*, which is a partnership in trade (Usmani, 1998:22). A diminishing *musharaka* is thus a derivative of *musharaka*, being a *musharaka mutanaqisa*, which is a short-term partnership in which the share of one partner is diminished gradually (Shah, 2009:18).

The recently developed concept of a diminishing *musharaka* comprises of two independent contracts. Firstly, one wherein a client and a financier initially jointly acquire an asset as partners (referred to as *shirkat-ul-milk* or ownership partnership), and secondly, a contract whereby the client acquires the financiers' partnership share over a period of time resulting in the client eventually becoming the sole owner of the asset (Usmani, 1998:57). It is required that these two contracts be independently entered into and one cannot be dependent on the condition that the other is entered into (Usmani, 1998:60). The gist of a diminishing *musharaka* contract is such that an asset, which is jointly owned, becomes the sole property of one partner by virtue of the other partner agreeing to periodically sell his share to the acquiring partner (Ayub, 2007:337). From a taxation perspective, a diminishing *musharaka* can be compared to a financing arrangement for the purchase of an asset by a client with any excess – over the purchase price that is paid by the client to the bank – being treated as finance charges (van der Zwan, 2017:773).

The AAOIFI definition of a diminishing *musharaka* is considered next, followed by the definition as contained in the Act.

3.1.1 AAOIFI definition of diminishing *musharaka*

AAOIFI Shari'ah Standard 12 titled, *Sharikah* (Musharakah) and Modern Corporations (AAOIFI, 2017:321) deals with *sharikat-al-'aqd* (contractual partnership), of which a branch is *sharikat-al-'Inan*, under which diminishing *musharaka* contracts are classified. These relate to a partnership in which two or more partners enter into a contractual relationship by contributing a specific amount of money in a scheme of profit making. This Shariah standard does not cover the first partnership contract (*sharikat-ul-milk*) mentioned above, but covers the second partnership contract (*sharikat-ul-aqd*) within which a diminishing *musharaka* is classified and hence subjected to the rules of such a contract (AAOIFI, 2017:326-348).

This Shariah standard describes a diminishing *musharakah* as, "Diminishing Musharakah is a form of partnership in which one partner promises to buy the equity share of the other partner gradually until the title to the equity is completely transferred to him. It is necessary that this buying and selling should not be stipulated in the original partnership contract dealing with the joint acquisition of the asset. In other words, the buying partner is allowed to only give a promise to buy. This promise should be independent of the original partnership contract. In addition, the buying and selling partnership agreement must, as such, also be an independent contract to the original partnership contract. It is not permitted that one contract be entered into as a condition for concluding the other" (AAOIFI, 2017:346).

The standard further provides that each partner should contribute his part of the capital, without any partner having the right to withdraw his capital unilaterally, and the apportionment of profit should be clearly stated, which does not necessarily have to be in proportion to their respective capital contributions, however, losses should be allocated in accordance with their respective equity share in the partnership. Each partner should also bear his appropriate share in the maintenance or insurance of the subject matter of the partnership and as such, the contract cannot stipulate that the partner that will eventually become the sole owner bear such costs (AAOIFI, 2017:348).

On the gradual acquisition of the share of one partner (resulting in the diminishing of the share of the selling partner) by the other partner, the price to be paid for acquiring the share or part thereof should be based on the market value of the share at the date of acquisition or the value agreed upon at the time of acquisition, but the contract cannot stipulate that the share be acquired at the original face value (AAOIFI, 2017:348). During the duration of the partnership, one partner may rent the share of the other partner and pay such rental to the other partner (AAOIFI, 2017:348).

It can thus be summarised that an 'Islamic' diminishing *musharaka* transaction can be defined as, "A proportionate equity owning partnership between parties in an asset whereby one partner, in an agreement separate from the original partnership agreement, gradually acquires the shares of the other partner, at the respective market value on acquisition date or by mutual agreement, thereby eventually becoming the sole owner of the property. A partner may rent his share of the asset to the other partner."

Having defined a diminishing *musharaka* as envisaged by AAOIFI, the section 24JA definition is now considered.

3.1.2 Section 24JA definition of diminishing *musharaka*

In order to provide natural persons the access to finance by means of a diminishing *musharaka*, which through a piece-meal acquisition would enable such persons to become the sole owner of an asset, the legislature embarked on specifically defining such a transaction so that this type of a Shariah arrangement can be accommodated (South Africa, 2010:54).

Section 24JA(1) of the Act defines a diminishing *musharaka* transaction as:

"diminishing musharaka" means a sharia arrangement between a bank and a client of that bank whereby –

- (a) (i) the bank and the client jointly acquire an asset from a third party (the seller); or
(ii) the bank acquires an interest in an asset from the client;
- (b) the client will acquire the bank's interest in the asset after the acquisition of the asset by the bank as contemplated in paragraph (a); and
- (c) the amount of consideration payable by the client to the bank for the acquisition of the interest of the bank in the asset will be paid over a period of time as agreed between the client and the bank;"

The definition of an 'Islamic' diminishing *musharaka* is now compared to its section 24JA-defined counterpart.

3.1.3 Comparative analysis of the definition of a diminishing *musharaka*

In this section, the 'Islamic' diminishing *musharaka* is used as a benchmark against which the section 24JA(1)-defined diminishing *musharaka* is compared. The taxation relevant attributes of an 'Islamic' diminishing *musharaka*, as derived from the AAOIFI standards (reference to the respective clause in the AAOIFI standard indicated in parenthesis), can be listed as follows:

1. Equity owning partnership (5/1).
2. Underlying asset (5/2).
3. One partner acquiring the others' share in a separate agreement (5/1).
4. Rental by one partner of the others' share – optional (5/9).
5. Share acquired over time (5/1).
6. Acquisition price market value or mutually agreed (5/7).
7. Asset eventually sole owned by purchaser (5/8).

The provisions in 24JA(1) of the Act, defining a diminishing *musharaka*, are evaluated in order to determine whether the attributes of the 'Islamic' transaction as listed above are sufficiently addressed. Each attribute is evaluated as referenced to its number above and an overall conclusion drawn as to whether the definition in the Act, taken as whole, sufficiently addresses the 'Islamic' diminishing *musharaka*.

1. Equity owning partnership –The bank and the client jointly acquire an asset as stipulated in paragraph (a)(i), thereby satisfying the requirement of an equity owning partnership in the asset.

2. Underlying asset – The subject matter of the transaction is an asset, as paragraph (a)(i) provides that an asset is acquired, hence complying to the requirement that a diminishing *musharaka* transaction should be underpinned by an asset.

3. One partner acquiring the others' share – The requirement that one partner acquires the share of the other in a separate agreement is only reflected in form, whereas in substance it is part of the transaction taken as a whole. The provision in paragraph (b) of the definition of the transaction requires the client to acquire the asset from the bank after the bank has acquired such asset from a third party; as such, there are two contracts in this 'scheme', the one being the contract between the third party and the bank, and the other between the bank and the client, thus this requirement is complied with.

4. Rental by one partner of the others' share – The definition in the Act contains no provision for the rental of the other partners' share. It only deals with the acquisition of the share of the one

partner by the other partner. As it is an optional agreement, which may or may not form part of a diminishing *musharaka* transaction, the Act provides from deeming provisions regarding the ‘share acquisition’ agreement and the rental agreement; it is not specifically covered as to whether it should be part of diminishing *musharaka*. (refer 3.4.3 below)

5. Share acquired over time – Regarding the requirement that the bank’s share be acquired over a period of time, although no specific reference is made to the share actually being acquired over a period of time, the definition in paragraph (c) of the Act provides that the consideration to be paid for the share, be over a period of time. The definition in the Act does not specifically deal with the timing of the acquisition of the share and neither contains anything contrary to the AAOIFI (2017) definition, therefore, by inference it can be deduced to indirectly comply with this requirement and as such, for definition comparative purposes, would satisfy this requirement. (The deeming provisions, as discussed in the next section, specifically provide for the timing of the acquisition of the bank’s share by the client)

6. Acquisition price market value of mutually agreed – The consideration paid by the client, as per paragraph (c), is mutually agreed upon between the bank and the client and as such, this requirement is met.

7. Asset eventually sole owned by purchaser – Paragraph (b) provides for the client acquiring the bank’s interest over a period of time, thereby becoming the sole owner of the asset, hence complying with this requirement.

The table below sets out the comparison between the definition of a diminishing *musharaka* as envisaged by AAOIFI to the definition as stated in section 24JA(1) as discussed above. The first column titled “Characteristic of Islamic Transaction” refers to the ‘benchmark’ diminishing *musharaka* with an indication in parenthesis referring to the specific clause in the AAOIFI standard from which it is derived. The next column headed “s24JA(1) Provision”, refers to the paragraph within the Act, which addresses the AAOIFI characteristic as contained in the first column. The third column labeled “Comment” indicates whether the respective provision in the Act sufficiently addresses that component of the ‘Islamic’ transaction. This structure is followed in the tables contained in the Chapters that follow as well.

Table 3.1 Comparison between an 'Islamic' diminishing *musharaka* and section 24JA(1) defined diminishing *musharaha*

Characteristic of Islamic Transaction (AAOIFI standard clause)	s24JA(1) Provision	Comment
1. Equity owning partnership (5/1)	(a)(i)	Complied
2. Underlying asset (5/2)	(a)(i)	Complied
3. One partner acquiring the others' share in a separate agreement (5/1)	(b)	Complied, form of transaction
4. Rental of partners' share (optional) (5/9)	-	Option not provided for Complied
5. Share acquired over time (5/1)	(c)	Complied, by inference of payment over time
6. Acquisition price market value or mutually agreed. (5/7)	(c)	Complied
7. Asset eventually sole owned by purchaser (5/8)	(b)	Complied

3.1.4 Conclusion:

The definition of the Act does not recognise nor provide for the rental agreement component (which is an optional component), which may form part of diminishing *musharaka* transactions offered by certain South African banks. As such, in instances where a diminishing *musharaka* transaction contains a rental agreement, this rental agreement would not be subjected to any of the deeming provisions that are contained in section 24JA. Only the component of diminishing *musharaka* transactions, dealing with the acquisition of the share of the one partner, would fall within the ambit of section 24JA.

The definition of a diminishing *musharaka* transaction in section 24JA(1) of the act is consistent with the features of the 'Islamic' transaction as measured against the AAOIFI standard. Without qualifying the aforesaid, it should be pointed out that the definition in the Act extends this type of an arrangement to include the bank acquiring an interest in an asset held by the client, which is not recognised by AAOIFI, resulting in such diminishing *musharaka* transactions, although not compliant to the 'Islamic' transaction, nonetheless, being covered by the Act, as the Act specifically provides for such transactions. All diminishing *musharaka* transactions that comply with the definition in terms of the Act would be subjected to the deeming provisions as contained therein.

3.2 Critical analysis of the deeming provisions of the Act

3.2.1 Deeming provisions of the Act

The Act specifically defines a diminishing *musharaka* and as such, the enquiry centers' around this definition and its specified tax treatment. Instances where the tax treatment does not address aspects of the 'Islamic' transaction are highlighted and discussed in the following section. Sections 24JA(5) and 24JA(6) of the Act deal with the tax treatment of a diminishing *musharaka* and state:

“(5) For the purposes of determining the tax on income of the client in respect of a diminishing musharaka –

(a) where the bank and the client jointly acquire an asset, the client is deemed to have acquired the bank's interest in the asset –

(i) for an amount equal to the amount paid by the bank in respect of its interest in the asset; and

(ii) at the time that the seller of the asset was divested of its interest in the asset by virtue of the transaction between the seller and the bank; or

(b) where the bank acquires an interest in an asset from the client, the client is deemed not to have disposed of the interest in the asset or to have acquired that interest from the bank.

(6) (a) For the purposes of subsection (5), where an instalment is paid by the client to the bank, a portion of that instalment, the amount of which must be determined in accordance with paragraph (b), is deemed to be interest as defined in section 24J(1).

(b) The amount contemplated in paragraph (a) must be determined in accordance with the formula –

$$X = A - B$$

in which formula-

- (i) 'X' represents the amount to be determined;
- (ii) 'A' represents the total amount of the instalment payable by the client to the bank;
- (iii) 'B' represents the expenditure incurred by the bank to acquire the portion of the interest in the asset transferred to the client in exchange for the instalment payable by the client to the bank."

Having discussed the provisions contained in the taxation legislation relating to a diminishing *musharaka*, the next section conducts an analysis of these provisions.

3.2.2 Analysis of the deeming provisions

Having omitted direct reference to the timing of the acquisition of the share in the definition of a diminishing *musharaka* and the stipulation within such definition that the consideration to be paid for such share be mutually agreed upon between the bank and the client, the definition as contained in the Act thus brings a diminishing *musharaka*, as defined by the 'Islamic' transaction, into its ambit, whereafter the deeming provisions, as contained in sections 24JA(5) and 24JA(6) would apply. Section 24JA(5) relates to the acquisition of the interest in the asset by the client from the bank, whereas section 24JA(6) deals with deeming a portion of such an acquisition amount to be interest in accordance with a formula. These provisions specifically strip the transaction of its 'Islamic' nature and provide for recognition in alignment with conventional finance. The timing of the acquisition of the bank's share by the client is deemed to be the time that the bank had acquired the said share from the seller. The amount for which the client is deemed to acquire the bank's share, equals the amount the bank had paid for its share from the third party seller. A portion of the installment paid to the bank by the client for the acquisition of such share is deemed to be interest, thereby resulting in the transaction being transformed to resemble a conventional finance transaction. The provisions of the Act in section 24J for dealing with interest would thus be applicable to an amount deemed to be interest and hence dealt with as such.

Where the client pays the bank in installments for the acquisition of the bank's share, the portion of the installment that is deemed to be interest is calculated with reference to the formula provided in section 24JA(6). This approach adopted by the legislature in assimilating a conventional transaction could result in certain unintended consequences for both parties to the transaction, more so, in instances where the transaction does not strictly comply with the definition as contained in the Act or where the Act fails to recognise certain material aspects of the transaction which are expanded on below.

3.2.2.1 Capital nature and allowances

The client is deemed to have acquired the bank's share in the asset at the date the bank acquired such share from the third party seller, therefore, the bank is deemed not to have any share in the underlying asset. This deeming provision has the effect of not recognising the partnership structure, since the asset is regarded as being exclusively acquired by the client of the financial institution, thereby allowing the client to avail itself of the provisions in the Act dealing with a capital asset. Notwithstanding that the partnership and asset-backed structure of a diminishing *musharaka* transaction differs in substance from the perspective of both the parties, the Act deems the client to have exclusively acquired the asset, and as such, the aspects relating to the capital nature of the asset are thus adequately dealt with by these deeming provisions in the Act. This treatment may, however, result in an anomaly in the tax treatment of expenditure incurred by the party deemed not to have acquired the asset, e.g. maintenance and insurance expenditure, which would ordinarily have been a deductible expense under section 11(a) of the Act, being an expenditure incurred in the production of income.

3.2.2.2 Maintenance and insurance (AAOIFI Standard [refer 3.1.1] clause 5/3)

AAOIFI requires that each party bear the maintenance- and insurance-related costs for their own accounts and as such, the Shariah compliant form of the transaction would hence contain a clause to this effect. In a diminishing *musharaka*, the financier is responsible for any major maintenance and repair, and insurance relating to his share of the property (Hameed, 2006:online). From the bank's perspective, such expenditure would be incurred for an asset that is not owned by the bank, but rather deemed to be owned by the client and as such, the bank would not be able to claim this expenditure in the production of its income.

Similarly, should the bank recoup these expenses from the client by virtue of the installments payable by the client to the bank, these would also not be interest as deemed in section 24JA(6) of the Act, as the 'B' in the formula relates to the expenditure incurred by the bank in the acquisition of the interest in the asset and not the periodic maintenance and insurance costs. Should these expenses be recovered from the client, then as per the form of the transaction, the client would not be able to claim these as a deduction, as these expenses relate to the maintenance and insurance obligations of the bank in an asset held by the client. The income of the bank is akin to interest earned on a conventional loan. The deeming provisions should thus be extended to provide for the instance where one party, as part of its obligations, incurs expenditure related to the deemed asset of another party, which is not in the production of its own income. Income of the bank is deemed to be interest.

3.2.2.3 Acquisition of the bank's share by the client (AAOIFI Standard [refer 3.1.1.] clause 5/7 and clause 5/8)

The bank may sell its proportionate interest in the asset to the client on a cost plus mark-up basis and/or rent its proportionate share in the asset to the client, which amount payable by the client would represent a finance charge similar to interest in conventional finance (South Africa, 2010:50). The installment payable by the client may therefore comprise of (a) consideration for a portion of the bank's share in the asset that was deemed to be acquired by the client at the time the seller was divested of its interest in the asset; and/or (b) rental of the bank's equity share in the asset. In the South African context, certain banks use the cost plus markup method in a diminishing *musharaka*, while others sell the bank's share at cost to the client and charge the client a rental for renting the bank's share of the asset (Kholvadia, 2016:48).

In the case of (a) above, the markup on the acquisition of the bank's share will be deemed to be interest as per the formula contained in section 24JA(6). In the latter instance, (b) above, there are actually two Shariah arrangements involved. One being the diminishing *musharaka*, which is transacted at cost and the other a rental or lease agreement (Shariah arrangement equivalent called an *Ijara*). The installment payable by the client has two components, one being a capital portion to acquire the bank's share at cost (diminishing *musharaka*) and the other a rental portion for the use of the asset (*Ijara*) (Kholvadia, 2016:48). As section 24JA(5) deals with the acquisition of the bank's interest by the client, which in this instance would be at cost, the rental payable component of the installment paid by the client to the bank would, therefore, not come within the ambit of section 24JA(5), as this rental is paid for the use of the bank's share of the asset by the client and not for the acquisition of the bank's interest. Hence, the formula as prescribed in section 24JA(6) would not be applicable in determining the interest portion of the installment.

The following question may well be asked, in that as the client is deemed to have acquired the bank's share at the time the seller was divested of its interest, albeit the consideration for this share is paid over a period of time, and since from a tax perspective, the bank is deemed to have no share; what then does the nature of these rental payments reflect? This creates a conundrum in that both from the bank and the client's perspective (and as this is a separate agreement to the diminishing *musharaka* agreement), the substance and the form of this agreement is one of rental. However, the underlying asset to which this rental relates is governed in terms of a diminishing *musharaka* contract, which from a tax perspective, deems the asset to be acquired exclusively of the client since the inception of the agreement. If it is argued that the rental payable is a consideration for the share that remains unpaid, it would not further any cause in deeming such to be interest as it would still reflect a rental payment for the use of an asset and not a payment towards the acquisition of the share *per se*. As these Islamic financial products are relatively new,

South African case law may not be sufficiently developed in order to deduce how such a scenario would be interpreted by the courts. Thus, this rental component may also be subjected to VAT. The legislature should consider introducing provisions relating to the renting of the bank's share by the client.

3.2.2.4 General considerations

Regarding the phrase "amount paid by the bank in respect of its interest in the asset" (section 24JA(5)(a)(i)) and "expenditure incurred by the bank to acquire the portion of the interest in the asset" (section 24JA[6][b][iii]), the former is more specific, relating purely to the acquisition of the interest in the said asset by the bank from the seller, ("by virtue of the transaction between the seller and the bank"). Whilst the latter is more general in that it relates not only to the transaction with the seller to acquire the portion of the said interest, but extends to all expenditure associated to and incurred by the bank in the acquisition of the said interest that is charged to the client by virtue of the installments that are paid by the client to the bank. The effect is that only amounts that are charged by the bank to the client, which exceed the cost of the share acquired by the bank exclusively from the seller, would be deemed to be interest as defined in section 24J(1), with the capital cost of the asset to the client being the amount paid by the bank to the seller (i.e. cost of bank's share from seller).

Diminishing *musharaka* transactions as applied to property finance by banks in South Africa, follow the normal banking process and requirements, e.g. registering of bonds, etc (Kholvadia, 2016:47). Should the bank charge the client by virtue of the installments payable to the bank, any other amounts that are not paid to the seller, but are nonetheless an expenditure incurred to acquire the bank's share, (e.g. bond registrations), would be excluded in the determination of the interest portion of the respective installments, by virtue of them forming part of the 'B' as defined in the formula contained in section 24JA(6)(b)(iii). The treatment of these types of expenditure should be addressed in the legislation.

Notwithstanding that a transaction is a Shariah transaction and is interest free in form, the bank will be entitled to claim *mora* interest should the debtor be in default (Lodhi 5 Properties Investments CC v Firstrand Bank Limited [2015]). In the case of a diminishing *musharaka* transaction, the client is deemed to have acquired the bank's interest in the asset at a value that is equal to the acquisition cost by the bank of its interest. The provisions do not provide for the treatment of any *mora* interest or penalties that may be payable to the bank, and as such, there may be uncertainty as to whether these amounts would be of a revenue or capital nature, as from the client's perspective, the substance and the form of the transaction to which this interest or the penalties relate, is rental and may therefore, be of a revenue nature; whereas it could also be argued that a

portion of these amounts relate to a breach of contract, and depending on the specific circumstances, be regarded as capital in nature. Legislation should therefore provide for clarity regarding *mora* interest and penalties in Islamic finance transactions.

The deeming provisions are enacted in the Income Tax Act and applicable to taxes covered by the aforesaid Act, and as such, these provisions are not specifically provided for in terms of other taxing statutes. This may result in defeating the objective of creating a full spectrum-enabling environment for Islamic finance to thrive, and as such, the legislature has enacted accommodating legislation in other taxing statutes, which are discussed next.

3.3 Amendments to other legislation

The introduction of deeming provisions in section 24JA of the Act leads to certain taxes being imposed on the same transaction twice. In order to provide relief for any double taxing of these transactions, the legislature has amended the respective provisions in the Value Added Tax (VAT) Act no. 89 of 1991, the Securities Transfer Tax (STT) Act no. 25 of 2007 and the Transfer Duty Act (TDA) no. 40 of 1949.

In terms of the VAT act, the purchase and sale of assets constitutes a supply and are subjected to Vat by any party that is a vat vendor. The vendor disposing of the asset will pay an output tax, whilst the acquirer will be entitled to claim an input tax should it be used for the furtherance of the vendor's enterprise. In terms of the Transfer Duty Act, when a fixed property is sold it will attract a transfer tax. The Securities Transfer Tax Act similarly places a tax on the transfer of any securities between parties. The effect of these deeming provisions are such that it places a transaction undertaken in a Shariah arrangement on an equal footing to one undertaken through conventional finance in so far as the VAT, Transfer Duty and Securities Transfer taxes are concerned. The underlying legislation providing for Shariah compliant arrangements is the Income Tax legislation, with VAT, Transfer Duty and Securities Transfer Tax legislation provisions being enacted to cater for the elimination of double taxing of the same transaction. Section 8A(2)(c) of the VAT Act contains a reference to section 24JA(5)(d) of the Income Tax Act, this should be to section 24JA(3)(d), a typo error in the text of the VAT Act.

In a diminishing *musharaka* transaction, the deeming provisions provide for two scenarios, one being the situation where the client and the bank jointly acquire an asset, in which case the client is deemed to have acquired the bank's interest in the asset; and the other in which the bank acquires an interest in the asset of the client, in which case the client is deemed not to have supplied an interest in the asset to the bank and thus deemed not to have acquired an interest in the asset. Section 8A(2)(a) of the VAT act deems the bank not to have supplied or acquired any goods. The

effect of these deeming provisions are such that it puts the bank in a neutral position from a VAT perspective, as the bank is not considered to have supplied or acquired any goods, thereby eliminating any double accountability for vat on these transactions. The client is deemed to have acquired the goods directly from the supplier and thus the VAT is levied only between the third party seller and the client.

Should the asset in question be fixed property, the sale of the fixed property will attract transfer duty. Section 3A(2) of the Transfer Duty Act has the same deeming provisions as discussed above in the VAT act, in that the bank is deemed to be in a neutral position as the bank is deemed not to have acquired any property under a Shariah arrangement, thereby eliminating the double payment of transfer duty upon the same transaction. Transfer duty is thus payable only on the deemed transaction between the seller and the client. There is no transfer of any 'securities' as defined in the STT Act, therefore no amendments in respect thereto are required.

The above-mentioned discussion critically analysed the taxation considerations relating to a diminishing *musharaka* as a Shariah compliant financing arrangement with a summary of the findings and the overall conclusion relating to such a transaction forming part of the next section, which concludes this Chapter.

3.4 Findings relating to a diminishing *musharaka*

3.4.1 Aspects of a diminishing *musharaka* to be considered by the Legislature

- Financial institutions in South Africa offer diminishing *musharaka* at (a) a cost plus mark-up basis or on (b) cost basis with an associated rental or lease agreement. In the instance of (b), there are actually two separate contracts. One being a diminishing *musharaka* contract relating to the acquisition of the asset and the other contract being an *Ijara* (lease or rental), relating to the lease or rental of the bank's share by the client. The provisions in the Act only address the diminishing *musharaka* contract and such only deal with issues relating to the acquisition of the asset and not the *Ijara* (lease or rental) contract. This may result in the *Ijara* (lease or rental) contract being treated as per its form for taxation purposes and as such, may have both Income Tax and VAT implications for both the client and the bank. (refer to 3.2.2.3)
- The asset is deemed to be the property of the client since the inception of the contract, legislation should therefore provide for recognition of expenditure incurred by the bank in a diminishing *musharaka*, relating to an asset deemed to be owned by the other party and which is not used in the production of the bank's income. (refer to 3.2.2.2)

- The client is deemed to have acquired the asset for an amount relating to the transaction between the bank and the seller of the asset and as such, any expenditure incurred by the bank to parties other than the seller, which are reflected in the instalment payable by the client to the bank, would neither be interest nor capital repayments. The tax treatment of such amounts should be clarified. (refer to 3.2.2.4)
- Ancillary matters pertaining to the revenue or capital nature of any penalties or *mora* interest payable by the client should be clarified in the light of a Sharia-compliant diminishing *musharaka* arrangement. (refer to 3.2.2.4)

3.4.2 Conclusion

From the client's perspective, however, the substance of the payment by the client (one partner) to the bank (other partner) remains one of either rental or the acquisition of a share as the case may be, and not interest. From the bank's perspective, the substance of the amounts received over and above the cost price of the asset to the bank is akin to a return on a conventional loan and is thus regarded as interest. These deeming provisions as contained in sections 24JA(5) and 24JA(6) relate only to the diminishing *musharaka* transaction and in that, only seeks to accommodate the substance of such a transaction from the perspective of the bank. The *Ijara* (lease or rental) transaction is addressed neither from the client nor from the bank's perspective and as such, would be dealt with in terms of the normal provisions of the Act.

The process of Shariah arbitrage results in the substance of the 'Islamic analogue', in this case a diminishing *musharaka*, being different to its form, in that the prohibition of one contract being entered into as a condition for concluding the other contract is bypassed, by having two separate contracts entered into in form. This may lend credence to the argument that a diminishing *mushakah* transacted on this basis is itself contradictory to the substance that it ought to be aligned with in terms of the spirit of such a transaction. Nevertheless, this misalignment is not directly relevant from a taxation perspective and is a matter for Islamic scholars, which is beyond the scope of this study.

The legislative provisions as contained in section 24JA, dealing with a diminishing *musharaka*, defines such a transaction in conformance with the 'Islamic' diminishing *musharaka* transaction within the context of AAOIFI standards, thereby bringing within the purview of the Act all such transactions. The provisions then dealing with such a diminishing *musharaka* provide for certain deeming provisions, which strips the transaction of its Islamic identity and assimilates it to a conventional finance transaction. The substance of the transaction, primarily from the bank's

perspective, which equates to a finance transaction, is legislatively imposed upon the client, disregarding in totality the substance of the transaction from the client's perspective. This assimilation results in certain issues being overlooked in a diminishing *musharaka* transaction, particularly the implications of the combination of an *Ijara* (rental or leasing) transaction as offered by certain banks.

Bar the reservation of not providing for the rental component in a diminishing *musharaka*, the objective of the legislature was to provide for tax parity between conventional and Islamic finance, which it attempted to achieve, not by an interrogation of the true substance of a diminishing *musharaka*, but rather by imposing provisions upon a diminishing *musharaka*, which would change its nature and assimilate it to conventional finance. Taken in this context, sections 24JA(5) and 24JA(6) read together with the definitions contained in section 24JA(1), sufficiently address the taxation consideration of a diminishing *musharaka* transaction.

Diminishing *musharaka*, as dealt with in this Chapter, is one of the four Shariah compliant financing arrangements recognised in the Act. The remaining being *mudaraba*, *murabaha* and *sukuk*. The focus of the next Chapter is a *mudaraba* transaction.

CHAPTER 4 MUDARABA

This Chapter reviews a *mudaraba* Islamic finance transaction and conducts an analysis so as to determine whether the deeming provisions of the Act sufficiently address the taxation aspects of such a *mudaraba* transaction. Flowing from this analysis, recommendations are made to be considered by Legislature to refine legislative provisions relating to *mudaraba* transactions.

4.1 *Mudaraba* as defined

The term *mudarabah* is derived from the Arabic phrase '*al-darb al ard*', which literally means "travelling through the land" in the pursuit of seeking bounty, which was prevalent in the times of pre-Arabs, where it was required for the entrepreneur to undertake a journey to run the business with the capital provided by the financier as a sleeping partner (Sapuan, 2016:350). A *mudaraba* is a special kind of partnership in which one partner (*Rabb-ul-mal*) provides the capital to another (*Mudarib*), who provides management and services by investing the capital in a commercial enterprise (Usmani, 1998:31). The *Rabb-ul-mal* can be regarded as the financier, with the *Mudarib* being the entrepreneur. The financier does not actively participate in the management of the partnership but has access to the information and records of the partnership (Aljifri & Khandelwal, 2013:82). Cementing this view, Dewar and Hussain (2017:vii) state that a *mudarabah* is akin to an investment fund arrangement, where one party provides capital to a second party who contributes labour. The risk to the partners is such that, excluding an event of negligence by the entrepreneur (*Mudarib*), the financier (*Rabb-ul-mal*) bears all the risk of the loss of capital, whereas the entrepreneur loses time and effort (Mia *et al.*, 2016:67). Hence, there is no loss sharing in a *mudaraba* partnership with profits being shared as per a pre-agreed (*ex-ante*) ratio (Ramli & Ramli, 2014:3).

A *mudaraba* contract is usually for a fixed duration, and its application in modern banking can be found where the investor as financier deposits funds with the bank that would be the entrepreneur, and by having expertise in financial markets would thus invest these funds in profitable projects on the investor's behalf (Iqbal & Mirakhor, 2011:90). In conventional parlance, a *mudaraba* is used to access retail investors in the form of a partnership investment or transactional account, with the return being compared to interest (van der Zwan, 2017:771). However, the *mudaraba* contract cannot be regarded in totality as a general loan in conventional finance parlance, as the financier bears the risk of loss in the venture (Morapi, 2014:6).

The AAOIFI-defined definition is considered next, whereafter the similar transaction definition as contained within section 24JA(1) of the Act is stated and a comparative analysis of these definitions undertaken, resulting in a conclusion being drawn thereby concluding the first section of

this chapter. The deeming provisions in the Act relating to such a transaction are dealt with in the remainder of the chapter, thereby concluding the chapter.

4.1.1 AAOIFI definition of *mudarabah*

AAOIFI Shari'ah Standard 13, titled Mudarabah (AAOIFI, 2017:370), covers *mudarabah* contracts entered into between financial institutions and individuals or other entities. The standard acknowledges that a *mudarabah* contract may be concluded by means of a memorandum of understanding or a general framework agreement between the parties. A *mudarabah* contract may be a fixed term contract, in which case it will remain in force for the duration of the agreement although the general rule is that any of the parties may unilaterally terminate it as long as it is before the entrepreneur has commenced trading. As it is a trust-based contract, the entrepreneur would not be liable for any losses incurred provided there is no negligence. The standard recognises two types of *mudarabah* contracts, the one being a restricted *mudarabah* and the other an unrestricted *mudarabah*. In a restricted *mudarabah* the financier restricts the entrepreneur as to the particular type of investment but may not encroach on the manner in which the entrepreneur conducts such operations, whereas in an unrestricted *mudarabah* the entrepreneur administers the funds as his absolute discretion using his expertise (AAOIFI, 2017).

Ideally, the capital in a *mudarabah* should be provided in cash or alternatively in tangible assets. The profit sharing ratio should be based on the actual profit earned and not on the amount of capital employed. In a *mudarabah* contract, a party may not earn a fee in addition to a profit share, however, there is no restriction on the same parties entering a separate independent agreement, providing for a fee unrelated to the *mudarabah* contract and for service not in the ordinary course of business of the specific *mudarabah* contract. Unless the capital is maintained, no profit would be recognisable and in the instance where losses are incurred, these may be carried forward to subsequent periods for set-off against future profits, and in the event there be no profit to set-off against these losses upon the termination of the agreement, these losses would be only for the account of the financier. This standard thus defines a *mudarabah* as follows, "Mudarabah is a partnership in profit whereby one party provides capital (*Rab al-Mal*) and the other party provides labour (*Mudarib*)" (AAOIFI, 2017).

It can thus be summarised that an 'Islamic' *mudarabah* transaction can be defined as: 'A limited partnership contract between two parties, where the one provides the capital and the other provides a service to work the said capital, entitling them to an agreed upon percentage of the profits of the venture so undertaken. The party providing the work is not liable for any losses incurred in good faith and is entitled to his stipulated profit share should the profit materialise.'

Having defined a *mudaraba* as envisaged by AAOIFI, the section 24JA definition is now considered.

4.1.2 Section 24JA definition of a *mudaraba*

A *mudaraba* is mainly used as an investment or a transactional account by financial institutions. To accommodate such an account from an Islamic finance perspective, the legislature set out to define a *mudaraba* so as to reflect an investment of transactional account.

Section 24JA(1) of the Act defines a *mudaraba* transaction as:

“**mudaraba**’ means a Sharia arrangement between a bank and a client of that bank whereby –

- (a) funds are deposited with the bank by the client;
- (b) the anticipated return in respect of the Sharia arrangement is dependent on the amount deposited by the client in combination with the duration of the period for which the funds are deposited;
- (c) the bank invests the funds deposited by the client in other Sharia arrangements;
- (d) the client bears the risk of the loss in respect of the Sharia arrangements contemplated in paragraph (c); and
- (e) the return in respect of the Sharia arrangements contemplated in paragraph (c) is divided between the client and the bank as agreed at the time that the client deposits the funds with the bank.”

The definition of an ‘Islamic’ *mudaraba* is now compared to its section 24JA-defined counterpart.

4.1.3 Comparative analysis of the definition of a *mudaraba*

In this section, the ‘Islamic’ *mudaraba* is used as a benchmark against which the section 24JA(1)-defined *mudaraba* is compared. The taxation relevant attributes of an ‘Islamic’ *mudaraba* as derived from the AAOIFI standards (reference to the respective clause in the AAOIFI standard indicated in parenthesis) can be listed as follows :

1. Limited partnership (2)
2. One party provides the capital (2)
3. Other party provides labour/service (2)
4. Agreement as to profit share based on actual profit earned (8/1)
5. Capital provider bears the risk of loss (4/4)

The provisions in section 24JA(1) of the Act defining a *mudaraba* are evaluated in order to determine whether the attributes of the 'Islamic' transaction as listed above are sufficiently addressed. Each attribute is evaluated as referenced to its number above and an overall conclusion drawn as to whether the definition in the Act, taken as whole, sufficiently addresses the 'Islamic' *mudaraba*.

1. Limited partnership – Although the definition in the Act does not specifically provide for a partnership agreement, it can be inferred that by the client depositing the money with the bank there is a meeting of the minds as to the purpose and expectations of such a deposit, and hence, there is an understanding between the client and bank similar to the existence of an agreement. Whether this agreement is indeed a partnership agreement is not altogether clear from the definition as it stands.

2. One party provides the capital – Paragraph (a) provides for the client to deposit funds with the bank, therefore, the capital is provided by the client and as such the requirement that one party contribute the capital is complied with.

3. Other party provides labour/service – The bank's role is to invest the funds in other sharia arrangements and as such the bank provides a service similar to an investment fund manager thereby complying with the requirement that the one party provides a service.

4. Agreement as to profit share based on actual profit earned – As per AAOIFI, the returns to the party providing the capital should be based on the actual profit earned and more so, it specifically prohibits that the return be based on a percentage of the capital (AAOIFI, 2017:373), whereas the Act bases these returns on the amount of capital deposited and a function of time. The non-compliance of the definition in the Act to the AAOIFI definition is material in that it directly relates to the amount that the deeming provisions seek to reclassify.

5. Capital provider bears the risk of loss – The risk of loss of capital as being that of the client is specifically provided for in paragraph (d) in that the client, being the provider of the capital bears all the risk of loss, thereby complying with this requirement.

The table below sets out the summary of the comparison between the definitions of a *mudaraba*.

Table 4.1 Comparison between ‘Islamic’ *mudaraba* and section 24JA(1) defined *mudaraba*

Characteristic of Islamic Transaction (AAOIFI standard clause)	s24JA(1) provision	Comment
1. Limited partnership (2)	-	Partially complied, agreement type not defined but by inference
2. One party provides capital (2)	(a)	Complied
3. Other party provides labour/service (2)	(c)	Complied
4. Agreement as to profit share based on actual profit earned (8/1)	-	Not Complied, clause (b)
5. Capital provider bears the risk of loss (4/4)	(d)	Complied

4.1.4 Conclusion

The definition of a *murabaha* in the Act bases the return earned on the quantum of funds invested as a factor of time instead of the actual profit earned from an economic activity. The return is more aligned to actually being a return on money (akin to *riba*), which is strictly prohibited in Islam, hence resulting in non-compliance with the ‘Islamic’ transaction requirement.

The definition of a *mudaraba* transaction in section 24JA(1) of the act is not consistent with the features of the ‘Islamic’ transaction as measured against the AAOIFI standard. Without qualifying the aforesaid, it should be pointed out that unless the process of Shariah arbitrage creates an ‘Islamic’ analog wherein the return based on the amount of capital is deemed to be a return on profit, a *mudaraba*, based purely on AAOIFI principles, would not conform to the definition in the Act, and hence not be subjected to the deeming provisions. In the instances where a *mudaraba* complies with the definition in the Act, even though not compliant to the AAOIFI definition, certain deeming provisions would apply for taxation purposes, which are discussed next.

4.2 Critical analysis of the deeming provisions of the Act

4.2.1 Deeming provisions of the Act

The Act specifically defines a *mudaraba* and as such, the enquiry centers around this definition and its specified tax treatment. Instances where the tax treatment does not address aspects of the

'Islamic' transaction would be highlighted. Section 24JA(2), in dealing with the tax treatment of a *mudaraba*, states:

"Any amount received by or accrued to a client in terms of a *mudaraba* is deemed to be interest as contemplated in paragraph (a) of the definition of 'interest' in section 24J(1)."

The effect of this provision, and as intended by the legislature, is to strip any amount received by or accrued to a client in a *mudaraba* transaction of its nature, whatever that may be, and to deem the nature of that amount as interest, as defined in section 24J(1). The deeming provision in a *mudaraba* transaction therefore does not address any of the issues related to the structure of the transaction and adopts a blanket approach by deeming any amounts received by the client under such an arrangement to be interest. This approach may raise certain taxation specific considerations, which are discussed next.

4.2.2 Analysis of the deeming provisions

The more salient specific issues, amongst others, that arise from a tax perspective, which would need to be addressed in tax legislation are the following:

4.2.2.1 The form of the transaction (AAOIFI standard clause 2)

From a legal point of view, a *mudaraba* is a partnership (Brincker, 2011:B18-2). The definition of a *mudaraba* in the Act does not sufficiently address the issues relating to the form, nor the substance of the profit and loss agreement structured into a *mudaraba* transaction, and in so doing, does not bring a *mudaraba* transaction, as envisaged by the substance of the 'Islamic' transaction, within the ambit of a *mudaraba* as defined in the Act. Therefore, such a *mudaraba* would be dealt with within the broader provisions of the Act.

However, a Shariah transaction termed and marketed as *mudaraba*, which complies with the said definition in the Act, will avail itself of being dealt with as per the provisions as contained in the Act. Where a *mudaraba* transaction falls within the scope of the Act, the deeming provisions would apply. These deeming provisions, however, only deal with transforming the nature of the amount received by the partner (client) into interest, and since the form suggests this arrangement could be in the scheme of profit making there are no deeming provisions providing otherwise. In contrast to the treatment of a diminishing *musharaka*, wherein deeming provisions were introduced in dealing with the underlying contract relating to the acquisition of the asset, there are no such deeming provisions provided for in a *mudaraba*, relating to the profit and loss agreement between the parties.

4.2.2.2 The risk of loss (AAOIFI Standard clause 4)

Losses in a murabaha are born by the client as financier (Cerovic *et al.*, 2017:246). A mudaraba as defined in the Act, recognises that the client bears the risk of loss in this arrangement but falls short by not providing for any deeming provisions relating to this loss. In the absence of a deeming provision relating to this loss, coupled with the form of the transaction not being deemed to be anything else, there may be grounds for a client that has suffered such a loss to aver that the loss was on revenue account as it was in the scheme of profit making.

4.2.2.3 General considerations

Banks in South Africa accept mudaraba funds as deposits, upon which pre-agreed returns are paid to clients (the depositors) (Kholvadia, 2016:32). Mudaraba funds received by the bank are invested in Islamic financing activities with the yield assimilating conventional returns (Brincker, 2011:B18-3). The risk of assimilating a conventional transaction in a blanket approach without addressing specific issues of the transaction may also result in certain unintended consequences. Paragraph (c) of the definition of *mudaraba* places a restriction as to the avenues into which the bank may invest funds that are deposited by the clients, in that these funds may only be invested in other Shariah arrangements. A Shariah arrangement is defined in the Act as,

“an arrangement that is –

- (a) open for participation by members of the general public; and
- (b) presented as compliant with sharia law when the members of the general public are invited to participate therein.”

A Shariah arrangement is, therefore, one which is presented as compliant with Shariah law when the public are invited to participate therein and is open for participation by members of the general public. The important distinction being that *mudaraba* funds received by the bank may not be invested by the bank in just any Islamic financing activity, but are restricted to those that are Shariah-compliant in financing arrangements as specifically defined in the Act. In most instances, the deposits received from *mudaraba* clients by banks exceed money loaned to borrowers, and as such, the excess is invested by the bank in short-term investments, equity or commodities (Kholvadia, 2016:35). As an example, Albaraka bank, an Islamic bank operating in South Africa,

invests murabaha funds in the bank's financing activities and investment in equity deals. (AlBaraka: online). By investing in equity deals, these *mudaraba* transactions run the risk of not being *mudaraba* as defined in the Act and hence not availing of the deeming provisions.

The contracts entered into between the parties (the bank/financier and the client) are enforceable by law. These contracts in form are based on Shariah principles, which are materially different to the principles of conventional finance transactions. The legal risks of these contracts are different. In a *mudaraba* transaction, the client bears the risk of loss in respect of the funds deposited with the bank, whereas in a conventional savings account no such risk arises, yet the returns are subjected to tax on the same basis by virtue of deeming the *mudaraba* return as interest. There is no specific provision as to deeming the nature of any such loss in a *mudaraba* transaction.

These deeming provisions may result in double taxes being imposed by other taxing statutes, which provide no such deeming provisions, and as such the legislature, in order to avoid any such taxes to be imposed, extended such relief by corresponding amendments within such statutes. These are discussed next.

4.3 Amendments to other legislation

There is no underlying asset in a *mudaraba* transaction and no transfer of any 'securities' as defined and as such, there would be no impact on Transfer Duty or Securities Transfer Tax hence no deeming provisions are required. The returns in a *mudaraba* may only be derived from investing in other Shariah compliant financing arrangements as defined in the act, and which returns the Act deems to be interest, which is an exempt supply for VAT purposes; there is no double layer of taxation imposed and as such no specific deeming provisions are needed to provide for any Vat relief. In the absence of deeming provisions addressing the form of a *mudaraba* transaction, specifically the profit and loss partnership agreement, more specifically in the event that a loss is distributed to the client, the nature of this loss and its treatment by other taxing statutes may need to be provided for.

The above discussion critically analysed the taxation considerations relating to a *mudaraba* as a Shariah compliant financing arrangement, with a summary of the findings and the conclusion dealt with in the next section.

4.4 Findings relating to a *mudaraba*

4.4.1 Aspects of a *mudaraba* to be considered by the Legislature

- The deeming provisions do not address the form of the transaction specifically relating to its legal nature being a scheme of profit making and as such (used primarily in the form of savings accounts), may result in certain unintended consequences for both parties. It is recommended that the legislature provide for such form and substance matters in a *mudaraba*. (refer to 4.2.2.1)
- A *mudaraba* in Islamic finance can be related to a savings account in conventional finance, with the added risk that should the avenue within which such funds return a loss, the loss would be for the client's account. No provisions are provided to deal with the capital or revenue nature relating to such a loss. (refer 4.2.2.2)
- The avenues within which to invest *mudaraba* capital are restricted to only the Shariahcompliant financing arrangements as contained within section 24JA of the Act. In the event that any such *mudaraba* funds are invested in other Shariah approved avenues by the bank, if those avenue are not Shariah compliant financing arrangements as described in section 24JA, such *mudaraba* transactions will not be treated in terms of the deeming provisions of section 24JA(2), and as such would be subjected to the normal provisions contained in the Act relating to such a transaction. The legislature should revisit this restriction as it may not be applied as such in practice, which may result in unintended consequence should such transaction not qualify as *mudaraba*. (refer 4.2.2.3)

4.4.2 Conclusion

The definition of a *mudaraba* in the Act is not consistent with the definition as per the 'Islamic' transaction, as the return is not based on profit and loss but rather the quantum of the capital invested as a factor of time, therefore, section 24JA(2) read together with section 24JA(1) does not sufficiently address the taxation implications of a *mudaraba* transaction as defined in an 'Islamic' transaction. Despite this, a *mudaraba* transaction which, due to the process of Shariah arbitrage, results in a profit or loss being aligned with a return based on a time factor, would bring such a *mudaraba* transaction to be covered by the Act and the deeming provisions will hence apply to such an 'Islamic' analog *mudaraba*. The provisions do not contain any deeming provisions as to the form of the transaction, therefore, a *mudaraba* may, despite the return being treated as interest, be treated to be in the scheme of profit making.

Having discussed a diminishing *musharaka* in the previous Chapter and a *mudaraba* in this Chapter, the remaining two Shariah compliant financing arrangements as recognised by the Act are a *murabaha* and *sukuk*. Chapter 5, which is the next Chapter deals with a *murabaha*.

CHAPTER 5 MURABAHA

This Chapter reviews a *murabaha* transaction by firstly discussing such a transaction so as to gain an understanding of such a transaction. The approach followed thereafter is to conduct a comparative analysis of a *murabaha* transaction as defined in the Act to one as defined with reference to AAOIFI standards, in order to determine whether the provisions of the Act sufficiently address the taxation considerations of such a *murabaha*. Recommendations, where necessary, are made for consideration by The legislature thereby concluding this chapter.

5.1 *Murabaha* as defined

Murabaha is derived from the Arabic root word ‘*r-b-h*’, which means to profit, gain or an addition (Waheed, 2008:131). Murabaha, in its original application, stems from an Islamic jurisprudence term referring to a type of a sale transaction and has absolutely no connotation with reference to financing (Usmani, 1998:65). A *murabaha* is a transaction in which, at the request of a particular party, an asset is purchased by the counterparty from a third party who then resells the asset to the particular party (Dewar & Hussain, 2017:vii). In the same vein, a *murabaha* is in essence a ‘cost-plus sale’, wherein the cost price is known and the parties negotiate on the margin of the profit (Ayub, 2007:213). The main feature of a *murabaha* is that cost price is known to both parties with the mark-up agreed upon, and the settlement of the purchase price can either be immediate or subsequent to the transaction (credit sale) as agreed by the parties (Usmani: 1998:65). In the banking environment, this type of an arrangement can be found where a financier acts as an agent between the buyer and the seller from whom the property is acquired with a profit being paid to the financier by the buyer, which in essence is interest (van der Zwan, 2017:772). Many criticisms have been leveled against a *murabaha* as practiced today, primarily because of the similarity between the profit charged and an interest rate as applied to conventional loans, with many scholars questioning the legitimacy of such *murabaha* contracts (Shinsuke, 2007:74).

The AAOIFI-defined definition is considered next, whereafter the similar transaction definition as contained within section 24JA(1) of the Act is stated and a comparative analysis of these definitions undertaken.

5.1.1 AAOIFI definition of *murabaha*

AAOIFI Shari’ah Standard 8, titled *Murabahah* (AAOIFI, 2017:221), deals with *murabaha* transactions between a financial institution and its client. A client may seek an item that he wishes to acquire by getting quotations for the article and requesting an institution to purchase the item from the seller for onward sale to the client, however, the client may not accept an offer directly

from the seller as it should be the institution that is required to purchase the item from the seller, which should be an independent third party. A *murabaha* contract cannot be concluded on the same subject matter that is the subject of a *murabaha* arrangement, as this would be tantamount to refinancing and is prohibited. The client may not be charged a commitment or credit facility fee, however, a documentation fee may be agreed upon between the parties which fee should reflect a fair charge for the amount of work done as regards the preparation of the documentation and not as a cover to facilitate a commitment or credit facility fee being imposed upon the client. The risks associated with the shipment or storage of the article cannot be diverted to the client and the institution as purchaser would bear all such risks. The institution should acquire constructive possession of the item before it can onward sell such item to the client and as such, cannot enter into an agreement to sell the asset to the client before it has received possession of the item for its own risk and account (AAOIFI, 2017).

The institution may appoint an agent to act on its behalf in a *murabaha* transaction, provided the capacity in which the agent acts is clearly defined. The customer as purchase orderer, may not be forced to conclude the transaction with the institution even though the institution has concluded the transaction with the supplier, however, the institution is entitled to claim compensation for any actual loss suffered by the institution as a result of the client not going ahead with the purchase from the institution. It is obligatory to disclose to the client any other expenses that are included in the purchase price, however, customary expenses ancillary to the nature of the item need not be specifically disclosed; examples of these being storage, transportation, insurance and the like. It is an explicit requirement that both the price of the item and the institution's profit be fixed and known, and any commissions or kick-backs earned by the institution should be applied in reducing the selling price to the client (AAOIFI, 2017).

It is strictly prohibited that the profit be linked to any variable, for example, an inter-bank rate or the like, as the profit should be fixed and not based upon a time factor. In a *murabaha*, it is not acceptable that the ownership of the asset only passes to client upon full payment of the purchase price, however, the institution may receive an authority from the client to repossess and sell the asset in the event of a default by the client, and in such an instance, be entitled to only recoup the actual loss that the institution has suffered thereby refunding any excess from such a default sale to the client. The client may give an undertaking to pay an amount by way of a donation in the event that it defaults on the agreed repayment plan, which amount when received by the institution should be donated to a charitable cause. In the event of an early settlement, the institution may grant, at its discretion, a discount on the original price to the client.

This standard defines a *murabahah* as, "It is the sale of a commodity by an institution to its customer (the purchase orderer) as per the purchasing price/cost with a defined and agreed profit

mark-up (as set out in the promise/*Wa'd*), in which case it is called a banking *Murabahah*. The banking *Murabahah* involves deferred payment terms, but such deferred payment is not one of the essential conditions of such transaction, as there is also a *Murabahah* arranged with no deferral of payment. In this case, the seller only receives a mark-up that only includes the profit for a spot sale and not the extra charge it would, otherwise, receive for deferral of payment.”

It can thus be summarised that an ‘Islamic’ *murabaha* transaction, which is to be used in this analysis for comparative purposes can be stated as, ‘An asset purchase and sale transaction in which one party acquires an asset upon request from a prospective purchaser, from a third party, and then sells this asset at a disclosed cost-plus basis to the prospective purchaser.’

Having defined a *murabaha* as envisaged by AAOIFI, the section 24JA definition is now considered.

5.1.2 Section 24JA definition of a *murabaha*

The purchase of an asset by a client, who does not have sufficient capital to acquire such asset at the spot price, may be accommodated by means of a *murabaha* transaction, whereby the bank acquires the asset from a third party for onward sale at a markup and on credit terms to a client. To accommodate such a transaction, the Act defined a *murabaha* so that it could place such a transaction on same footing, from a tax perspective, to that of a conventional loan.

Section 24JA(1) of the Act defines a *murabaha* transaction as:

“‘murabaha’ means a Sharia arrangement between a financier and a client of that financier, one of which is a bank or a listed company, whereby-

(a) the financier will acquire an asset from a third party (the seller) for the benefit of the client on such terms and conditions as are agreed upon between the client and the seller;

(b) the client-

(i) will acquire the asset from the financier within 180 days after the acquisition of the asset by the financier contemplated in paragraph (a); and

(ii) agrees to pay to the financier a total amount that-

(aa) exceeds the amount payable by the financier to the seller as consideration to acquire the asset;

(bb) is calculated with reference to the consideration payable by the financier to the seller in combination with the duration of the Sharia arrangement; and

(cc) may not exceed the amount agreed upon between the financier and the client when the Sharia arrangement is entered into; and

(c) no amount is received by or accrued to the financier in respect of that asset other than an amount contemplated in paragraph (b)(ii);”

The definition of a section 24JA-defined *murabaha* is now compared to its ‘Islamic’ counterpart.

5.1.3 Comparative analysis of the respective definitions of a *murabaha*

In this section the ‘Islamic’ *murabaha* is used as a benchmark against which the section 24JA(1)-defined *murabaha* is compared. The taxation relevant attributes of an ‘Islamic’ *murabaha* as derived from the AAOIFI standards (reference to the respective clause in the AAOIFI standard indicated in parenthesis) can be listed as follows :

1. Order is placed to purchase an asset (2/1/3)
2. Asset is purchased by the financier (2/2/3)
3. Asset is sold to orderer (3/2/2)
4. Selling price based on a cost plus basis (4/7)
5. Profit is disclosed (4/6)

The provisions in section 24JA(1) of the Act defining a *murabaha* are evaluated in order to determine whether the attributes of the ‘Islamic’ transaction as listed above are sufficiently addressed. Each attribute is evaluated as referenced to its number above and an overall conclusion drawn as to whether the definition in the Act, taken as whole, sufficiently addresses the ‘Islamic’ *murabaha*.

1. Order is place to purchase an asset – The client and supplier agree on the terms and conditions of the asset that the client wishes to acquire. The financier acquires such an asset from the seller for onward supply to the client, hence the requirement that an order be placed to acquire the asset is complied with.

2. Asset is purchased by the financier – As the financier acquires the asset from the third party, the requirement that the asset be purchased by the financier is also complied with.

3. Asset is sold to orderer – The client acquires the asset from the financier within a period of 180 days and as such, the requirement that the asset be sold to the orderer is also met.

4. Selling price based on a cost plus basis – As the selling price exceeds the cost as provided in subparagraph (b)(ii)(aa), this increase should be based on the agreed mark-up, however, subparagraph (b)(ii)(bb) references this increase to a function of time and as such, although compliant to the definition *per se*, in that it is an increase above the cost price, it may not be in the spirit of the AAOIFI guidelines regarding a *murabaha*. The concluding factor would be dependent on the analysis of the extent to which the 'Islamic' analogue reconciles the duration and the mark-up so as to be regarded in substance to be the same. For the purposes of our analysis, this requirement, being greater than the cost price, would be considered as complied with.

5. Profit is disclosed – Paragraph (a) of the definition in the Act refers to the terms and conditions between the client and the seller, and as such, it can be concluded that the client is aware of the cost price and hence the profit. This requirement is also thus complied with.

The table below summarises the comparison between the definitions of a *murabaha*.

Table 5.1 Comparison between the definition of an 'Islamic' *murabaha* and the section 24JA(1) defined *murabaha*

Characteristic of Islamic Transaction (AAOIFI Standard clause)	s24JA(1) provision	Comment
1. Order is placed to purchase asset (2/1/3)	(a)	Complied
2. Asset purchased by financier (2/2/3)	(a)	Complied
3. Asset sold to orderer (3/2/2)	(b)(i)	Complied
4. Selling price exceeds cost and based on a cost plus basis (4/7)	(b)(ii)(aa)	Complied, referenced also to the duration of the contract
5. Profit disclosed (4/6)	(a)	Complied, by inference as client and seller agree on terms.

5.1.4 Conclusion

The definition of a *murabaha* transaction in section 24JA(1) of the act is consistent with the features of the 'Islamic' transaction based on the AAOIFI standard. Without qualifying the previously mentioned, it should be pointed out that the definition in the Act links the repayment by the client to a function of the amount paid by the financier to the seller, and the duration of the agreement. In contrast to a *mudaraba*, in which there is no underlying asset against which the repayments are referenced, (referenced purely to an amount of money deposited), in a *murabaha* there is an underlying asset which is not money.

Paragraph (c) of the definition is of significance, in that should any amount be received by or accrued to the financier other than as described in paragraph b(ii) of the said definition, the transaction would not constitute a *murabaha* as defined.

Having discussed the provisions contained in taxation legislation defining a *murabaha*, the next section conducts an analysis of these provisions with reference to the terms of the Act relating to such a defined *murabaha*.

5.2 Critical analysis of the deeming provisions of the Act

5.2.1 Deeming provisions of the Act

The Act specifically defines a *murabaha* and as such the enquiry will centre around this definition and its specified tax treatment. Section 24JA(3), in dealing with the treatment of a *murabaha*, states:

"Where any *murabaha* is entered into between a financier and a client of that financier as contemplated in paragraph (a) of the definition of 'murabaha'-

- (a) the financier is deemed not to have acquired or disposed of the asset under the Sharia arrangement;
- (b) the client is deemed to have acquired the asset from the seller-
 - (i) for consideration equal to the amount paid by the financier to the seller; and

- (ii) at such time as the financier acquired the asset from the seller by virtue of the transaction between the seller and the financier;
- (c) the murabaha is deemed to be an instrument for the purposes of section 24J;
- (d) the difference between the amount of consideration paid for the asset by the financier to the seller and the consideration payable to the financier by the client to acquire the asset as contemplated in paragraph (b)(ii) of the definition of “murabaha” is deemed to be a premium payable or receivable, contemplated in paragraph (a) of the definition of ‘interest’ in section 24J(1); and
- (e) the amount of consideration paid by the financier to acquire the asset as contemplated in paragraph (a) of the definition of ‘murabaha’, is deemed to be an issue price for the purposes of section 24J.”

The deeming provisions provide for the asset to be acquired by the client from the seller and at the time the seller was divested of its interest in the asset, whereas the bank is deemed to not have acquired nor disposed of the asset. The *murabaha* is deemed to be an ‘instrument’ for the purposes of section 24J. The ‘issue’ price being the consideration that the bank paid to the seller, while the ‘premium’ being the mark-up that the bank charges the client.

The effect of this provision, and as intended by the legislature, is to strip the *murabaha* of its component parts, whatever that may be, and to deem it to be treated as an interest instrument. Whereas in *mudaraba* and diminishing *musharaka* contracts, one of the parties has to be a bank, in a *murabaha* transaction the scope of the qualifying participants has been extended to include one party being either a bank or a listed company.

In dealing with a *murabaha*, the legislature has taken into consideration the substance of the transaction only from the perspective of the bank and has not dealt with issue of substance as reflected in the form of the transaction from the client’s perspective, and in so doing, imposed upon the client the substance of the transaction from the bank’s perspective, in the determination of the transaction’s treatment for tax purposes.

This approach adopted by the legislature in assimilating a conventional transaction could result in certain unintended consequences from a taxation perspective for both parties to the transaction, more so in instances where the transaction does not strictly comply with the definition as contained in the Act or where the Act fails to recognise certain material aspects of the transaction which are expanded on below.

5.2.2 Analysis of the deeming provisions

The more salient specific issues, amongst others, that arise from a tax perspective, which would need to be addressed in tax legislation are highlighted below.

5.2.2.1 Holding costs(AAOIFI standard clause 3/2)

A requirement of a *murabaha* is that the financier solely bears the risk and commercial hazards for the period between the asset purchase from the seller and the sale to the client by the financier (Kurniawan & Shomad, 2016:9). Subparagraph (b)(ii)(bb) of the definition of *murabaha* provides that the total amount that the client agrees to pay the financier is calculated with reference to the consideration payable by the financier to the seller. As subparagraph (b)(i) provides for a 'holding period' of up to 180 days between the acquisition of the asset by the financier and the subsequent disposal to the client, holding costs may arise. Where these holding costs are paid to persons other than the seller from which the asset is acquired, they may not form part of the amount payable by the client to the financier in respect of the asset financed, failing which, the transaction would not be recognised as a *murabaha*.

5.2.2.2 Default penalties and donations (AAOIFI standard clause 5/6)

In a *murabaha* transaction, the total amount that the client agrees to pay the financier may not exceed the amount that was agreed upon between the financier and the client at the inception of the contract and that in the event any other amount is received by or accrued to the financier, in respect of that asset, the transaction would not qualify as a *murabaha* arrangement. It is debatable that in the event that *mora* interest or a penalty is received by the bank, this would fall foul of paragraph (c) of the definition of a *murabaha*. It is common practice in Islamic finance globally that in the event of a client defaulting on an agreed repayment, a penalty is payable by the client in the form of a donation, which is paid to the bank to be channeled for charitable purposes (Hatta & Samah, 2015:8). The financier may also maintain a charity fund to which such default payments are credited and used for advancing interest-free loans to needy persons (Usmani, 2003:9).

The provisions in the Act do not deal with the case of a default penalty paid by the client as a donation to a charity via the bank or financier. Should a client be required to pay a penalty to the bank and where such amount is donated to a charity, clarity should be given as to the accrual of such amount in the hands of the bank and the treatment of this amount as interest by the client. The party that would be deemed to have made this donation should also be clarified.

5.2.2.3 Amounts other than in cash

Banks in South Africa offer motor vehicle and trade financing in the form of *murabaha* and *Ijara* (leasing or rental) contracts (Kholvadia, 2016:32). In a *murabaha* transaction, the client is deemed to have acquired the asset for a consideration equal to the amount that the financier paid to the seller. For example, A dealer sells a vehicle for R100 000. The client wishes to pay R20 000 deposit and finance the balance of the purchase price. The invoice to the financier from the dealer would indicate the purchase price of R100 000 less a deposit of R20 000 and an outstanding balance of R80 000, which the financier would pay to the dealer. A *mudaraba* transaction would deem the cost of the vehicle as the amount paid by the financier to the dealer being R80 000, however, it can be argued that the client, in paying the dealer the R20 000 deposit, paid it as agent of or on behalf of the financier and as such, the contract between the financier and the client would reflect a price of R100 000 less the R20 000 already paid, which would imply the cost of the car being R100 000. The issue arises when the client does not pay the R20 000 deposit in cash but rather trades in a vehicle to the value of R20 000. In this case, as the vehicle is the client's asset, he cannot simply tender it on behalf of the financier without first disposing of, or in VAT parlance, 'supplying' it to the financier. Should it be contended that he has tendered the vehicle as the agent of the financier, there would be a disposal of the asset from the client to the financier and from the financier to the motor dealer. This may lead to VAT implications on the supply and disposal of the vehicle for all the parties, including the dealer. The implication of amounts other than cash should be addressed in legislation.

The Shariah standards, allow for a reasonable documentation fee to be charged in a *murabaha* transaction, (AAOIFI, 2017) and in certain instances the client is charged fees to facilitate the transaction (Wesbank, online). The provisions in the Act do not deal with documentation fees on such a transaction and paragraph (c) of the definition of a *murabaha* specifically provides that no amount may be received by the financier as regards such an asset, except an amount calculated with reference to the amount that the financier paid to the seller. The legislature could look to include *Ijara* (leasing) as a Shariah transaction category and provide clarity on the treatment of the above mentioned issues.

Where a transaction complies with the definition in the Act of a *murabaha*, certain deeming provisions would apply. The deeming provisions are contained primarily in the Act. The implication thereof should also extend to provide similar relief against double taxing of the same transaction under other taxing statutes. Amendments accommodating these deeming provisions providing for tax relief in other taxation legislation are discussed next.

5.3 Amendments to other legislation

The deeming provisions provide that the financier is deemed to not have acquired or supplied goods under a Shariah arrangement. The client is deemed to have acquired the goods directly from the seller at the price paid by the financier to the seller. There is a further deeming provision, which provides for any premium payable by the client to the financier as being consideration paid for a financial service, provided the amount payable does not constitute any fee, commission or a similar charge. The effect of these deeming provisions are such that it puts the bank in a neutral position from a VAT perspective in that the bank is considered to not have supplied or acquired any goods, thereby eliminating, and double accountability for, Vat on these transactions. The client is deemed to have acquired the goods directly from the supplier.

Section 3A(2) of the Transfer Duty Act deems the financier to not have acquired any property under a Shariah arrangement and deems the client to have acquired the property from the seller at the inception of the arrangement, for the value that was paid by the financier to the seller. Section 3A(2) has the same deeming provisions as discussed above in the VAT act in that the bank is deemed to be in a neutral position and deemed to not have acquired any property under a Shariah arrangement, thereby eliminating the double payment of transfer duty upon the same transaction.

Similarly, section 8A of the Securities Transfer Tax Act deems the financier to not have acquired any beneficial ownership of a security under a Shariah arrangement. The client is deemed to have acquired the beneficial ownership in the security directly from the seller at the value paid by the financier to the seller at the time that the financier acquired the beneficial ownership from the seller. The effect of this deeming provision is that no securities transfer tax is payable by the bank, as the client will pay such, thereby eliminating the potential for double securities transfer tax to be paid upon the transfer of a beneficial ownership in security under a Shariah arrangement. These amendments to other legislation are not directed at providing for any specific provisions dealing with the nature of an Islamic finance transaction but rather to accommodate the deeming provisions of section 24JA so as to avoid any double taxing issues as a result of the provisions of section 24JA on the said legislation.

The discussion above critically analysed the taxation considerations relating to a *murabaha* as a Shariah compliant financing arrangement with the summarised findings and the conclusion relating to this type of a transaction following in the section below, thereby concluding this Chapter.

5.4 Findings relating to a *murabaha*

5.4.1 Aspects of a *murabaha* to be considered by the Legislature

- Where amounts are paid to persons other than the seller from which the asset is acquired, they may not form part of the amount payable by the client to the financier in respect of the asset financed, failing which, the transaction would not be recognised as a *murabaha*. This requirement in paragraph (c) of the definition of a *murabaha* should be revisited as this may have unintended consequences by excluding *murabaha* transactions that the legislature intended to cover as they may, in certain instances, fall foul of this provision of the definition. (refer 5.2.2.1)
- As a refinement of the legislation, consideration should be given to introduce legislation dealing with holding costs, *mora* interest and default penalties. (refer to 5.2.2.2)
- Provisions relating to instances where a part of the consideration for the acquisition of the asset is settled to the supplier in an amount other than cash should be looked into. (refer 5.2.2.3)

5.4.2 Conclusion

The definition of a *murabaha* in the Act is consistent with the definition of an 'Islamic' *murabaha*, therefore allowing for all *murabaha* transactions to be dealt with in accordance with the deeming provisions. These provisions re-assign the substance of the transaction from the bank's perspective to the client, thereby assimilating a conventional finance transaction. No deeming provisions recognising the substance of the transaction from the client's perspective are provided for.

The deeming provisions, as contained in section 24JA(3) and read together with section 24JA(1) of the Act, sufficiently address the taxation considerations of a *murabaha* transaction within the context of the policy of legislature to deem the transaction to be similar to a conventional finance transaction.

Chapters 3 and 4 dealt with diminishing *musharaka* and *mudaraba*, respectively, and this Chapter dealt with *murabaha*. The commonality between these transactions is that in all of them, it is an explicit requirement that a bank be a party to the transaction. The fourth and final Shariah-

compliant financing arrangement that the Act recognises is a *sukuk*, which is dealt with in the next chapter.

CHAPTER 6 *SUKUK*

The aim of this Chapter is to determine whether the provisions in the Act relating to a *sukuk*, as originated by the public sector, sufficiently address the taxation aspects relating to such *sukuk*. In order to arrive at a conclusion, a comparative analysis of a *sukuk*, as defined in the Act against a *sukuk* and as referenced to AAOIFI standards, is conducted. Recommendations are made to The legislature for consideration.

6.1 Theory and background

Having discussed diminishing *musharaka*, *mudaraba* and *murabaha* in the previous Chapters, the remaining Shariah compliant financing arrangement, being *sukuk*, is dealt with in this Chapter. In formulating the definition of the 'Islamic' *sukuk* transaction, which is to be used as a basis for comparison against the definition as contained in section 24JA(1) of the Act, a brief background of the definition of *sukuk* is firstly given, whereafter the AAOIFI definition is stated and thus the 'Islamic' definition formulated. This 'Islamic' definition is then compared to the definition as stated in the Act and a conclusion is drawn as to whether the respective definitions are consistent with each other. Thereafter, the provisions as contained in the act are evaluated with a view to conclude as to whether the taxation provisions sufficiently address the issues of *sukuk*, and in the event of it found wanting, appropriate recommendations are made. Ancillary aspects having a bearing on taxation issues are also pointed out where appropriate, with a focus on the maiden *sukuk* issued by the Government in 2014.

The investment certificate that represents the undivided proportional ownership of collective shareholders in an underlying asset, where the holder assumes all rights and obligations to such an asset, is termed a *sukuk* (IFSB, 2017). *Sukuk* that are primarily issued in the market can be classified in two broad categories, one being asset-based and the other asset-backed. The primary difference between asset-based and asset-backed *sukuk*, is that in the former, the purpose of the sale of the underlying asset is mainly to enable a *sukuk* arrangement and as such, only beneficial ownership is transferred with the originator holding the legal title; whereas, in the latter the asset is transferred to the investor in a true sale, signifying both ownership and legal title to the asset (Zakaria *et al.*, 2015:2). Much controversy has surrounded the Shariah compliance nature of an asset-based *sukuk* currently practiced, after AAOIFI declared their contemporary application to be un-Islamic (Arabian Business, 2007:online). The 'Islamic analog', in the form of an asset-based *sukuk* as opposed to an asset-backed *sukuk*, has been so fundamentally re-engineered that it resulted in it being considered non-compliant to Shariah principles. This is primarily because the requirement of the transfer of ownership in the underlying asset is neither true in form nor in substance (Dusuki & Mokhtar, 2010:29). Qin (2013:9), in evaluating *sukuk* as contemporarily practiced, and with reference to international standards, concluded that many *sukuk* are not

Shariah compliant in substance nor in form, however, each transaction must be individually analysed.

The Financial Services Board has adopted compliance with the standards of AAOIFI guidelines in defining a Shariah compliant portfolio (South Africa, 2014). South African Shariah scholars have also adopted AAOIFI guidelines in evaluating financial products (Jakoet, 2012:online). Krom (2013:58) defines *sukuk* as follows, "They are asset-backed securities and entitle investors to a share of the profits of the underlying pool of assets held in trust by a special-purpose vehicle." Ayub (2007:390) goes on to explain that *sukuk*, "Represent common undivided shares in the ownership of underlying assets with the effect that the *Sukuk* holders share the return as agreed at the time of issuance and bear the loss, if any, in proportion to their share in investment." Van der Zwan (2017:774) describes a *sukuk* as "an Islamic certificate of investment evidencing an investor's proportional beneficial interest in an underlying asset (or in a comparable usufruct)".

The AAOIFI definition of a *sukuk* is considered next, which is then compared to the section 24JA(1) definition of a *sukuk* and a conclusion is drawn as to the compatibility of these two definitions. Thereafter, certain taxation specific considerations are considered.

6.1.1 AAOIFI definition of *sukuk*

AAOIFI Shari'ah Standard 17, titled Investment Sukuk (AAOIFI, 2017:468) defines *sukuk* as, "Investment Sukuk are certificates of equal value representing undivided shares in ownership of tangible assets, usufruct and services or (in the ownership of) the assets of particular projects or special investment activity, however, this is true after receipt of the value of the Sukuk, the closing of subscription and the employment of funds received for the purpose for which the Sukuk were issued."

It can thus be summarised that an 'Islamic' *sukuk* transaction can be defined as, "Undivided Shares in an asset, or a usufruct in an asset, which are held by common shareholders by virtue of the subscription of these shares, which funds are employed for the purpose sought, that entitles the beneficial owners to a share in the profits or loss in the returns of the said asset or usufruct."

Having defined a *sukuk* as envisaged by AAOIFI, the section 24JA definition is now considered.

6.1.2 Section 24JA definition of a *sukuk*

Section 24JA(1) defines a *sukuk* transaction as:

“*sukuk*’ means a Sharia arrangement whereby –

- (a) the government of the Republic, any public entity that is listed in Schedule 2 to the Public Finance Management Act or a listed company disposes of an interest in an asset to a trust; and
- (b) the disposal of the interest in the asset to the trust by the government, the public entity or the listed company contemplated in paragraph (a) is subject to an agreement in terms of which the government, that public entity or that listed company undertakes to reacquire on a future date from that trust the interest in the asset disposed of at a cost equal to the cost paid by the trust to the government, to that public entity or to that listed company to obtain the asset.”

The definition of a section 24JA defined *sukuk* is now compared to its ‘Islamic’ counterpart.

6.1.3 Comparative analysis of the definition of a *sukuk*

The approach adopted by the legislature in defining a *sukuk* is materially different to that adopted in defining the other Shariah compliant arrangements contained in the Act, namely diminishing *musharaka*, *mudaraba* and *murabaha*. In the case of the latter three transactions the focus was on defining the transactions as per their form and then enacting provisions to dilute the form and deem the substance to be imposed upon them. In defining a *sukuk* the approach made no attempt in defining the form but rather defined an ‘enabling transaction’ which was considered to have the desired effect. The approach of not dealing with the form and substance of the transaction directly in the definition may result in certain material unintended consequences, which are discussed in more detail later in this Chapter.

As the Act makes no attempt to define a *sukuk* as envisaged by AAOIFI a direct comparison is irrelevant, however for completeness the table below highlights this misalignment between the definitions of a *sukuk*.

Table 6.1 Comparison between ‘Islamic’ *sukuk* definition and section 24JA(1) defined *sukuk*

Characteristic of Standard Transaction (AAOIFI standard clause)	s24JA(1) provision	Comment
1. Shares/Usufruct held in asset (2)	-	Not Complied
2. Common shareholders (3/1)	-	Not Complied
3. Subscription for shares (3/1)	-	Not Complied
4. Entitlement to profit/loss in returns of the asset/usufruct (3/2/1/1)	-	Not Complied

6.1.4 Conclusion

The definition of a *sukuk* transaction in section 24JA(1) of the act is not consistent with the features of the ‘Islamic’ transaction as measured against the AAOIFI standard, as the act in defining a *sukuk* does not refer to the direct *sukuk* transaction but rather defines an enabling environment for a *sukuk* transaction to be accommodated and defines such as a *sukuk*.

The provisions as contained in the Act relating to the taxation issues emanating from a *sukuk*, as defined in the Act, are now considered.

6.2 Critical analysis of the deeming provision of *sukuk*

The stated approach by government is to deal with matters arising from Islamic finance in a phased approach. After the introduction of diminishing *musharaka*, *mudaraba* and *murabaha* in 2010 the legislature, in 2011, introduced provisions dealing with *sukuk* initially limited to cater for *sukuk* as a form of Islamic finance limited only to government, which was subsequently extended to cover public entities and listed companies (South Africa, 2015:21). All banks are required to hold a certain percentage of interest bearing Government bonds within their investment portfolios, thereby prejudicing Islamic banks as Shariah law precludes them from holding such investments and as such they may not yield any economic benefits from the holding of such bonds which have been regulatory imposed upon them (South Africa, 2011:70). No benchmark of a ‘risk free’ pricing standard for Islamic finance bonds existed in the South African market, which in the case of conventional finance are referenced to government bonds. It is against this backdrop that Government initiated a structure to facilitate the issuance of a Government *Sukuk* to serve Islamic finance.

The *sukuk* form adopted by Government was *Ijara* (leasing) which would allow it to fall within the global standard for Government issued *sukuk*. As this form of *sukuk* is essentially a lease of an

asset or a usufruct it would trigger adverse tax consequences when compared to a conventional bond and this necessitated amendments to taxation legislation in order to try and achieve tax parity. The approach therefore followed by government was enacting a tax framework to allow for asset-based financing with the associated yield being equivalent to interest (South Africa, 2011:70).

The initial focus of the legislation was exclusively to accommodate Government originated *sukuk* and as such a discussion of the structure of this *sukuk* may be beneficial in putting into perspective the rationale as to why amendments to tax legislation were deemed necessary. The Explanatory Memorandum on The Taxation Laws Amendment Bill 2011, which sets out the reasons for the proposals to be enacted, describes the proposed Government *sukuk* structure in the following four steps:

Step 1: Establishing a special purpose vehicle (SPV in the form of a conduit entity) to hold an interest in immovable property that would be identified by National Treasury.

Step 2: Prospective investors would subscribe for *sukuk* certificates in cash which certificates would evidence a beneficial ownership of the assets of the SPV. Upon the transfer of these funds to National Treasury, National Treasury would transfer the beneficial ownership (Usufruct) in the immovable property to the SPV.

Step 3: National Treasury would then lease back the usufruct over a fixed term with the lease payments based on the market-related cost of funding, which would be paid to the SPV, where-after the SPV, after deducting a service fee, would pay to the *sukuk* holders.

Step 4: The *sukuk* will be redeemed at the end of the lease term by National Treasury by the payment of an amount equal to the initial amount paid by the SPV, where-upon the usufruct will revert back to National Treasury.

The challenge thus posed was to enact legislation dealing with such a *sukuk* structure so that it could be treated on par to conventional finance from a taxation perspective. Where taxation legislation does not specifically define a *sukuk*, or where a *sukuk* does not meet the definition as defined in the legislation, the tax treatment of the said transaction will, in those instances, be based upon the general provisions as contained in the act. The more salient specific issues, amongst others, that arise from a tax perspective which would need to be addressed in tax legislation, if not already addressed, are the following:

- Trusts (recognition and rules governing same).
- Acquisition, disposal or trading of a usufructory interest.
- Income or losses from the holding of a usufructory interest in a trust or company, both capital and revenue.
- Rules pertaining to the underlying asset upon which the usufruct is based.

Although the conclusion reached above (4.1) that the definition in the Act of a *sukuk* is not consistent with the 'Islamic' definition which is based on the AAOIFI guidelines, however since the Act specifically defines a *sukuk* the enquiry will now centre around this definition, as contained in the Act, and its associated specified tax treatment.

6.2.1 Analysis of the provisions of the Act

Section 24JA(7), in dealing with the tax treatment of a *sukuk*, states:

"Where any *sukuk* is entered into-

- (a) the trust is deemed not to have acquired the asset from the government of the Republic, the public entity that is listed in Schedule 2 to the Public Finance Management Act or the listed company under the sharia arrangement;
- (b) the government, that public entity or that listed company is deemed not to have disposed of or reacquired the asset; and
- (c) any consideration paid by the government, that public entity or that listed company in respect of the use of the asset held by the trust is deemed to be interest as contemplated in paragraph (a) of the definition of 'interest' in section 24J(1)."

The definition of *sukuk* in the Act is one of a sale and a buyback, and as such, the taxation issues that arise are those of a disposal and acquisition of an asset and the associated periodic lease payments with respect to the use of the asset. Section 24JA(7)(a) and (b) addresses these issues by providing that in the case of the sale of the asset, the sale be deemed to not have taken place, which results in there being no acquisition or disposal of the asset. The only remaining issue would thus be the treatment of the lease payments so as to reflect interest amounts, thereby providing for tax parity between conventional finance and Islamic finance. As the conduit principle would preserve the identity of an amount received by a trust (or SPV) and current taxation legislation is fairly well developed in recognising the taxation of trusts, if the amount received by the trust was dealt with in such a way as to deem it interest, this would avoid the need for any further specific provisions being introduced to deal with such an amount. Section 24JA(7)(c) thus provides for any consideration paid for the use of the asset to be deemed as interest, as defined in section 24J(1), thereby negating the need for providing any other taxation specific provisions relating to such *sukuk*, as this deeming provision would serve the intended purpose.

Theoretically, the provisions as contained in section 24JA(7) sufficiently address the taxation related issues of a *sukuk* should such a *sukuk* fall within the ambit of the Act, within the objective of creating tax parity between conventional bonds and *sukuk*.

The approach followed by The legislature in not defining a *sukuk* as envisaged by AAOIFI, but rather by defining an 'enabling transaction' as being the definition of a *sukuk*, may have merit but also has an associated risk in the event of there being shortcomings in the implementation of the said 'enabling transaction'. This is discussed in the next section.

6.3 The 'enabling transaction'

Whereas similar issues would arise whether the party to the *sukuk* is the Government, a public entity or a listed company, the discussion refers the Government as an example, which is more appropriate as thus far, the Government has already issued a *sukuk* (issued in 2014). The 'enabling transaction' defining a *sukuk* as stated in 4.1 above, consists of two interrelated parts, (a) The Government disposing of an interest in an asset to a trust, and (b) The Government undertaking to reacquire the interest that it disposed of on a future date at a cost equal to what it had received for the said interest disposed. This 'enabling transaction' by definition would also have to be a 'sharia arrangement', as text in section 24JA(1), introducing the transactions in (a) and (b) above states, "'sukuk' means a sharia arrangement". This, therefore, subjects the 'enabling transaction' to the requirements of being a 'sharia arrangement' in order for it to be recognised as a *sukuk* and hence for the deeming provisions of section 24JA(7) to apply. If it fails the definition of a *sukuk*, the provisions of section 24JA(7) would not apply.

'Sharia arrangement' as defined in section 24JA(1), stipulates that it should be open for participation by members of the general public and that it should be presented as compliant with Shariah law, when members of the general public are invited to participate therein. As it is only the 'enabling transaction' that is defined as a *sukuk* and should the said 'enabling transaction' not be compliant with being a 'sharia arrangement' as defined, it would not fall within the ambit of section 24JA of the Act and will thus be dealt with in terms of the normal provisions of the Act. Even though, if by an unrealistic stretch of the interpretation, it can be contended that the intention of the legislature was for the entire scheme as a whole to be a 'sharia arrangement', then the scheme too may be foul of the 'sharia arrangement' requirement, where this is not expressly complied to.

A prospectus sets out the details of an investment offering to the public (CIPC: online). In the light of the above, with specific reference to the Republic of South Africa's maiden *sukuk* issued in 2014, the reading of the prospectus does not seem to indicate that the 'enabling transaction' was open for participation by members of the general public, but rather an SPV (special purpose

vehicle) in the form of ZAR Sovereign Capital Fund Propriety Limited was formed as a trustee of The RSA *Sukuk* No. 1 Trust, which facilitated the 'enabling transaction'. This arrangement, unless offered to the general public for participation, which seems very remote, would preclude this *sukuk* from availing the provisions of section 24JA(7). If the scheme in its entirety is to be taken into account, then it too would not comply with the 'sharia arrangement' requirement, as the prospectus gives the indication that it was a restrictive placement to certain qualifying investors, thereby not open to the general public and also falls foul of paragraph (b) of the definition of 'sharia arrangement', which requires the arrangement to be presented as compliant with Shariah law when the general public are invited to participate therein. In this Government *sukuk* the prospectus explicitly states, "There is no assurance that the Certificates will be compliant with the principles of Shari'a" (ZAR Sovereign Capital Fund Pty Ltd, 2014:18).

The investor distribution in the *sukuk* from the Middle East, Asia, Europe and the USA together, represent 92% of investors with the rest of the world accounting for the balance (South Africa, 2014). The *sukuk* issuance was for US\$500 million. The lease rentals payable are for the use of assets that are located in South Africa (ZAR Sovereign Capital Fund Pty Ltd, 2014:12) and as such, should the deeming provisions of section 24JA(7) not apply, the source of the income being South Africa will have taxation implications on non-residents, as non-residents are taxed on any South African sourced income, unless such income is excluded in the respective Double Tax Agreements.

These potential unintended consequences may be addressed in one of two ways. The approach that was adopted by defining a transaction, as opposed to defining an enabling transaction, may be followed, as was adopted for the other Shariah compliant transactions discussed in Chapter 2; or the definition of *sukuk* could be amended to remove the reference to a "sharia arrangement". The market impact of the latter approach would need careful consideration, as the differentiating factor between a *sukuk* and a conventional bond is its Islamic characterisation, together with the potential for abuse, resulting from delinking a *sukuk* from a Shariah arrangement.

To create an accommodating taxation environment for a *sukuk*, these deeming provisions necessitate relief being provided for in other taxations' legislation so as to avoid the same transaction being taxed adversely, which amendments are discussed next.

6.4 Amendments to other legislation

The deeming provisions as contained in section 24JA of the Act regarding the treatment of *sukuk*, necessitated accompanying relief provisions in other taxation statutes, in order to address any taxation-related anomalies that may arise therefrom. The Acts that may require amendments are,

the Value Added Tax (VAT) Act no. 89 of 1991, the Securities Transfer Tax (STT) Act no. 25 of 2007 and the Transfer Duty Act (TDA) no. 40 of 1949.

The deeming provisions provide for the sale and buyback of the asset under a *sukuk* to be deemed as not having taken place, as well as the lease payments deemed as not being rental but rather interest. Provision is created in the TDA act in the form of section 3A(3), whereby the trust is deemed to not have acquired the asset from the government, thereby not being subjected to any transfer duty. Similarly, proviso (xii) of the definition of an enterprise in the VAT act specifically excludes an activity undertaken by a trust as part of a *sukuk* transaction as being that of conducting an enterprise, thereby also excluding such activity from being subjected to the provisions of the VAT Act. The issue, transfer and redemption of the *sukuk* certificates do not constitute 'securities' as defined in the STT act and as such, will not attract any securities transfer tax, hence there is no specific need to introduce any provisions relating thereto as there is no anomaly.

The above-mentioned discussion critically analysed the taxation considerations relating to a *sukuk* as a Shariah-compliant financing arrangement, with a summary of the findings and the conclusion forming part of the next section.

6.5 Findings relating to a *sukuk*

6.5.1 Aspects of a *sukuk* to be considered by the Legislature

- The approach followed by the legislature in dealing with Shariah-compliant financing arrangements was to define the transaction substantially in accordance with its form and then to provide certain deeming provisions, which would have the effect of the Islamic transaction being treated as a conventional finance transaction for tax purposes. However, the approach for *sukuk* was somewhat different in that the legislature did not attempt to define the transaction in terms of its form but rather defined an 'enabling transaction', which was meant to serve a similar purpose. The concept of a trust as a conduit is an integral part of a *sukuk* and as such, the emphasis was to transform rental to interest, which would then be dealt with within the existing provisions of the Act. However, the risk in following such an approach is that it may lead to unintended consequences should the transaction not strictly comply with the provisions of the stated definition, hence unavailing it of the deeming provisions. The requirement in the definition of a *sukuk*, compelled it to be a Shariah arrangement, as defined, in that it had to be open to the general public for participation. As the Act only defined the 'enabling transaction' to be a *sukuk*, it cannot be seen how this enabling transaction could be open for participation by the general public and as such, the

sukuk would not be a *sukuk* as defined for tax purposes. The legislature should revisit a *sukuk* in its entirety. (refer 6.3)

6.5.2 Conclusion

In order to broaden the investor base and to set benchmarks for State-Owned Companies (SOCs) seeking diversified sources of funding for developmental needs, National Government issued its debut *sukuk* in 2014 (South Africa, 2015:23). The market demand for such a *sukuk* was demonstrated by the offering being more than four times oversubscribed (South Africa, 2014). To facilitate the issuance of *sukuk* and to provide for tax parity between a *sukuk* and a conventional bond, specific legislation was introduced in the ITA, which was aimed at accommodating such a Shariah arrangement. The *sukuk* was based on the sale of an interest (usufruct) in a fixed asset to a trust for a fixed term, which at end of the term, would be sold back to Government at the same price for what it had initially sold the said interest. In the interim period Government would lease back the asset at a rental payable to the trust. The trust would issue certificates to source funding to purchase the said interest from Government. The rental received from Government would pass to the holders of the certificates.

It is recommended that either the approach followed in defining the other Shariah compliant financing arrangements be also followed for a *sukuk*, or alternatively, the reference to 'sharia arrangement' in the definition be omitted. In the case of the latter approach being followed, careful consideration must be given to the market perception and the uptake of such a *sukuk* should the primary market for which it is intended demand a Shariah compliant product. The potential abuse that may result from the omission of a reference to a 'sharia arrangement' should also be considered.

The provisions as contained in sections 24JA(1) and 24JA(7) theoretically sufficiently address a *sukuk* transaction. It cannot be seen how the practical implementation of a *sukuk* as defined, can be implemented without it falling foul of the theoretical provisions of the Act. The 'enabling transaction', which is defined as *sukuk* (and as applied in the maiden Government issued *sukuk*) will bring such a *sukuk* within the ambit of the Act. As such, theoretically, the provisions as contained in section 24JA(7) address the taxation related issues of a *sukuk* with the objective of creating tax parity between conventional bonds and *sukuk*.

Chapter 3 to Chapter 6 dealt with the Shariah-compliant financing arrangements as contained in section 24JA of the Act, thus concluding the analysis of the transactions under the scope of this study, thereby leading to the overall conclusion in the next and final Chapter, being Chapter 7.

CHAPTER 7 CONCLUSION

As stated in 1.3, it was the objective of this study to determine whether the taxation aspects of Shariah-compliant financing arrangements as dealt with in the South African taxation legislation are sufficiently addressed. The approach followed was to provide a contextual background of the provisions of the Act, with relevance to the concepts of substance over form and capital versus revenue. Thereafter, the respective Shariah-compliant financing arrangements, as defined in the Act, were critically analysed to realise the objective of this study. This final chapter provides a summary of findings related to such research objective. This chapter and study closes with the limitations of this study and recommendations of areas that may be considered for further research.

7.1 Summary of findings

The findings of this study are presented below, together with recommendations for consideration by The legislature to refine legislation addressing such transactions.

7.1.1 Contextualising section 24JA

The legislature, in intending to position South Africa as a regional financial centre, has recognised the need for the enactment of specific taxation legislation as a step towards creating tax parity between Islamic and conventional financial products (South Africa, 2010:49). It has adopted a phased approach in dealing with the introduction of legislation, specifically addressing currently available products offered in the market. This is a reactive as opposed to a proactive approach, but nonetheless one in the right direction. The methodology adopted by the legislature is somewhat questionable in that after having correctly identified the salient features of an Islamic finance transaction at the transactional level, it had disregarded the broader contextual framework environment within which this transaction was designed to be in strict adherence of, in that it should be interest free and based on the principles of the risk associated with profit and loss sharing. In fact, it had fundamentally contradicted the philosophy of Islamic finance by specifically ingraining within the definitions of such transactions, provisions which are in direct conflict and in-fact opposed to the risk sharing and interest free operating model of Islamic finance. Our conclusion does not take into consideration the broader implications of the contextual application of Islamic finance transactions, as these are only indirectly linked to this study, but considers the impact of specific issues that directly relate to the transactions under evaluation.

The concepts of substance versus form and capital versus revenue from a taxation perspective are relative to the taxpayer that they refer to. What one party may consider capital may be considered

as revenue by the counter-party, similarly, the substance and form of a transaction between parties need not necessarily be the same from their respective perspectives. There is no 'one size fits all' rule in making such determinations and each transaction would have to be evaluated based on its facts. Section 24JA deems certain amounts to be interest. Where legislation does not address all the aspects of the form of the transaction from both the client's and the bank's perspective, which may result in unintended consequences in the treatment of an item as being that of a capital or revenue nature and as such, the taxation implications may differ. (refer 2.3 and 2.4)

It is principally accepted that transactions be taxed according to their substance. The explanatory memorandum introducing the taxation treatment of Islamic finance products does not shed any light on whether any studies were conducted in order to determine the relationship between the substance and the form of an Islamic transaction from the perspective of the client of the bank. It recognised the form of the transaction as being different from its substance from the bank's perspective and therefore, considered it necessary to legislatively impose this substance upon the client. The fact that upon introduction of this legislation, it was made compulsory that a bank be a participant to a Shariah-compliant financing arrangement, further cements this view of primarily accommodating the bank's perspective.

The legislature should, therefore, consider:

- Conducting a study to determine the relationship between the substance and the form of a Shariah-compliant financing arrangement from the perspective of the client of the bank. (refer 2.8)
- As it is the stated objective of government to create an environment within which South Africa can be attractive as a base for a regional and global Islamic financial centre, consideration should be given to extend legislation to cover a broader spectrum of Shariah-compliant financing arrangements – supplementing the four currently covered. (refer 2.5)

7.1.2 Diminishing *musharaka*

A diminishing *musharaka*, as defined in section 24JA(1) of the Act, conforms with the definition of an 'Islamic' diminishing *musharaka*, thereby bringing such transactions within the ambit of the Act. The provisions then dealing with such a diminishing *musharaka* strips the transaction of its 'Islamic' identity and assimilates it to a conventional finance transaction. The 'Islamic' transaction has now been baptised to assimilate a conventional finance transaction. Within this context, sections 24JA(5) and 24JA(6), read together with section 24JA(1), sufficiently address the taxation considerations of a diminishing *musharaka*. However, this assimilation results in certain issues

relating to a diminishing *musharaka* being overlooked, which may have unintended consequences, defeating the purpose of enacting such deeming provisions, which should thus be considered. (refer 3.4.2)

The legislature should, therefore, consider:

- Where banks offer a diminishing *musharaka* entwined with an *Ijara* (rental or leasing) contract. the asset is sold at cost to the client and the rental reflects the banks 'profit'. As the deeming provisions only deal with the asset transaction, the rental would be treated as per the normal provisions of the Act, thereby resulting in minimal deemed interest in such a transaction. Consideration should, therefore, be given to the treatment of such a packaged *Ijara* transaction. (refer 3.2.2.3)
- The asset is deemed to be acquired completely by the client and in certain instances the bank may incur expenses towards such an asset which it is deemed not to own. Consideration should be given to the treatment of expenditure incurred by the bank in an asset which is not used in production of the banks income. (refer 3.2.2.2)
- The amount that the client is deemed to have acquired the asset for is based on the transaction between the bank and the seller and as such the treatment of any expenditure incurred by the bank to parties other than the seller should be considered. (refer 3.2.2.4)
- Matters relating to the treatment of any penalties or *mora* interest paid by the client to the bank should be clarified, especially in the case where such penalties are reflected as donations in the form of a transaction. (refer 3.2.2.4)

7.1.3 *Mudaraba*

A *mudaraba* as defined in section 24JA(1) of the Act does not conform with the definition of an 'Islamic' *mudaraba* as the return is based on the quantum of capital invested as a factor of time without the risks of any underlying activity being reflected in such a return, apart from the risk of the loss of capital which is solely borne by the client. The baptism of a *mudaraba* is of such a material nature that it conflicts with the very fundamental principle of Islamic finance in that interest is strictly prohibited. The provisions of section 24JA(2) read together with section 24JA(1) therefore do not sufficiently address the taxation considerations of a *mudaraba*. However, a *mudaraba* which may somehow conform to such a definition would avail itself of the provisions as contained in the Act. Certain refinements may need to be considered relating to legislation dealing with a *mudaraba* as dealt with in the Act. (refer 4.4.2)

The legislature should, therefore, consider:

- The deeming provisions do not address the form of the transaction and such the transaction would be considered to be in the scheme of profit making. Therefore the form of the transaction should be addressed. (refer 4.2.2.1)
- The loss in such a transaction is borne by the client and no provisions exist to deal with such a loss. The taxation treatment of such a loss should be considered. (refer 4.2.2.2)
- *Mudaraba* funds received by the bank may only be invested in diminishing *musharaka*, other *mudaraba*, *murabaha* and *sukuk* transactions. Shariah-compliant financing arrangements is a subset of Islamic financing activities. Should these funds be invested in any other general 'Islamic' banking activities or equities the transaction will not be recognised as a *mudaraba* which may result in unintended consequences for both parties. Clarity should be provided as to the investment of *mudaraba* funds. (refer 4.2.2.3)

7.1.4 *Murabaha*

A *murabaha* as defined in section 24JA(1) of the Act conforms with the definition of an 'Islamic' *murabaha* thereby bringing such transactions within the ambit of the Act. The provisions of the Act thereafter re-assign the substance of the transaction from the banks perspective upon the client thereby baptising an 'Islamic' *murabaha* to assimilate a conventional finance transaction. The deeming provisions as contained within section 24JA(3) read together with section 24JA(1) sufficiently address the taxation considerations of *murabaha*. One of the mandatory participants to a *murabaha* was subsequently extended to cover listed companies. Therefore a *murabaha* can be transacted with either a bank or a listed company. Should certain aspects of a *murabaha* not be addressed by such an assimilation it could result in unintended consequences which would need consideration. (refer 5.4.2)

The legislature should, therefore, consider:

- Amounts that are paid to persons other than the seller from which the asset is purchased may not form part of the amount payable by the client to the financier. This requirement should be re-visited as it may result in transactions that the legislature intended to cover not being covered. (refer 5.2.2.1)
- Consideration should be given to providing for the treatment of holding costs, *mora* interest and default penalties, more specifically when such are paid in the form of donations. (refer 5.2.2.2)
- Where part of the acquisition price is settled by the client directly to the supplier in an amount other than cash, these may result in the VAT considerations of such a supply to be

overlooked. The treatment of amounts other than cash in a *murabaha* should be considered. (refer 5.2.2.3)

7.1.5 *Sukuk*

The definition in the Act does not deal with a *sukuk* transaction per se, but rather with defining an 'enabling transaction' to accommodate a *sukuk* and such does not address the identity of a *sukuk*. Therefore, a *sukuk* as defined in section 24JA(1) of the Act does not conform with the definition of an 'Islamic' *sukuk*. The provisions of section 24JA(7), read together with section 24JA(1), do not sufficiently address the taxation considerations of a *sukuk*. The legislation provides for *Sukuk* origination by only the Government, state-owned companies and listed companies. Banks are not recognised as originators of *sukuk*. To date, the Government has issued only its inaugural *sukuk*, in 2014. Upon strict interpretation of the provisions of the Act, the *sukuk* as issued by Government would not be recognised as a *sukuk* for taxation purposes and this may result in significant taxation concerns, which should be addressed by the legislature. (refer 6.5.2)

The legislature should, therefore, consider:

- Revisiting a *sukuk* in its entirety, especially regarding the 'enabling transaction', which forms the basis of what the legislature refers to as *sukuk*, with a view to defining a *sukuk* in its entirety as has been the approach in the other Shariah-compliant financing arrangements dealt with earlier. (refer 6.3)

7.1.6 General conclusion

The treatment of Shariah-compliant financing arrangements as contained in the Act have been alchemised from Islamic finance transactions to conventional ones, and as such may give rise to certain unintended consequences in the extent of their application. The degree of 'Shariah arbitrage' is so glaring, that it can be said that the 'islamic analog' has been cloned from its conventional counterpart. Reservations aside; as to the incorporation of the principles of interest in a *mudaraba* and a *murabaha* transaction, and the absence of a risk sharing model in a diminishing *musharaka* transaction, their respective salient transactional features as referenced to the 'standard' transaction have been sufficiently defined in the legislation. Having satisfactorily defined these transactions, the legislature then went on to strip them of their identity by enacting deeming provisions. These provisions are inherently deficient, in that they only take cognisance of the substance of the transaction from the bank's perspective and imposes this lob-sided interpretation upon both parties. The substance of the transaction from the client's perspective is totally ignored.

The anomaly resulting from this approach is that the tax treatment for the client is based on the substance of the transaction from the bank's perspective.

The VAT, Transfer Duty and Securities Transfer Tax laws have been amended by the introduction of deeming provisions, which have the effect of avoiding double tax on a Shariah arrangement as compared to its conventional counterpart, thereby providing for tax parity for these taxes as well.

It can thus be concluded that from the bank's perspective, the taxation legislation sufficiently addresses Shariah-compliant financing arrangements leading to conformity with conventional finance, whereas from the client's (primarily Muslim market) perspective it does not, as it deems something purporting to be the substance of the transaction being imposed onto the client, which from a factual, objective and subjective determination is clearly not the case. However, notwithstanding this approach, there exists room for further refinement and clarity of the legislation as highlighted in the points for consideration by The legislature that are discussed above.

7.2 Limitations of this study

The scope of this study was limited to the four transactions covered by section 24JA, namely diminishing *musharaka*, *mudaraba*, *murabaha* and *sukuk*, and did not deal with any other Islamic finance transactions.

This study dealt with these transactions as found to be practiced in a traditional western environment and not as they were originally conceived as being an integral part of the broader Islamic socio-economic sphere. This study was limited to taxation considerations of these Islamic finance transactions within their conventional financial application.

Whereas, differences of opinion may exist as to the Shariah-compliant nature of these transactions, this study used the definitions as contained in the AAOIFI standards relating to these transactions and as such, did not interrogate the Shariah compliancy of such standards.

7.3 Areas for further research

The disruptive impact of the finding of this study relating to a *sukuk*, justifies a complete evaluation of the provisions relating to a *sukuk*, specifically the implications of how a *sukuk* has been defined in the Act and the whether a *sukuk* arrangement may be provided for without reference to a 'sharia arrangement'.

It may also be appropriate to conduct a further study to critically analyse the substance and the form of an Islamic transaction, and correlating this to a conventional transaction while paying particular attention to the substance from the perspective all parties involved.

Section 24JA, although open for participation by any taxpayer, primarily caters for the dealings of banks aimed at the Muslim market. It is thus recommended that a study be undertaken to determine whether it is appropriate to adopt taxation legislation catering specifically for taxpayers' morality and ethical considerations on a general basis.

LIST OF REFERENCES

AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions). 2017. Shari'ah Standards. Manama, Kingdom of Bahrain: Dar AlMaiman.

AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions). <http://aaoifi.com/founding-members/?lang=en> Date of access: 4 August 2018.

AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions). <http://aaoifi.com/announcement/aaoifi-launches-a-its-peer-reviewed-journal-of-islamic-finance-accountancy-joifa-and-issues-call-for-papers/?lang=en> Date of access: 29 September 2018.

Abdel Karim, R.A. s.a. Regulatory Environment of Islamic Financial Institutions. AAOIFI. <https://www.sc.com.my/wp-content/uploads/eng/html/iaffairs/Rifaat.pdf> Date of access: 29 September 2018.

Abdul Wahab, A.A.O., Ab. Aziz, M.R., Abuzraida, O.A., Al Sanousi, A.M., Al Hinai, A.R.H. & Ibrahim, A. 2014. A comparative study of Islamic financial system and conventional system. *Global business and economics research journal*, 3(5):15-29.

Acts **see** South Africa.

Ahmad, A.U.F. & Hassan, M.K. 2006. The Adoption of the UK Finance Bill Proposals on Islamic Finance into Islamic Banking in Australia. *Review of Islamic Economics*, 10(1):41-57.

AlBaraka. Profit Calculation And Distribution.

http://www.albaraka.co.za/ProductsandServices/Investment/Profit_Calculation_and_Distribution.aspx Date of access: 17 October 2018.

Aljifri, K. & Khandelwal, S.K. 2013. Financial contracts in conventional and Islamic financial institutions: an agency theory perspective. *Review of business and finance studies*, 4(2):79-88.

Aljudaibi, N., Melebari, A.S. & Simbawah, H. 2017. Comparative analysis of AAOIFI Vs IFSB. Islamic Finance Expert. <https://ifinanceexpert.wordpress.com/2017/07/03/comprative-analysis-of-aaoifi-vs-ifsb/> Date of access: 29 September 2018.

Arabian Business. 2007. Most sukuk 'not Islamic', body claims.

<https://www.arabianbusiness.com/most-sukuk-not-islamic-body-claims-197156.html> Date of access: 30 September 2018.

Askari, H. & Krichene, N. 2014. Islamic finance: an alternative financial system for stability, equity, and growth. *PSL quarterly review*, 67(268):9-54.

Australia. The Board of Taxation. Review of the Taxation Treatment of Islamic Finance Products. Retrieved from the Australian Government Board of Taxation website:

<http://taxboard.gov.au/consultation/taxation-treatment-of-collective-investment-vehicles-2/> Date of access: 13 May 2018.

Ayub, M. 2007. Understanding Islamic Finance. West Sussex, England: John Wiley.

Bankman, J. 2000. The economic substance doctrine. *Southern California law review*, 74(5):5-30.

Bartmann, R. 2017. Causes and effects of 2008 financial crisis. HFU Business School. Term Paper.

Beck, T., Demirgüç-Kunt, A. & Merrouche, O. 2010. Islamic vs. Conventional Banking: business model, efficiency and stability. Policy Research Working Paper 5446. The World Bank.

Bentley, D. 2006. A model of Taxpayers' Rights as a Guide to Best Practice in Tax Administration. Bond University. (Thesis – PhD).

Bobsguide. 2013. Malaysia's new regulation covers both Islamic finance and conventional FS. 4 July 2013. <http://www.bobsguide.com/guide/news/2013/Jul/4/malaysias-new-regulation-covers-both-islamic-finance-and-conventional-fs/> Date of access: 5 April 2018.

Botha, L. & Kotze, L. 2018. The capital v revenue question in the context of government grants: the SCA decides in favour of the motor manufacturing industry. Cliffe Dekker Hofmeyr (CDH). <https://www.cliffedekkerhofmeyr.com/en/news/publications/2018/Tax/tax-alert-15-june-The-context-of-government-grants-The-SCA-decides-in-favour-of-the-motor-manufacturing-industry-.html> Date of access: 28 July 2018

Brincker, T.E. 2011. Taxation principles of interest and other financing transactions. Durban: LexisNexis.

Cerovic, L., Nikolaj, S.S. & Maradin, D. 2017. Comparative analysis of conventional and Islamic banking: importance of market regulation. *Ekonomika I praznaka DBK*, 26(1):241-263.

CIPC (Companies and intellectual Property Commission). Public Offering of Company Securities (Prospectus). CIPC. <http://www.cipc.co.za/index.php/manage-your-business/manage-your-company/public-company/compliance-obligations/public-offering-company-securities-prospectus/>

Date of access: 25 September 2018.

Coetsee, D. & Buys, P. 2018. A doctrinal research perspective of master's degree students in accounting. *South African Journal of Higher Education*, 32(1):71-89.

D'Cruz, R.G. & Aziz, M.Z.Z. 2017. The Islamic Finance and Markets Review, edited by Dewar, J. & Hussain, M. London, UK: Law Business Research.

Deloitte. 2016. Islamic Finance at Deloitte: no interest... but plenty of attention.

<https://www2.deloitte.com/lu/en/pages/islamic-finance/articles/islamic-finance-deloitte.html> Date of access: 12 May 2018

DeLorenzo, Y. 2000. The Religious Foundations of Islamic Finance. *The jurist*, 60:137-161.

Dewar, J. & Hussain, M. 2017. Islamic finance and markets law review. 2nd ed. London, UK: Law Business Research.

Djebbar, M. 2011. Islamic Financial Markets: achievements, prospects and challenges. *Eurasian Economic Review*, vol.3.

Durack, J.W. 1979. Tax Law: form versus substance (In context of Australian income tax law). *De Rebus*, 1979(143):603-609.

Dusuki, A.W. & Mokhtar, S. 2010. Critical appraisal of Shari'ah issues on ownership in asset-based Sukuk as implemented in the Islamic debt market. ISRA Research Paper.

El Gamal, M.A. 2006. Islamic Finance: law, economics and practice. New York: Cambridge University Press.

Gait, A.H. & Worthington, A.C. 2007. A Primer on Islamic Finance: definitions, sources, principles and methods. University of Wollongong, School of Accounting and Finance

Gooden, S. Islamic Finance and its Application in Housing Projects. *Housing finance international*. 25(3):43-48.

- Hameed, T. 2006. Does the Diminishing Musharakah reflect the spirit of Sharia? Mortgage Financial Gazette. <https://www.mortgagefinancegazette.com/market-news/does-the-diminishing-musharakah-reflect-the-spirit-of-sharia-2-08-01-2006/> Date of access: 16 October 2018.
- Hanif, M. 2011. Differences and Similarities in Islamic and Conventional Banking. *International journal of business and social science*, 2(2):166-175.
- Hanlon, M. & Heitzman, S. 2010. A Review of Tax Research. *Journal of Accounting and Economics*, 50(2-3):127-178.
- Harrison, T. & Ibrahim, E. 2016. Islamic Finance: principles, performance and prospects. Switzerland: Springer Nature.
- Hasan, A. 2015. Globalisation of Islamic Financial Services and World City Networks. *Journal of Islamic Finance*, 4(1):6.
- Hatta, M.F.M. & Samah, S.A.A. 2015. Compensation and Penalty Imposed on Debt Settlement of Islamic Products. *Global journal al-thaqafah*, 5(1):7-18.
- Hayat, U. & Malik, A. 2014. Islamic Finance: ethics, concepts, practice (a summary). The CFA Institute Research Foundation.
- Honohan, P. 2001. Islamic Financial Intermediation: economic and prudential considerations. The World Bank Group.
- Huet, J.M. & Cherqaoui, S. 2015. The rise and rise of Islamic finance. BearingPoint Institute. EU: Le Réveil de la Marne.
- Hurcan, Y., M. Mansour, and B. Olden. 2015. "Taxation and Public Financial Management Implications of Sukuk Instruments," IMF Working Paper (forthcoming), International Monetary Fund. Washington, DC.
- IFSB (Islamic Financial Services Board). 2016. Strategic Performance Plan 2016 – 2018. https://www.ifsb.org/press_full.php?id=343&submit=more Date of access: 29 September 2018.
- IFSB (Islamic Financial Services Board). 2017. Guiding principle on disclosure requirements for Islamic capital market products (Sukuk and Islamic collective investment schemes). IFSB-19.

- IMF (International Monetary Fund). 2017. The IMF and Islamic Finance.
<http://www.imf.org/external/themes/islamicfinance/> Date of access: 5 April 2018.
- Iqbal, M. & Molyneux, P. 2005. Thirty years of Islamic Banking: history, performance and prospects. *J.KAU: Islamic econ.*, 19(1):37-39.
- Iqbal, Z. 1999. Financial Engineering in Islamic Finance. *Thunderbird International Business Review*, 41(4/5):541-560.
- Iqbal, Z. & Mirakhor, A. 2006. An introduction to Islamic Finance – theory and practice. New Jersey: John Wiley.
- Iqbal, Z & Mirakhor, A. 2011. An Introduction to Islamic Finance : theory and practice. 2nd ed. Singapore: John Wiley.
- Jakoet, I. 2012. A window into South African Shari’ah unit trusts. FA News.
<https://www.fanews.co.za/article/investments/8/unit-trusts/1008/a-window-into-south-african-shari-ah-unit-trusts/12049> Date of access: 27 September 2018.
- Jobst, A.A. 2007. The Economics of Islamic Finance and Securitization. *Journal of structured finance*, 13(1):1-35.
- Kamali, M.H. 2008. Shari’ah Law: an introduction. England: Oneworld Publications.
- Kammer, A., Norat, M., Pinon, M., Prasad, A., Towe, C., Zeidane, Z. & IMF Staff Team. 2015. International Monetary Fund. Islamic Finance: opportunities, challenges, and policy options.
<https://www.imf.org/en/Publications/Staff-Discussion-Notes/Issues/2016/12/31/Islamic-Finance-Opportunities-Challenges-and-Policy-Options-42816> Date of access: 20 March 2018
- Kholvadia, F. 2016. Islamic banking in South Africa – form over substance? Johannesburg: University of Witwatersrand. (Thesis – MCom).
- Krom, C.L. 2013. Islamic Banking and Finance: understanding the basics. *The CPA journal*, 83(1) :56-59.
- Kurniawan, A. & Shomad, A. 2016. The Development of Murabaha in Indonesian Islamic Banks. *Rechtsidee*, 3(1):1-16.

Kyeong, P.R., Piao, S.Z. & Nam, D. 2012. A Comparative Study between the Islamic and Conventional Banking Systems and Its Implications. *Scholarly journal of business administration*, 2(5):48-54.

Lee, Y.N. 2017. Islamic finance is becoming so attractive that even non-Muslims want in. CNBC website: <https://www.cnbc.com/2017/12/19/sukuk-islamic-finance-grows-in-non-muslim-countries.html>. Date of access: 26 February 2018.

Lewis, M.K. 2008. In what ways does Islamic banking differ from conventional finance? *Journal of Islamic economics, banking and finance*, 4(3) :9-24.

Maloof, M. 1956. Substance Versus Form in Tax Litigation. *Journal of public law*, 5(1):269-282.

Maydew, E. 2001. Empirical tax research in accounting: a discussion. *Journal of Accounting and Economics*, 31:389-403.

McKenzie, D. 2010. Islamic Finance 2010. Islamic Financial Services London (IFSL) Research. <http://www.londonstockexchange.com/specialist-issuers/islamic/downloads/ifsl-research.pdf> Date of access: 10 March 2018.

McKerchar, M. 2008. Philosophical Paradigms, Inquiry Strategies and Knowledge Claims: applying the principles of research design and conduct to taxation. *eJournal of Tax Research*, 6(1):5-22.

Mia, M.R., Hasnat, M.A. & Mahjabeen, W. 2016. Mudharabah and Musharakah from the accounting perspective by referring to AAOIFI, IFRS and MFRS. *Journal of business and management*, 18(7):67-72.

Millar, R. 2008. Religious foundations of Islamic Finance. (In Anwar, H. & Millar, R., eds. *Islamic Finance: a guide for international business and investment*. United Kingdom: GMB Publishing. p. 3-8).

Mirrlees, J., Adam, S., Besley, T., Blundell, R., Bond, S., Chote, R., Gammie, M., Johnson, P., Myles, G. & Porterba, J.M. 2011. *Tax by design*. Oxford University Press.

Mohamed, S. & Goni, A. 2017. Islamic Finance Development Report 2017. ICD-Thomson Reuters. <https://www.zawya.com/mena/en/ifg-publications/231017094152F/> Date of access: 12 April 2018.

Morapi, L. 2014. The Regulation of Islamic Banks and Financial Institutions in South Africa. Johannesburg: University of Johannesburg. (Thesis – LL.M.).

Norton Rose Fulbright. 2016. Changes announced to support Islamic finance in Australia. 10 May 2016. http://www.nortonrosefulbright.com/knowledge/publications/139402/changes-announced-to-support-islamic-financing-in-australia?utm_source=Mondag&utm_medium=syndication&utm_campaign=View-Original Date of access: 12 May 2018.

OECD. 2010. Model Tax Convention (Condensed version). <http://www.oecd.org/berlin/publikationen/43324465.pdf> Date of access: 22 July 2018.

OECD (Organization for Economic Co-operation and Development). 2015. Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports. Paris: OECD Publishing.

Pearce, D., Campbell, E. & Harding, D. 1987. Australian Law Schools: a discipline assessment for commonwealth tertiary education commission. Canberra: Australian Government Publishing Service.

PWC (PricewaterhouseCoopers). 2009. My Islamic Finance (My Tax Companion Series). <https://www.pwc.com/my/en/assets/services/myislamicfinance-2009.pdf> Date of access: 13 May 2018.

Qin, J.A.Y. 2013. Are *Sukuk* truly Islamic? National University of Singapore. <https://ssrn.com/abstract=2432649> Date of access: 29 September 2018.

Qur'aan. 1930. The Meaning of the Glorious Qur'aan. Translated into English by Marmaduke Pickthall. <http://www.khayma.com/librarians/call2islaam/quran/pickthall/> Date of access: 28 September 2018.

Ramli, J.A. & Ramli, M.I. 2014. Managing the Risks of *Mudharabah* contract in Malaysian Islamic Banks: an examination of issues.

Rammal, H.G. 2010. Islamic Finance: challenges and opportunities. *Journal of Financial Services Marketing*, 15(3):189-190.

- Rayner, D. & Falkner, C. 2016. Australia: changes announced to support Islamic financing in Australia. 17 May 2016.
<http://www.mondaq.com/australia/x/491564/islamic+finance/Changes+announced+to+support+Islamic+financing+in+Australia> Date of access: 5 April 2018.
- Raza, M.F. 2010. IFAAS (Islamic Finance Advisory & Assurance Services). Regulation of Islamic Finance in the UK and France. <http://www.iefpedia.com/english/wp-content/uploads/2011/01/Farrukh-Raza-IFAAS-Astana-0710.pdf> Date of access: 12 April 2018.
- Renneboog, L., Horst, J.T. & Zhang, C. 2008. Socially responsible investments: institutional aspects, performance, and investor behaviour. *Journal of banking & finance*, 32(9):1723-1742.
- Rodgers-Glabush, J. 2015. IBFD International Tax Glossary. 7th ed. IBFD.
- RSA (Republic of South Africa) **see** South Africa.
- Sapuan, N. M. 2016. An Evolution of Mudarabah Contract: A viewpoint from classical and contemporary Islamic scholars. *Procedia economics and finance*, 35:349-358.
- SCOF (Standing Committee on Finance). 2010. Response Document National Treasury and SARS. Taxation Laws Amendments Bills, 2010.
- Scottish Government. See Scotland.
- Shafi Alam, M. (2011). Islamic Finance: an Alternative to the Conventional Financial System. *Korea Review of International Studies*, :37-59.
- Shah, S.H. 2009. Profit and Loss Sharing System in Islam: a study of *Musharakah* (partnership). Srinagar: University of Kashmir. (Thesis – PhD).
- Shinsuke, N. 2007. Beyond the theoretical Dichotomy in Islamic Finance: analytical reflections on murabahah contracts and Islamic debt securities. *Kyoto bulletin of Islamic area studies*, 1-2:72-91.
- Siddiqi, M.N. 2006. Islamic banking and finance in theory and practice: a survey of state of the art. *Islamic economic studies*, 13(2):1-48.
- Smith, A. 1776. An Inquiry into the Nature and Causes of the Wealth of Nations. Edinburgh: Thomas Nelson.

South Africa. 1910. Zandberg v Van Zyl 1910 AD 302.

South Africa. 1920. Dadoo Ltd v Krugersdorp Municipal Council 1920 AD 530.

South Africa. 1924. CIR v George Forest Timber Ltd 1 SATC 20 (AD).

South Africa. 1936. Westminster v CIR 1936 19 TC 490.

South Africa. 1937. Visser v CIR 1937 TPD 77 8 SATC 271.

South Africa. 1941. Randles, Brothers & Hudson Ltd v Commissioner of Customs 1941 AD 396 33 SATC 48 at 395.

South Africa. 1945. Pyott Ltd v CIR 1945 AD 128 13 SATC 121.

South Africa. 1946. New State Areas Ltd v CIR 1946 14 SATC 155 (AD).

South Africa. 1949. Transfer Duty Act 40 of 1949.

South Africa. 1952. CIR v Estate Kohler 1952 (2) SA 584 (A) 18 SATC 354.

South Africa. 1962. CIR v Berold 1962 (3) SA 748 (A) 24 SATC 729.

South Africa. 1962. Income Tax Act 58 of 1962.

South Africa. 1965. SIR v Cadac Engineering Works (Pty) Ltd 1965 2 All SA 547 (a).

South Africa. 1977. Estate Dempers v SIR 1977 (3) SA 410 (A) 39 SATC 95.

South Africa. 1991. Value Added Tax (VAT) Act 89 of 1991.

South Africa. 2002. Samril Investments v C: SARS 2002 (1) SA 658 65 SATC 1.

South Africa. 2007. Securities Transfer Tax (STT) Act 25 of 2007.

South Africa. 2010. Budget Speech. Minister of Finance: Parvin Gordhan. 17 February 2010.

South Africa. 2010. Explanatory Memorandum on the Taxation Laws Amendment Bill, 2010.

South Africa. 2010. Introduction: Taxation Laws Amendment Bills, 2010. Address to the National Assembly by the Honourable Minister of Finance.

South Africa. 2010. Memorandum on the Taxation Laws Amendment Bill, 2010.

South Africa. 2010. Taxation Laws Amendment Bills, 2010. Response Document prepared by National Treasury and SARS.

South Africa. 2010. Taxation laws amendment act No.7 of 2010. Government Gazette, 545: Nov.2:1024.

South Africa. 2011. Draft Taxation Laws Amendment Bill, 2011.

South Africa. 2011. Explanatory Memorandum on the Taxation Laws Amendment Bill (Draft), 2011.

South Africa. 2011. SARS v NWK Ltd 2011 (2) SA 67 (SCA).

South Africa. 2014. Collective Investment Schemes Control Act, 2002. (Notice 90 of 2014). *Government gazette*, 37895, 8 Aug.

South Africa. 2014. South Africa concludes debut sukuk bond. National Treasury, Media Statement.

South Africa. 2014. South Africa concludes debut sukuk bond.
http://www.treasury.gov.za/comm_media/press/2014/2014091701%20-%20Sukuk%20Statement.pdf Date of access: 25 March 2018.

South Africa. 2015. Debt Management Report 2014/15.

South Africa. 2015. Explanatory Memorandum on the Taxation laws Amendment Bill (Draft), 2015.

South Africa. 2015. Lodhi 5 Properties Investments CC v Firststrand Bank Limited 2015 3 ALL SA 32 (SCA).

South Africa. 2016. Commissioner for the South African Revenue Service v Capstone 556 (Pty) Ltd 2016 (20844/2014) ZASCA 2.

Taner, S. 2011. An analysis of 'murabaha to purchase orderer' with particular reference to Turkey and its adoption of AAOIFI standards. Manchester: University of Manchester. (Dissertation: Master of Arts).

Thomson Reuters. Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). [https://uk.practicallaw.thomsonreuters.com/3-500-7938?transitionType=Default&contextData=\(sc.Default\)](https://uk.practicallaw.thomsonreuters.com/3-500-7938?transitionType=Default&contextData=(sc.Default)) Date of access: 4 August 2018.

United States of America. 1924. Weiss v Stearn 1924 265 US 242.

United States of America. 1926. Berkey v Third Ave railway Co 1926 155 NE 58.

Usmani, M.T. 1998. An introduction to Islamic Finance. <http://islamicfinancenews.files.wordpress.com/2009/09/an20introduction20to20islamic20finance.pdf> Date of access: 21 July 2018.

Usmani, M.T. 2003. Ijarah. https://kantakji.com/media/8641/islam_ijarah.pdf Date of access: 18 October 2018.

van der Zwan, P. & Wilcocks, J. 2017. Instruments and interest-bearing instruments. (In Stiglingh, M., ed. SILKE: South African income tax. South Africa: LexisNexis. p.725-775).

Waheed, K. 2008. A critical study of Murabahah as an Islamic mode of financing. Aligarh: Aligarh Muslim University. (Thesis – PhD).

Warde, I. 2000. Islamic Finance in the Global Economy. Edinburgh: Edinburgh University Press.

WesBank. Islamic finance for individuals. <https://www.wesbank.co.za/wesbankcoza/foryou/islamic> date of access: 16 October 2018.

World Bank & Islamic Development Bank Group. 2016. Global Report on Islamic Finance: a catalyst for shared prosperity? Washington, DC: World Bank and IDBG.

Zakaria, M.Z., Salleh, A.Z. & Abdul Aziz, A.Z. 2015. The Application of Beneficial Ownership in Asset-based Sukuk: a Shari'ah analysis. *Malaysian journal of Syariah and law*, 3:1-26.

ZAR Sovereign Capital Pty Ltd. 2014. Prospectus 22 September 2014.

<https://dl.bourse.lu/dl?v=ADyMFy5zxNFitbuuk6wDBrI750xZNo2tIRmGopGP7mwGgkZ5lcWE93q6epKF2q70HIj7wpSE+JT5INZqIUZCSWLTdvZKHNdTG1t0ylgg8aWeRqqpMoONrSzWpls5wc1V8FL5xnGkJAd+MMTTsTTIug>== Date of access: 24 September 2018.