IS IT POSSIBLE TO BUY IN BELGIUM A PROPERTY ACCORDING TO ISLAMIC FINANCES PRINCIPLES ?
LEGAL AND TAX REGIME FOR SUKUK IN BELGIUM

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CONVENTIONAL SYSTEM
Usual steps to buy a home in Belgium



1° The Buyer searches for a house or an appartment
2° The Buyer contacts one or various Banks or Credit institutions.
3° Signature of a « compromis de vente » between Seller and Buyer usually with a suspensive conditions (obtaining the credit. This is to avoid the problem of indemnities and double transfer tax in case the buyer dos not find a credit).
4° the Buyer finds credit (with mortgage as a garantee)
4° Final signatures at the public notary, 1° for the purchase with the Sellor and 2° with the Bank for the mortgage. Payment of the tranfer tax of 12,5 %.
5° Reimbursement of the loan each month (usually fixed amount with capital and interests).
6° Penalties in case of default.
7° With the mortgage the Bank can force the sale of the property in case of lasting default.

Tax and legal aspects



1° The Bank is only in contact with the Buyer.

2° The Bank has a claim on the Buyer = the amount of the loan.

3° The remuneration of the Bank are the interests, which are taxable as profit for the Bank (corporate tax)

4° Transfer tax of 12,5 % (some time reduction). Regional issue.

5° In case of anticipated reimbursement, limited indemnity of 6 months of interests.

6° The mortgage is the garantee of the Bank and allows the Bank to force the sale in its favour.

7° The Buyer is still bound to pay the balance if the proceed of the sale does not cover the debt towards the Bank.

BUYING A HOUSE ACCORDING TO THE PRINCIPLES OF ISLAMIC FINANCE.

Introduction

1° The Bank plays a rather different role even though the purpose is to allow the purchase of the house by the Buyer and making a profit out of the operation.

2°To get a profit the Bank must find something else than interest and find a sharia'h compatible way to do so.

3°Under Islamic Finance, a remuneration implies an underlying transfer of asset or service. The Bank will become part of the underlying transactions.

4°This can be done in different ways.

Usual Islamic contracts usuels



1° *Mourabaha* (مرابحة) ≈ purchase and resale, with deferred payment.

2° *Ijara wa iqtina3* (إجارة و ٱقتناع) ≈ long term lease with an option at the end of the contract.

3° *Degressive Musharaka* (مشاركة متناقصة): original co ownership between Buyer and financial agent with progressive transfer of ownership in favour of the Buyer and payment of a rent for the part which is not yet bought.

4° *Istisna* (إستصناع) ≈ “advance payment for future constructions”

5° *Sukuk* (صكوك) ≈ “Islamic bond”

MOURABAHA
How does it work?



A. <u>With the Seller</u>

The Bank buys the property choosen by the Buyer to the Seller and becomes full owner of the property.

B. <u>With the Buyer</u>

1° The Bank resell the property with a margin and become creditor of the Buyer.

2° A deferred payment is contractually agreed.

3°The Buyer becomes immediately owner of the property before payment.

4°Possibility to create a morgage to cover the Bank.

Précision : The Bank to the Buyer cannot sell the property before its purchase. The Bank bears a risk in case the Buyer changes his/her mind.

But the Bank has a property which can be either resold or leased.

This situation is very similar with financial leasing contracts.

MOURABAHA
Legal and tax aspects



A. Transfer tax:

1° Double transfer tax.

2° Possibility of « déclaration de command » but this is rather rigid.

B. For the Bank

2°Taxation of the capital gain for the Bank. Question : When ? At the time of the resale? or according the the payments made by the seller?

Possibility of a ruling (simple administrative decision).

C. For the Buyer

1°In case of anticipated reimbursement, full price must be paid. It is not a loan but a sale. However the Bank can make a commercial gesture and give a price reduction (this cannot be garanteed contractually) at the time of the early reimbursement.

HOW DOES IT WORK ?



1°The Bank AND the Buyer will buy TOGETHER the property.

2°The proportions are to be decided between the Bank and the Buyer (ie : 95% et 5%)

3° A contract est concluded between the Bank and the Buyer to progressively transfer the ownership from the Bank to the Buyer according to a schedule agreed between the parties (ie : 10 % each year)

4°The Buyer will pay monthly an amount which included purchase of ownership AND the payment of a rent. The amounf of the rent will progressively decrease until the property becomes full ownership of the Buyer.

MUSHARAKA
Consequences



A. For the Buyer

1°No debt

2°Limited second transfer tax between Bank and Buyer (1%)

3°Possibility to negociate to stop temporarily the purchase of the shares of ownership and only payement of rent in case of temporary financial difficulties.

B. For the Bank

1° the remuneration of the Bank is the rent and in some case the capital gain (if the sale of ownership is made on the market value and not on a fixed price)..

1°The Bank stays owner of what has not been yet bought by the Buyer (better garantee than a mortgage with similar ultimate possibiliy of judicial sale in case of default.

2°Possibility to issue some SUKUKS (صكوك) ≈ real estate certificate immobilier by the. This allows the Bank to get back its investment and creates porfolio assets and attracts local and foreign investors.



ISTISNA'
How does it work?

1°La Bank contracts with a builder to build a property according to the indications of the Buyer and becomes progressively the owner of the property.

2° In parallel the Bank contracts with the Buyer with a deferred payment.

3°The Buyer will pay monthly installments on the purchase price which includes the building costs +the margin of the Bank.

4°Both operations are made with successive and distinct contracts

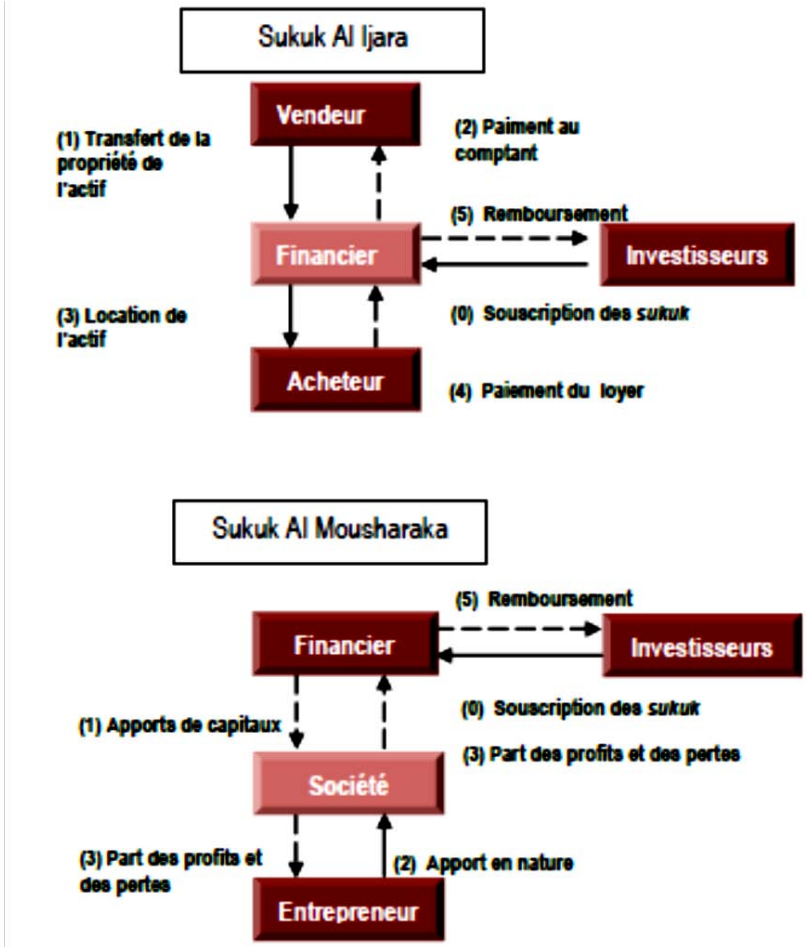
IJARA

- The Bank (usually a dedicated subsidiary) buys an property (or any other asset) and then lease it on a determined term with an option at the end of the contract.

- Banks do this on a regular basis in Belgium for professionals. For real estate the problem is the double transfer tax : at the time of the purchase by the Bank and and when the option is exercised.

- As owner of the asset the Bank can issue Sukuk issue on their portfolio and distribute the profit (rent) to the Holders (see infra).

SUKUK
Introduction



Source: G. Saint-Marc - 2008

The *sukuk* (saak): Islamic « bonds »

Based on underlying non monetary assets.

The remuneration for the Holder is calculated according to the performance of the underlying asset. Share of profit among the investors.

Intra-shariah debate :

« *Asset backed* »: the issuer pays a remuneration according to the performance of the underlying asset.

« *Asset based* »: the originator buys back the underlying asset.

→ Norm 17 de l'AAOFI – Admission of the flow of rents of an ijara as underlying asset to issue some sukuk.

TAX REGIME FOR THE INVESTORS IN BELGIAN SUKUK



- Belgium know already since decades a particuler form on investment called « Real Estate Certificates » similar to a Sukuk.
- To buy a real real estate a company issues « certificates » allowing the Investors to perceive the rents of the property and the capital gain according to the percentage of their investment.
- The value of the real estate certificate is bound to the value of the underlying asset.
- The Holder of the Certificate is considered as an « economical owner » but not as a legal owner. However there is a possibility to establish a mortgage in favour of the Certificate Holders giving almost the same rights than an owner (protection in case of bankrupcy).
- The transfer of such Certificates is allowed and does not trigger any transfer tax. The only possible taxation would be on a capital gain. The taxation depends on who is the seller (private individual, company, resident or non resident, etc).

TAXATION



- Under Belgian Tax law all payments made the Holders of the Certificates coming from the rent and from the capital gain, without limit of amount, is considered as a « interest » fully deductible from the taxable income of the issuing company. The taxation of interests is still rather favourable (21%) under Belgian Tax law (withholding tax).
- BUT some regulations offer the possibility to escape such withholding tax under certains conditions depending on who is the issuer and who is the holder of the Sukuk. For example income produced by Sukuk issued by governement and state subdidivions can be tax exempted in certain cases (ie : income paid to private foreign investors).
- Double taxation treaties are also to be checked.



- CONCLUSION

- To conclude Belgium is not a financial center but offers interesting possibilities to develop the issuance of Sukuk as a similar financial product already exists for real estate with a clear defined tax regime. Nothing prevents to use the same mechanism for other types of assets such as movables, etc.
- Reduced tax (21%) for the Holder, and possibility of total exemption in certain cases.
- However we should be very careful with the « meeting » of different legal environments and the possibilities of misinterpretations. Each operation must be very carefully examined from various angles to avoid unexpected surprises.
- Brussels has proportionnally a very large Muslim population, growing in numbers wealth and education, expecting the development of Islamic Finance.
- The use of Sukuk by non Muslim can also be an alternate way of raise funds especially but not only for the State, State subdivisions and Public administration.

THANKS FOR YOUR ATTENTION !

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