

ISLAMIC FINANCE



CONTENT

| | | |
|----|-------------------------------------|-------|
| 01 | ISLAMIC FINANCE | P. 4 |
| 02 | LUXEMBOURG - AN ESTABLISHED PARTNER | P. 7 |
| 03 | SHARIAH COMPLIANT INVESTMENT FUNDS | P. 13 |
| 04 | SECURITISATION VEHICLES | P. 26 |
| 05 | WEALTH MANAGEMENT | P. 28 |
| 06 | RESPONSIBLE INVESTING | P. 32 |
| 07 | SUKUK | P. 36 |
| 08 | TAKAFUL | P. 40 |
| 09 | TAX TREATMENT | P. 42 |
| 10 | GLOSSARY | P. 49 |
| 11 | USEFUL CONTACTS | P. 52 |

This brochure is aimed at those who are interested in setting up a shariah compliant product or service in the Grand Duchy of Luxembourg. It provides information on the legal framework, tax treatment, and professional services available in Luxembourg.

Luxembourg is recognised as one of the leading European centres for Islamic finance. With a track record that stretches back nearly four decades, Luxembourg is committed to help develop Islamic finance in Europe.

01

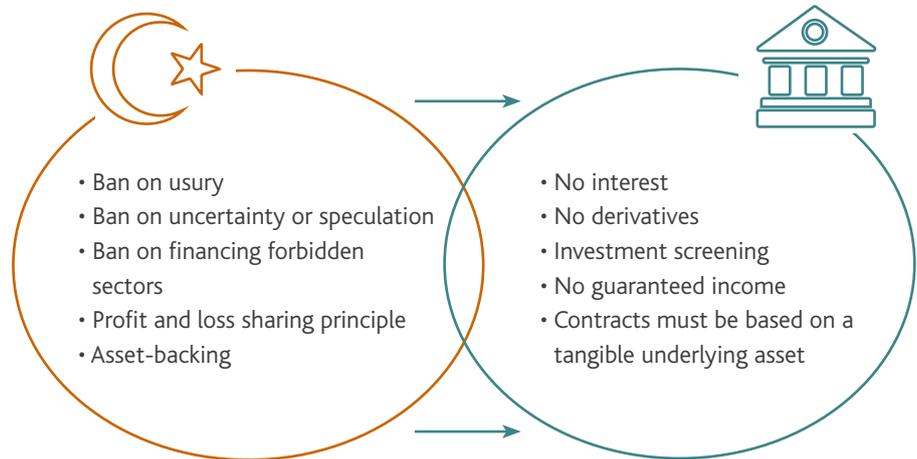
ISLAMIC FINANCE

Until recently, Islamic finance was virtually unknown outside the Muslim world. However, in the space of two decades it has become a widely accepted integral part of the global financial services industry and one that is projected to grow in the future.

At the end of 2015, the global market for Islamic finance was worth USD2.5 trillion, a figure that is expected to rise to USD3.5 trillion by 2021¹. The large majority of Islamic finance assets are held in deposit accounts, providing scope for growth in other products as the market matures.

What is Islamic finance? The term encompasses all banking and finance activity which is guided by the teachings of the Quran and the principles of shariah law. Institutions active in Islamic finance require access to a shariah scholar who is ultimately responsible for compliance with Islamic standards. It is estimated that there are some 1,000+ recognised shariah scholars worldwide².

MAIN PRINCIPLES OF ISLAMIC FINANCE



¹ICD Thomson Reuters Islamic Finance Developments report 2016

²ibid

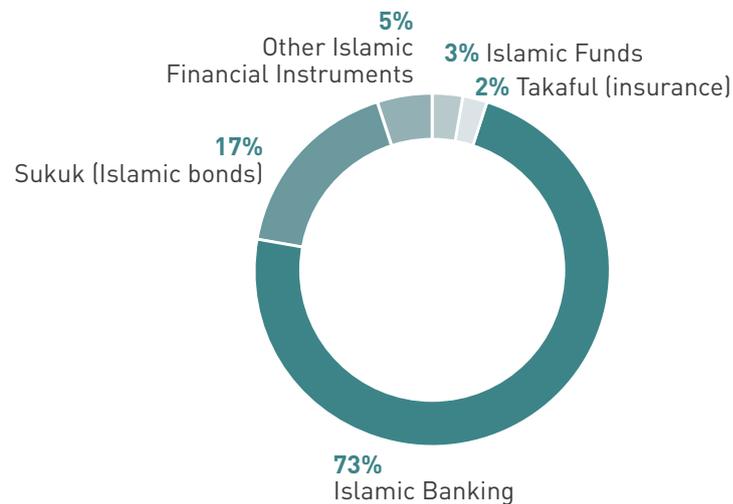
As in conventional finance, regulations and standards vary somewhat across jurisdictions; this is also true for Islamic finance.

Companies promoting shariah compliant products require access to the skills of one or more shariah scholars familiar with the interpretation of Islamic law in the given target market of reference.

Scholars and legal experts from the different schools of Islam are striving to reach a consensus. International bodies such as the 'Auditing and Accounting Organisation for Islamic Finance' (AAOIFI), the 'Islamic Financial Services Board' (IFSB), and the 'International Islamic Financial Markets' (IIFM) have published industry standards and guidelines. Standardisation is an important pre-requisite for the growth of the sector and its adoption by conventional investors.

Islamic financial products are open to all investors and often classed under the general umbrella of responsible investments.

BREAKDOWN OF GLOBAL ISLAMIC FINANCE ASSETS, 2015



Islamic Finance assets are expected to reach USD3.5 trillion Islamic finance assets worldwide by 2021.

02

LUXEMBOURG - AN ESTABLISHED PARTNER

DEFINING CHARACTERISTICS OF THE LUXEMBOURG FINANCIAL CENTRE



economic, political, social
and financial stability



decades of experience in
dealing with an international
client base and serving clients
on a cross-border basis



a legal, regulatory and tax framework
that caters to the specificities of all
types of international finance



a state-of-the-art IT infrastructure specifically
aimed at providing speed, security and
reliability to the financial centre



a culture of investor protection and
rigorous anti-money laundering policies



a strong working relationship
between the public and private
sectors

These factors have attracted banks, insurance companies, investment fund promoters, sovereign wealth funds and specialised service providers from all over the world.

THE LUXEMBOURG FINANCIAL CENTRE:

2nd financial centre in
the EU after London and
1st
in the Eurozone (2016)

Europe's **leading**
investment fund centre, worth
EUR 3.6 trillion EUR
(October 2016)
the second largest investment fund centre
in the world after the United States



the world leader in the cross border
distribution of retail investment funds

consistently rated
AAA
by all major credit-rating agencies

GDP 
growth above
the EU average
(+4.5 %)
in 2015

very low public debt,
22.1 %
of **GDP**

the most multilingual
country in Europe
8th
worldwide for
English proficiency

**premier international
wealth management**
centre in the Eurozone

home to Europe's leading international
bond listing centre, the



LUXEMBOURG
STOCK EXCHANGE

ISLAMIC FINANCE IN LUXEMBOURG

Luxembourg is a long-standing partner to the financial communities of Muslim countries in Asia and the Middle East. To these markets the Grand Duchy offers financial services that can be designed and delivered to conventional or Islamic finance standards.

Luxembourg has established its credentials as an Islamic finance centre: it was the first European country to authorise an Islamic insurance company, the first European market to list a sukuk, the first European Central Bank to join the IFSB and the first sovereign State to issue a euro-denominated sukuk.

Today, Luxembourg is the fourth largest Islamic fund centre and first outside the Muslim world, ranked by the number of Islamic funds established in the market.

Luxembourg provides a base from which to offer shariah compliant products and services to European Muslims, which represent 6% of the European population.

A number of major banks, legal and audit firms, fund administration companies and other service providers in Luxembourg have active and well-trained Islamic finance teams. A list of these companies can be found on our website www.islamicfinanceluxembourg.lu in the 'Service Providers' section.

Luxembourg does not have a standing shariah authority, in recognition of the existence of different interpretations of shariah law. Nevertheless, the financial centre welcomes standardisation as an important driver for growth of the sector in Europe.

In 2013, the Association of the Luxembourg Fund Industry (ALFI) published a set of 'best practice guidelines' for setting up and servicing Islamic investment funds. These have become an international standard in the sector.

“ *The level and quality of Sharia-compliant advisors and professionals in Luxembourg is unsurpassed, complementing the sophisticated and well established legal framework for Islamic financial institutions and investors in Luxembourg.* ”

Haitham Al Refaie,
Tawreeq Holdings Group CEO

LEGAL ENVIRONMENT

Luxembourg has been engaged in Islamic finance for several decades, thanks to the early support of the government and the regulatory authorities. The Luxembourg financial sector supervisory authority (CSSF), and the insurance sector regulator (CAA) have many years of experience in the authorisation and supervision of shariah compliant structures.

From a regulatory perspective, the supervisory authorities do not set any conditions with regard to the compatibility of assets with shariah law. Whether the project in question is setting up a bank, a sukuk, or an investment fund, the CSSF will seek to ensure that all applicable Luxembourg legal requirements are complied with. In the case of a fund, the CSSF will wish to establish that the persons involved in the management have adequate expertise and that the sales documentation (where applicable) is sufficiently clear to allow investors to understand the consequences of their investment.

LUXEMBOURG & ISLAMIC FINANCE TIMELINE

1978

First Islamic finance institution established in a non-Islamic country

1983

First Islamic insurance company in Europe

2002

First stock exchange in Europe to list a sukuk

2008

Government establishes a Task Force to promote Islamic finance

2009

Specialised Islamic finance training courses launched by the banking institute

2010

- First Central Bank in Europe to join the IFSB
- Circulars clarify the treatment of Islamic finance structures
- Founding member of the IILM facility

2013

Luxembourg fund association publishes "best practice guidelines" for servicing Islamic funds

2014

First sovereign state to issue a sukuk in EUR

03

SHARIAH COMPLIANT INVESTMENT FUNDS

THE INVESTMENT FUND TOOLBOX

Luxembourg is the leading centre for internationally distributed investment funds. Combined with service providers that have experience in Islamic finance, this has made it an ideal location for the setting up, administration, and cross-border distribution of shariah compliant investment vehicles.

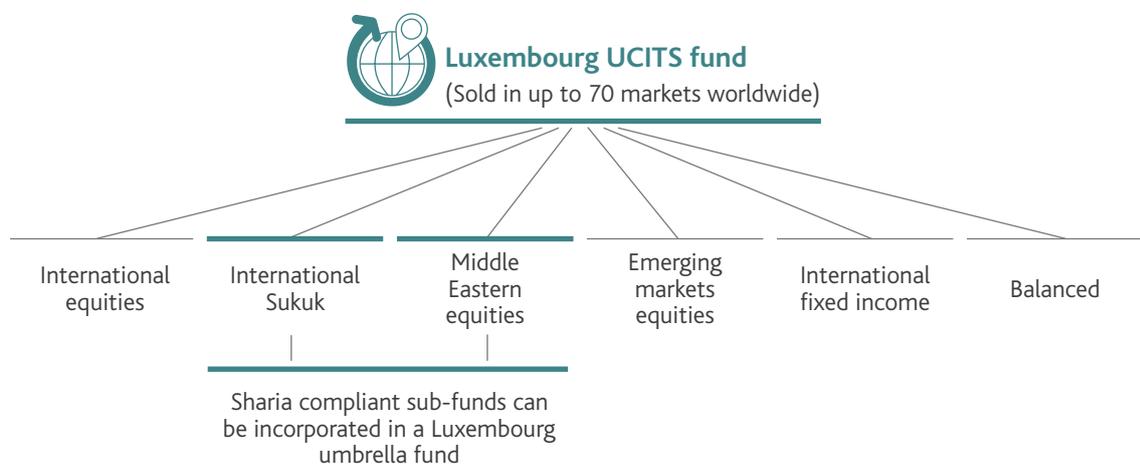
The Luxembourg financial sector toolbox contains a wide selection of regulated and unregulated investment vehicles, any of which can be used to establish a Shariah compliant investment fund.

The choice of regime will largely depend on the investment strategy and the target investor group; these factors will influence the structure and the level of product regulation required. In this, the challenges faced by a shariah compliant portfolio manager are similar to those faced by any other portfolio manager. Shariah compliant asset allocation can be achieved by putting in place a robust investment strategy and a careful selection process.

Most Luxembourg vehicles can be set up in an 'umbrella' form, where segregation is achieved by creating multiple compartments, each with distinct assets and liabilities. One or more of these compartments can be established as shariah compliant.

Example of a Luxembourg umbrella fund structure:

Fund promoters use Luxembourg to distribute Islamic funds internationally.

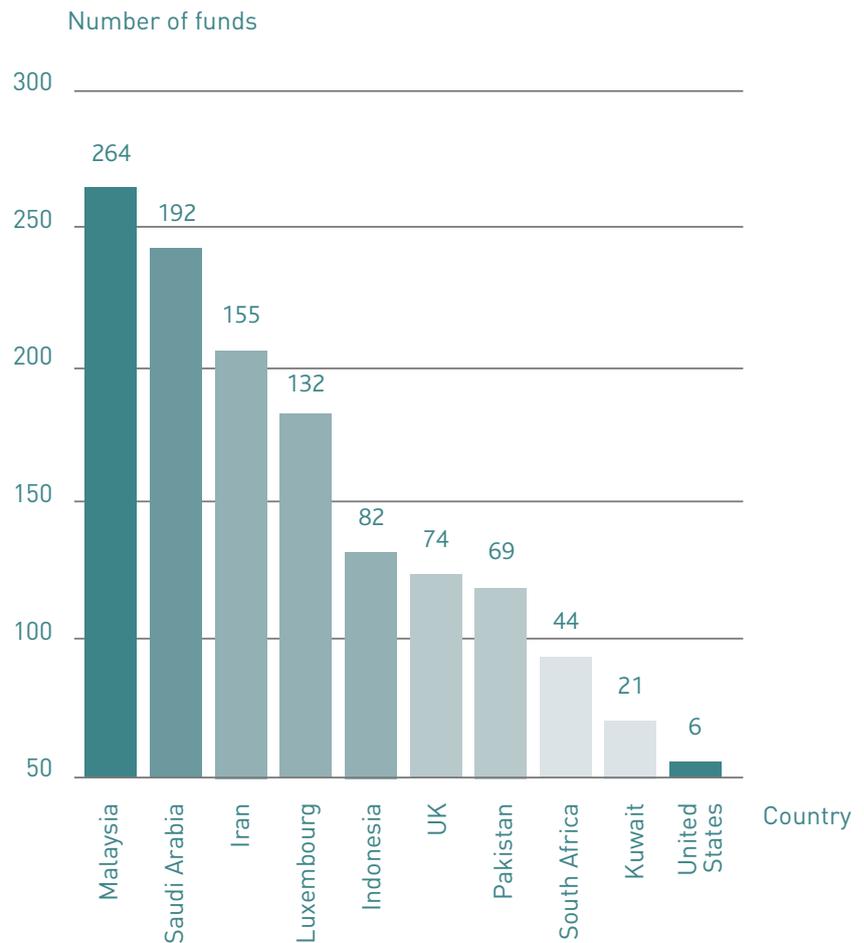


GOVERNANCE OF SHARIA COMPLIANT FUNDS

The assets of a fund are usually managed by an investment manager or advisor, under the ultimate responsibility of the fund's board of directors or its management company.

The specific features of an Islamic scheme normally require that the board of directors (or the manager in the case of a management company) appoint a shariah advisor or a board of sharia advisors to ensure that the investment strategy is compliant.

TOP 10 ISLAMIC FUND DOMICILES



Luxembourg is the fourth largest domicile for shariah compliant investment funds, ranked by the number of Islamic funds in the market³.

³Thomson Reuters Islamic Finance Development Report 2016.

RETAIL FUNDS

Over the last 25 years, Luxembourg has built and reinforced its position as the most popular domicile for Undertakings for Collective Investment in Transferable Securities (UCITS). Originally designed as retail investment products, UCITS are now widely sold both to the public and to institutional investors across the globe.

Luxembourg UCITS not only benefit from a passport for distribution within the European Union, but are also recognised for distribution in another 40 jurisdictions worldwide including countries in Asia, Latin America, and the Middle East, a network that is unique in the industry.

For example, of the 576 foreign investment funds registered for sale in Bahrain, 76% (440) are domiciled in Luxembourg. Similarly, 69% of foreign funds in the United Arab Emirates are domiciled in Luxembourg.⁴

At a global level, 65% of all cross-border funds are domiciled in the Grand Duchy⁵. This expertise in cross-border distribution makes Luxembourg the ideal location for the domiciliation of shariah compliant funds for sale to retail or institutional investors around the world.

Any UCITS may be set up as a shariah compliant fund.

PROFESSIONAL FUNDS

Similarly to the UCITS, professional fund structures reserved for well-informed investors can be made shariah compliant. A range of vehicles exist for investment in transferable securities and alternative investments such as real estate, private equity, venture capital and hedge funds.

Professional investment fund initiators wishing to take advantage of the European passport must appoint an authorised Alternative Investment Fund Manager (AIFM) to manage their fund.

Smaller AIFMs⁶ may choose a lighter regulatory regime by adopting 'registered AIFM' status. 'Registered AIFMs' simply register with the CSSF but the funds they manage do not qualify for an EU passport.

⁴ PwC Global fund Distribution chart 2016

⁵ ibid

STRUCTURING PROFESSIONAL FUNDS

The four main professional investment structuring solutions in Luxembourg are:

- The SIF, which provides an operationally flexible and fiscally efficient multi-purpose vehicle that can be used for all asset classes
- The SICAR, which is specifically designed for private equity investment and venture capital
- The UCI Part II, a flexible but more regulated pooled vehicle
- The RAIF, a non-regulated fund

The SICAR and the SIF are both lightly regulated investment vehicles subject to approval and on-going supervision by the CSSF. The CSSF ensures that the management bodies and the depository bank entrusted with custody of the assets have sufficient repute and professional expertise. However, it is worth adding that the portfolios of Luxembourg funds can be managed by managers based outside of Luxembourg.

Neither SIFs nor SICARs are required to comply with detailed investment restrictions or leverage rules. Nevertheless, a SIF must adhere to the principle of risk diversification, however, the CSSF may allow derogations on the basis of appropriate justification. By contrast, a SICAR may concentrate its holdings into one project, the only requirement being to invest in risk capital.

The most recent addition to the Luxembourg fund toolbox is the RAIF, which is not subject to any regulatory approval by the CSSF, permitting a significantly enhanced time-to-market for new fund launches, a feat especially appreciated by private equity and venture capital fund initiators. The RAIF offers many of the same features as the SIF and the SICAR, but removes the double layer of regulation: only the manager is regulated - the fund itself is not.

The UCI Part II exists for promoters of funds that do not meet all the criteria for a UCITS but which are substantially regulated and therefore also accessible to retail investors in Luxembourg.

⁶ An AIFM with less than EUR100bn assets under management (with leverage) or less than EUR500m under management (without leverage) are not required to seek full authorisation but may choose to do so if they wish to take advantage of the EU passport.

All the professional funds may also be structured as limited partnerships, either as traditional limited partnerships (SCS), or limited partnerships without a legal personality (SCSp). Limited partnerships which may be regulated or non-regulated, depending on the fund structure, will always consist of a general partner and one or more limited partners and are set up in a limited partnership agreement, with a notary.

“

Luxembourg's SIF law was particularly attractive as it provided the possibility for an aspiring multi-family office like SEDCO Capital to establish a single umbrella vehicle that invests in a number of diverse asset classes and to offer such a vehicle to investors globally. It also allowed SEDCO Capital to establish considerable economies of scale and to provide its clients transparency, independent custody and administration.

”

Hasan Al Jabri,
Chief Executive Officer, SEDCO Capital

EXPERIENCED INVESTORS

The SICAR, SIF, and the RAIF are designed for investors who require a lower level of protection. Investors must be “well-informed”, which is a term encompassing institutional and professional investors, or anyone else who declares his or her adhesion to the status and invests at least EUR 125,000 or can produce confirmation from a credit institution or management company certifying their appropriate experience and knowledge.

LEGAL FORMS

From a legal perspective, any Luxembourg vehicle can be used to set up a shariah compliant fund. In general, Luxembourg funds may be structured as:

- a public limited company (SA)
- a private limited company (S.à r.l.)
- a partnership limited by shares (SCA)
- a limited partnership (SCS)
- a special limited partnership (SCSp)
- a common investment fund (FCP)

The table on the following pages compares the Luxembourg structures commonly used for Islamic investment funds and provides an overview of their legal and regulatory framework.

CASE STUDY: RE-DOMICILING FUNDS TO LUXEMBOURG

Luxembourg has become widely recognised as an attractive and stable jurisdiction for Sharia compliant funds. Islamic funds domiciled in the country appeal to third party distributors across the GCC as well as in international markets such as Switzerland, the United Kingdom, Hong Kong, Singapore and South Africa. Luxembourg domiciled funds enjoy many advantages, including tax efficiency, cost competitiveness, the availability of large and experienced funds management workforce and a business-oriented regulatory environment. This is why Rasmala took the decision to re-domicile its key funds from the Cayman Islands to Luxembourg within a SICAV Umbrella Fund. We believe that Luxembourg is key to the expansion of our global distribution strategy, offering accessibility, transparency and scalability to Rasmala's product offering.

Eric Swats,
CFA Head of Asset Management, Rasmala

Summary of structures commonly used for islamic finance

| | UCITS and UCI | SIF | SICAR |
|--|--|--|--|
| | Undertakings for Collective Investment in (Transferable Securities) | Specialised Investment Fund | Investment Company in Risk Capital |
| Applicable regulation (see glossary for full legal reference) | 2010 UCI Law Part I (UCITS) and Part II (UCI), respectively, as amended | 2007 SIF Law, as amended | 2004 SICAR Law, as amended |
| Supervision by the CSSF | Yes | Yes | Yes |
| Eligible assets | Restricted for UCITS. Flexible for UCI. | Unrestricted | Unrestricted, as long as in risk capital |
| Risk diversification rules | Yes | Limited | No |
| Eligible investors | All types | Well-informed investors | Well-informed investors |
| Tax treatment | No tax except for an annual subscription tax of 0.05% on the Net Asset Value (reduced rate or exemption available) | No tax except for an annual subscription tax of 0.01% on the Net Asset Value, except if exempt | Corporation taxes at a combined rate of 27,08% ⁷ but full tax exemption on income from securities invested in venture capital |
| Required service providers | Auditor, Administrator, Central depository | Auditor, Administrator, Central depository | Auditor, Administrator, Central depository |
| Practical application for shariah compliant products | To be reviewed on a case by case basis | No limitation | No limitation |
| Benefit from tax treaties | Yes if in the form of a SICAV ⁸ | Yes if in the form of SICAV ⁸ | Yes ⁸ |
| EU passport | Yes ⁹ | Yes ¹⁰ | Yes ¹⁰ |

⁷ Rate applicable for 2017 (see chapter 9 for more details)

⁸ Individual treaties to be checked

⁹ For UCITS the EU passport applied to the fund. For AIFMD compliant UCIs, it applies to the fund manager.

¹⁰ Passport available for AIFMD compliant structures

| RAIF | Securitisation Vehicle | SOPARFI | SPF |
|---|---|---|--|
| Reserved Alternative Investment Fund | Vehicles for Securitisation Transactions | Company dedicated to holding, managing and financing subsidiaries | Family wealth management company for the holding of financial assets |
| 2016 RAIF Law | 2004 Securitisation Law, as amended | 1915 Companies Law, as amended | 2007 Law on SPF |
| No | No ¹¹ | No | No |
| Unrestricted | Unrestricted | Unrestricted | Financial assets |
| Limited | No | No | No |
| Well-informed investors | Unrestricted | Unrestricted | Individuals and their intermediaries |
| Follows SIF or SICAR tax treatment (if invested in risk capital). | Corporation taxes at a combined rate of 27,08% ⁷ , but any distributions made or declared to be made to investors are tax deductible | Corporation taxes at a combined rate of 29.22%. Net worth tax at 0.5% | No corp. tax unless 5%+ of dividends received from companies not subject to the equivalent of Lux corporate tax. Annual subscription tax of 0.25% with a maximum of EUR125,000 |
| Auditor, Administrator, Central depository | Auditor | Auditor | Domiciliation agent and/or auditor |
| No limitation | No limitation | No limitation | No limitation |
| Yes, if in the form of a SICAV | Yes ⁸ | Yes ⁸ | No |
| Yes | No ¹² | Yes ¹⁰ | No |

For a more detailed comparison of fund structures, including eligible management companies and tax treatment, the reader is referred to the following publication issued by the Association of the Luxembourg Fund Industry (ALFI): Luxembourg Investment Vehicles (November 2016) <http://www.alfi.lu/sites/alfi.lu/files/ALFI-Luxembourg-Investment-Vehicles-FINAL.pdf>

⁷ Rate applicable for 2017 (see chapter 9 for more details)

⁸ Individual treaties to be checked

⁹ For UCITS the EU passport applied to the fund. For AIFMD compliant UCIs, it applies to the fund manager.

¹⁰ Passport available for AIFMD compliant structures

¹¹ If securities are not issued to the public on a continuous basis

¹² Securitization vehicles are excluded from the scope of the AIFMD, however the definition of securitization vehicles in Luxembourg law is wider as the AIFMD exclusion, so that Luxembourg securitization vehicles might in some cases be AIFs

SHARIAH COMPLIANT REAL ESTATE & PRIVATE EQUITY FUNDS

Luxembourg is one of the leading locations for cross-border private equity, venture capital, and real estate investment funds (PE/RE), appealing to investors who seek a robust platform for international investment strategies, combined with a flexible regulatory regime and efficient tax treatment.

It is estimated that 80% of private equity transactions are structured through Luxembourg investment vehicles. The Top 10 Private Equity houses in the world do business out of Luxembourg.¹³

An increasing number of fund managers, particularly from the MENA region, have created shariah compliant PE/RE investment vehicles in Luxembourg.

The initiator of a PE/RE fund benefits from the increased flexibility offered to professional fund structures with regard to capitalisation, subscriptions and redemptions, distributions, asset valuation methods, the segregation of assets in separate compartments (sub-funds) and risk management. These factors enable the scheme to be adapted to shariah requirements.

The legal forms that appear to be the most flexible for structuring PE/RE are those that allow for strong control over the management of the structure.

Asset selection & financing in sharia compliant funds

Real estate and private equity investments are by their very nature long term and illiquid investments, i.e., the assets are tied up for a long duration and the turnover of assets may be slow. The challenges related to long-term investments are more pronounced in a shariah compliant fund, as conventional debt financing is prohibited. However, the problem can be addressed by financing acquisition of assets through alternative instruments, for example by issuing sukuk relating to a suitable Islamic contract such as sukuk al-murabahah (sales based financing) or sukuk al-ijarah (lease based financing).

Leverage restrictions will need to be determined on a case-by-case basis. The payment or receipt of interest as well as debt financing are considered as usury. In practice, it is generally accepted that a shariah compliant SICAR, SIF, or RAIF may engage in leverage through the use of shariah compliant financing instruments. However, it may not

¹³ Source: Luxembourg Private Equity and Venture Capital Association (LPEA)

receive or provide conventional loans or otherwise invest in traditional interest bearing instruments.

Another solution is to open the investment to additional equity based investors using the musharakah model: partnership based financing. These Islamic financing structures can easily be replicated through existing Luxembourg structures. Therefore, the asset managers have relative flexibility in structuring the transaction in such a way that it meets the requirement of shariah rules and principles while bringing tax and operational efficiency to the structure.

“*We develop Islamic Finance structures to invest into naturally eligible assets: renewable energy power plants, solar and wind farms. Our structures involve regulated Luxembourg fund vehicles.*”

Stéphan Boudon,
CEO, AIM Luxembourg SA

REAL ESTATE: ADDITIONAL CONSIDERATIONS

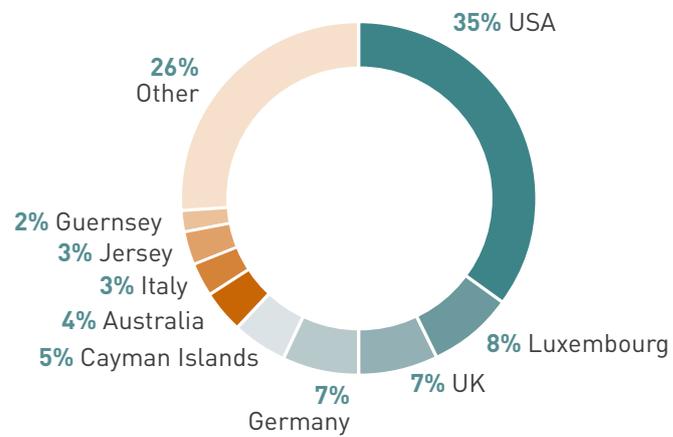
Shariah compliant real estate investments can be achieved in different ways, for example by using a mudarabah or ijarah contract, depending on the commercial objectives.

The mudarabah model mirrors the conventional structure of real estate funds from a legal perspective. For example, a mudarabah contract is similar to the relationship between a fund manager (general partner) and investors in a fund (limited partners), or a management company and its unit/share holders.

By contrast, an ijarah contract is considered to be a lease agreement. In general, the rules governing ijarah may be considered to be similar to those governing conventional leases, subject to a number of restrictions or modifications.

Fund vehicles in Luxembourg provide various options when structuring mudarabah contracts. The choice of the appropriate vehicle generally depends on the style (i.e. core, value added or opportunistic), operating model and preferred tax treatment of the fund. Continuing with the mudarabah contracts example within the sphere of regulated real estate funds, SIFs and RAIFs provide a useful degree of flexibility.

Market share of non-listed Real Estate funds invested internationally



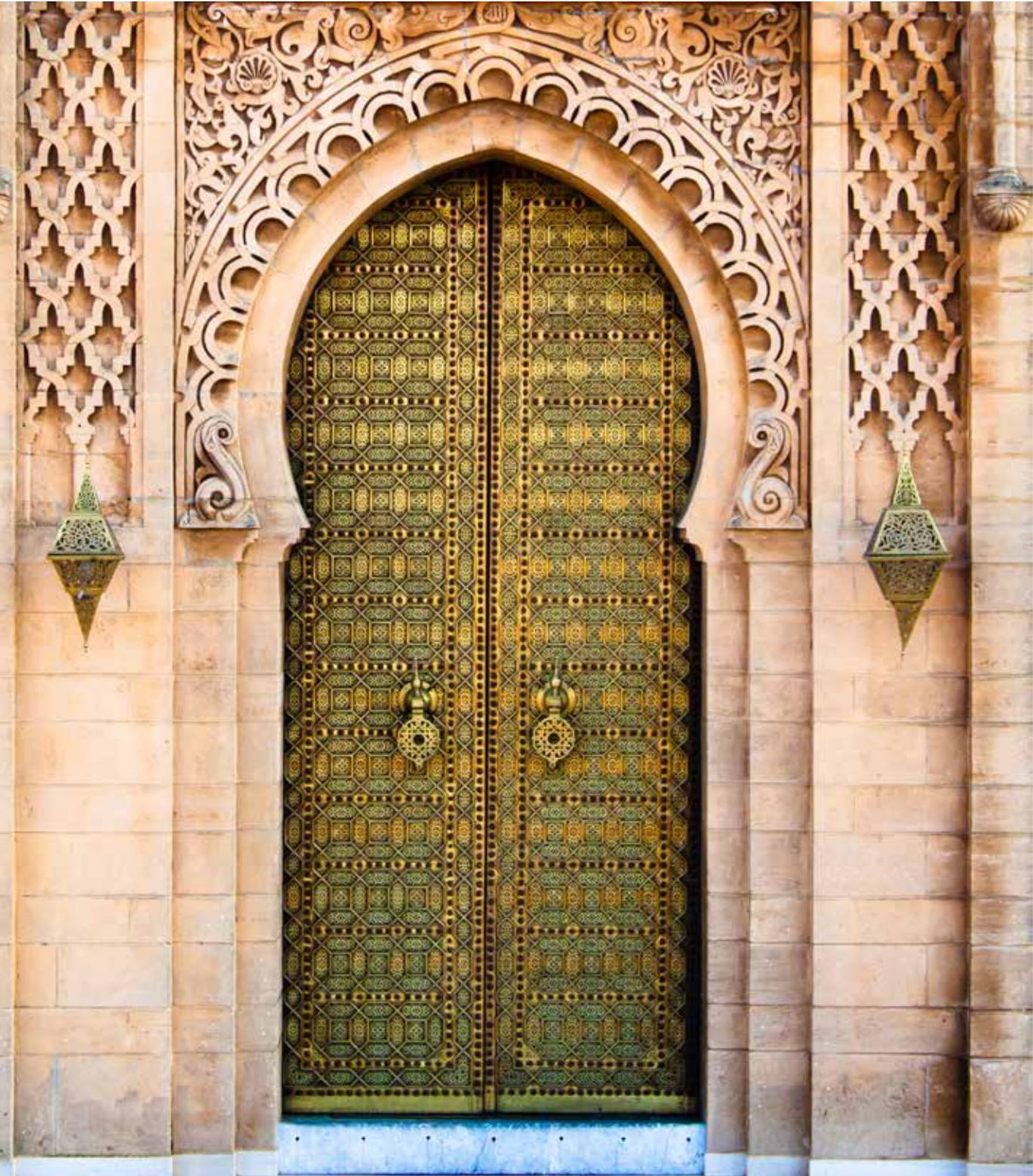
“

When, back in 2004, we had the ambition of launching one of the first shariah compliant pan-European real estate funds for our Middle Eastern clients, we could not find a better place than Luxembourg in terms of flexibility, expertise and regulations for the set-up and operational management of our innovative product. We intend to grow our Luxembourg platform with further product launches in the coming years.

”

Rachid Ouaich,
Head of European Operations, Wafra Capital Partners LP

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04

SECURITISATION VEHICLES

Luxembourg securitisation vehicles (SVs) provide a flexible and tax neutral regime for financial products. A number of shariah compliant SVs have been set up in Luxembourg, which has gained wide recognition as an international structured finance hub.

A key reason for the popularity of shariah compliant SVs is the wide range of eligible assets, which can be securitised through a Luxembourg SV. Risks relating to the holding of assets, whether movable or immovable, tangible or intangible income streams, as well as risks resulting from the obligations assumed by third parties or relating to all or part of the activities of third parties, may be securitised.

Securitisation transactions in Luxembourg over recent years have included diverse classes of assets, such as equity investments, real estate, commodities, receivables, and whole businesses. Luxembourg SVs have been used in several murabahah and ijarah structures.

Luxembourg SVs are in principle unregulated entities, that is, they are not subject to authorisation and supervision by the local regulator. However, SVs issuing securities to the public on a continuous basis¹⁴ must be approved and supervised. The acquisition of securitised risks by a Luxembourg SV has to be financed through the issuance of securities, the value or remuneration of which is linked to such risks. Luxembourg SVs may be financed through the issuance of sukuk.

An SV can be formed either as a corporation or as a co-ownership of assets without legal personality, (a securitisation fund, managed by a Luxembourg based management company). Securitisation funds constituting a co-ownership provide a closer connection to the securitised assets and easily ensure compliance with shariah principles.

In each of the above cases, the SV may be structured with multiple compartments, whereby each compartment represents a distinct part of the assets and liabilities of the SV. The SV may issue several classes of sukuk, each class being allocated to a specific compartment of the SV.

¹⁴ This is defined as 4 or more capital issues in a year.

05

WEALTH MANAGEMENT

Private banking has played a key role in driving Luxembourg's cross-border banking services. By helping mobile, entrepreneurial clients and their families pursue their international projects, Luxembourg private bankers contribute to creating wealth and welfare for current and future generations.

Most Luxembourg private banking clients have international interests and relationship managers are commonly confronted with complex family and business needs. Clients can be highly mobile, building up international networks, establishing a European footprint for their businesses, cultivating family ties in several countries, supporting philanthropic projects as social entrepreneurs or fulfilling a lifetime passion.

In consequence, many wealth managers do not limit themselves to the management of investment portfolios but go well beyond this traditional core competence. They work to reconcile long term and short term financial objectives, have expertise in structuring international real estate portfolios, companies and family holdings, manage corporate finance transactions and insurance contracts, prepare family succession plans, set up philanthropic projects or socially responsible investment portfolios, support commitments in commodity trading and finance cross-border mortgages.

Luxembourg private bankers have the advantage of being multi-lingual, multi-cultural, and familiar with international business, tax, and regulatory environments. They also have access to a wealth of complementary financial services in Luxembourg, including asset management, insurance, and reinsurance.

A number of banks have an established track record setting up tailor-made Islamic finance structures for private clients.

A REGULATED INDUSTRY

In 2012, Luxembourg adopted a legal and regulatory framework for the multi-Family Office sector, placing them alongside banks and asset managers under the supervision of the CSSF as Professionals of the Financial Centre (often referred to as 'PSF'). As a result, Multi-Family Offices comply with obligations relating notably to the transparency of its remuneration, to the combat against money laundering and terrorism financing and to confidentiality rules. Certain regulated professionals are automatically authorised to act as Family Offices.

INVESTMENT STRUCTURING

There are a series of holding vehicles that can be used to control a portfolio of shariah compliant business interests:

- The SOPARFI, a non-regulated company designed to optimise the management of holdings in a group of (typically, international) companies. It can benefit from Luxembourg's extensive double tax treaty network and the EU "Parent-Subsidiary" Directive. In addition to owning and controlling shares, a SOPARFI can perform activities related to the management of its holdings and any commercial activity connected with this. Dividends and capital gains realised in respect of qualifying subsidiaries may be exempt from corporation taxes in Luxembourg. Qualifying participations may further be exempt from net worth tax in Luxembourg.
- The family wealth management company (SPF) is an investment company that facilitates the administration and management of wealth on behalf of individuals. Its sole purpose is the acquisition, holding, management, and disposal of financial assets, to the exclusion of any commercial activity. It is exempt from corporate income tax and is only subject to an annual subscription tax of 0.25% with a maximum of EUR125,000 p.a.
- The specialised investment fund (SIF) is a regulated investment fund vehicle that can be used for any investment strategy but is reserved for use by well-informed investors.

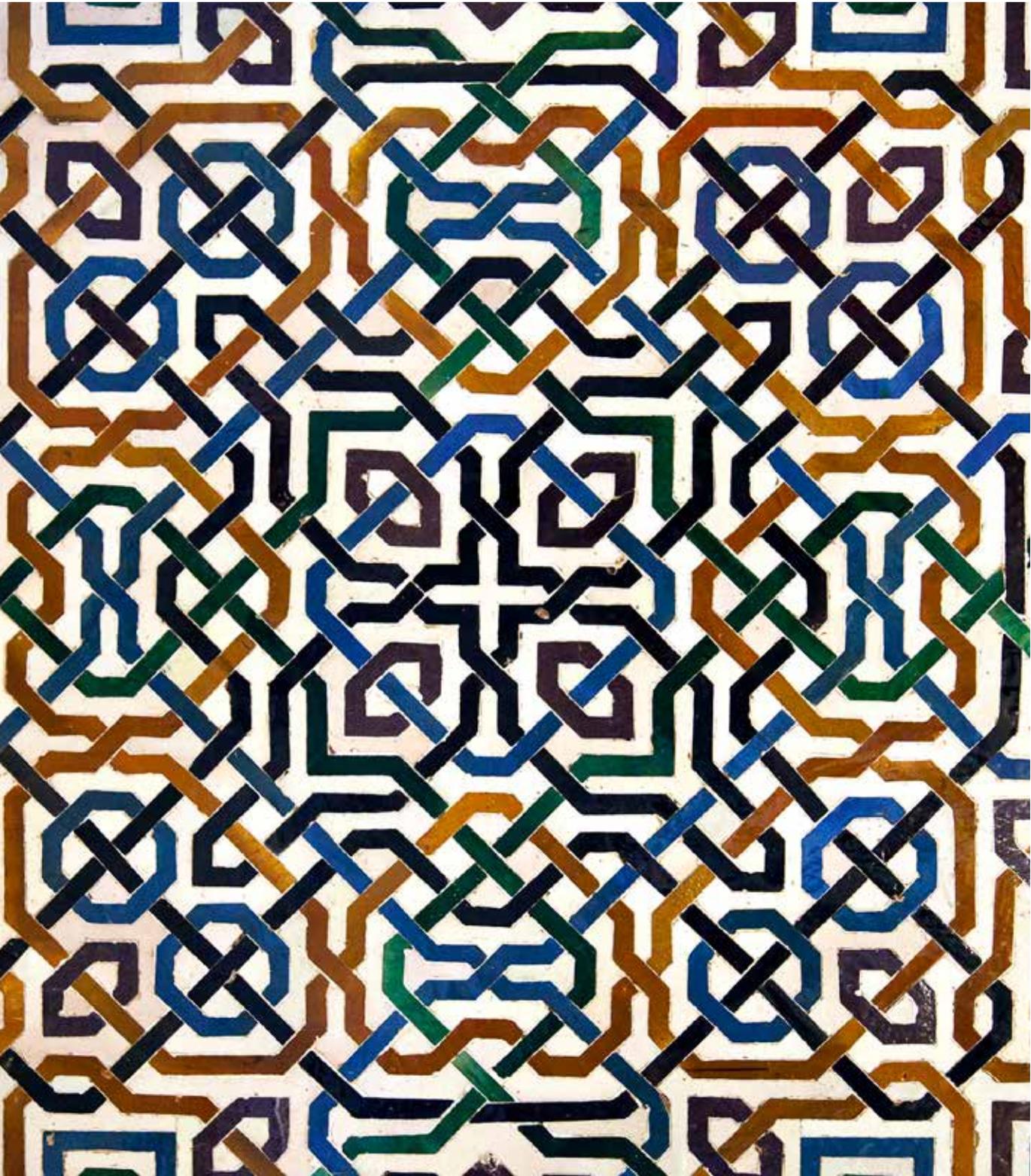
PHILANTHROPY

There is a growing trend for investors to support philanthropic causes, either during their lifetime or by means of a legacy. The legal environment in Luxembourg enables investors to realise these aims by setting up a foundation sheltered under the aegis of Fondation de Luxembourg. This foundation enables the donor to benefit from professional support at all stages, from the identification of a suitable project through to impact assessment, while relieving the donor from the burden of administration.

The objectives of a sheltered foundation must be in the "general interest", as defined in Luxembourg law, and avoid any conflict of interest. Within these parameters there is wide scope for the establishment of a foundation that complies with shariah rules.



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06

RESPONSIBLE INVESTING

FINANCIAL INCLUSION

Luxembourg is a socially engaged financial centre that is committed to the principle of financial inclusion.

Financial exclusion is the challenge whereby millions of people have no access to basic financial services on account of their poverty, financial illiteracy, geographical location, sex or religious beliefs. Many Muslims are deprived of financial services for lack of access to shariah compliant facilities.

One of the most effective tools for combatting financial exclusion is microfinance.

Luxembourg has a vibrant microfinance sector and over the last 20 years has acted as a pioneer, devoting resources to research and technical assistance, founding and hosting European Microfinance Platform and, in recent years, assisting in the development of shariah compliant microfinance.

Islamic microfinance is designed around small repeatable short-term financing instruments and group responsibility, a concept that also underlies Islamic micro-insurance. These products and services are available to microfinance institutions working among communities that cannot use traditional banking products.

Luxembourg has become a centre for the raising of capital through regulated and un-regulated investment structures. Microfinance investment vehicles (MIVs) may be structured as UCIs, SICARs, SIFs, RAIFs, or securitisation vehicles. The same structures may be used to build microfinance funds that comply with shariah principles.

Today, Luxembourg is the leading European domicile for regulated MIVs: over 61% all assets worldwide held in MIVs are held in Luxembourg domiciled funds¹⁵.

¹⁵ Microfinance funds: 10 years of research and practice, CGAP and Symbiotics, 2016

RESPONSIBLE INVESTMENT FUNDS

The notion of responsible investing has taken firm hold in Europe and many institutional investors now have strict environmental, social and corporate governance ("ESG") criteria when selecting an external fund manager.

Responsible investment can take many forms, including negative screening (the exclusion of unwanted companies), positive screening (the selection of "best in class" according to selected criteria), shareholder activism and impact investing (funds that directly support particular projects).

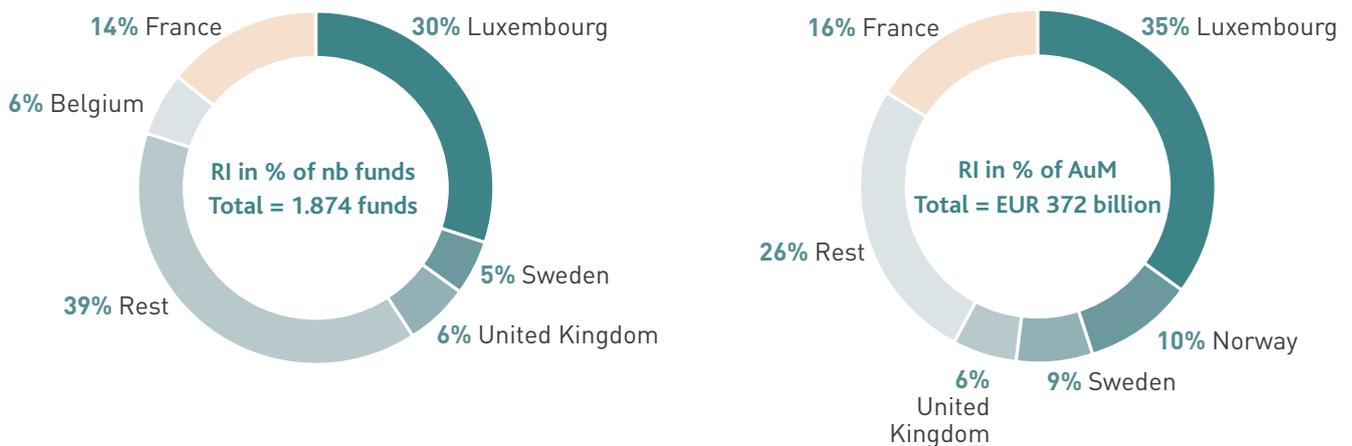
Many Islamic fund managers have gone beyond compliance with traditional shariah rules to add social and environmental screening to their investment process. Indeed, Islamic law encourages this. Certain Islamic asset management companies have signed up to the UN Principles for Responsible Investment.

30% of European funds with responsible investment profile are domiciled in the Grand Duchy including two out of every three funds in Europe with an impact strategy and 37% of all European environmental funds.

Adoption of recognised ESG standards opens the possibility of cross-selling Islamic funds to the European institutional asset management market.

The Luxembourg Finance Labelling Agency, Luxflag, grants labels to investment funds with specific ESG strategies. Luxflag labels are widely recognised in the institutional and retail fund markets. Existing labels are: Microfinance, ESG, Environment and Climate Finance.

Responsible Investments (RI) by domicile:



CASE STUDY: QUANT FUND MANAGER USING LUXEMBOURG UCITS TO DELIVER INNOVATIVE ESG PRODUCTS

Arabesque is a specialist ESG Quant fund manager that uses self-learning models and big data to assess the performance and sustainability of globally listed companies. Our strategies fuse environmental, social, and governance (ESG) performance with quantitative research and technology. In taking a systematic approach to sustainable investment, we aim to challenge the status quo and define the next generation of asset management. We value partners with the skill, commitment, and experience to work alongside us, and selected Luxembourg as a domicile for our UCITS funds based on its deep experience and user-friendly infrastructure. This is combined with a sound grasp of the specifics of delivering our products to a wide variety of groups, from institutional investors to those with moral, ethical, or religious priorities. Luxembourg's awareness of the many requirements across this wide sector, coupled with its long-standing international reputation, make it an ideal partner for us.

Dr Dominic Selwood

General Counsel & Chief Compliance Officer | Arabesque Partners

07

SUKUK

THE LUXEMBOURG STOCK EXCHANGE

Luxembourg has positioned itself as a leading centre for originating, structuring, and distributing sukuk certificates in international markets. Commercial banks are active both in primary dealerships, such as the IILM and in secondary trading. This is principally driven by demand from locally incorporated Islamic investment vehicles; however, Luxembourg also has the capacity for broader distribution into the European market.

Established in 1928, the Luxembourg Stock Exchange is the principal centre for the listing of international securities, handling listings in 55 different currencies and currently lists some 40,000 securities, predominantly bonds, on behalf of more than 3,000 issuers from 100 countries around the world.

[72 countries list their sovereign debt in Luxembourg.](#)

Luxembourg offers a full service process that includes listing, trading and reporting. It is competitive in terms of speed, transparency, value for money and post-listing services: 99% of all securities are listed in less than 2 days.

The Luxembourg Stock Exchange was the first European stock exchange to enter the sukuk market, in 2002. This pioneering issue by the state of Malaysia was followed by further sovereign and corporate sukuk from Malaysia, Saudi Arabia, the United Arab Emirates, Pakistan, Turkey, South Africa, Qatar, and other countries.

[In 2014 Luxembourg was the first sovereign state to issue a sukuk denominated in Euros.](#)

Sukuk issuers in Luxembourg have a choice of two markets:

- the Regulated Market complies with European legislation and securities may be distributed throughout the EU. This market is regulated by the CSSF. On 26 January, 2011 the CSSF issued a circular concerning the content of prospectuses relating to sukuk;
- the Euro MTF¹⁶ market enables non-European issuers who do not require a European passport to obtain a listing in a recognised financial centre in Europe. Issues on the MTF market are authorised by the Luxembourg Stock Exchange itself. This is the largest MTF market in Europe.

¹⁶ MTF: Multilateral Trading Facility

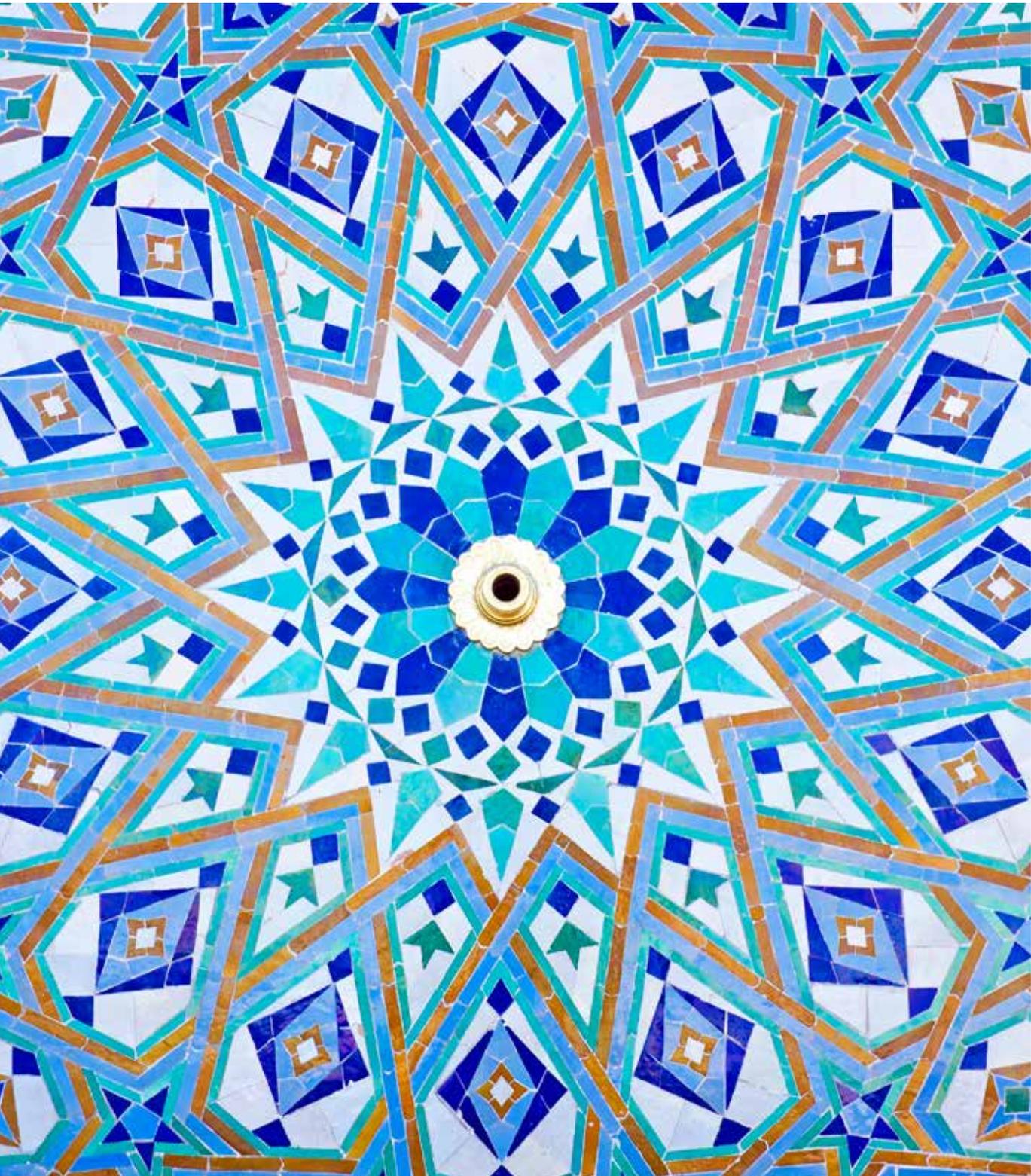
The Luxembourg Stock Exchange offers straightforward listing procedures and a competitive fee structure. All securities are registered with international clearing and settlement organisations and are automatically admitted to trading on the Universal Trading Platform (UTP) of NYSE Euronext.

THE LUXEMBOURG STOCK EXCHANGE:



- is the largest bond listing centre in Europe
- lists 40,000 securities from 100+ countries in 55 currencies
- offers a full service process that includes listing, trading and reporting
- is competitive in terms of speed, transparency, value for money and post-listing services:
 - 99% of all securities are listed in less than 2 days
- was the first to list a sukuk in Europe (2002)
- listed the first sovereign sukuk in EUR
- has attracted sukuk listing from issuers including the Islamic Development Bank, Malaysia, Qatar, Dubai, the UAE, South Africa, Pakistan, Petronas, Goldman Sachs and Emirates Airlines

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08

TAKAFUL

Luxembourg is a major international insurance centre. Around 100 insurance companies are established and supervised in the Grand Duchy.

The Grand Duchy is a popular domicile for insurance companies because it offers long term political, economic, and social stability, financial expertise and a modern legislative environment.

For the policyholders of a life insurance policy, Luxembourg offers investor protection and a level of security unique in Europe, with a system of protection known as the "triangle of security", between the regulator, the custodian and the insurance company. This ensures the legal and physical segregation of investors' assets on one hand and those of shareholders and creditors of the insurance company on the other. Moreover, policyholders have the status of the highest-ranking creditors with a priority claim on the assets.

These advantages are equally valid for companies targeting Islamic clients:

- With 98% of life assurance business emanating from cross-border sales, takaful companies can tap into existing distribution expertise to reach the Muslim customer base in Europe.
- The bulk of life assurance policies in Luxembourg are unit-linked. Similarly, takaful contracts enable customers to combine insurance cover with a return on shariah compliant investments.

Today, Luxembourg takaful products are being sold cross border into Germany and France, linked to a range of investment funds and asset management tools.

“

Luxembourg is very well positioned to advance the Islamic insurance (takaful) agenda globally. The financial centre is a leading cross-border provider of insurance, offering the necessary infrastructure and service platform to welcome takaful operators or to enable conventional insurers to sell takaful to their customers.

”

Sohail Jaffer,
Deputy CEO, Head of Business Development, FWU

09

TAX TREATMENT

INVESTMENT THROUGH FULLY TAXABLE LUXEMBOURG VEHICLES

There are no specific tax provisions in the Luxembourg income tax law with respect to Islamic Finance. However, as far as direct taxes (e.g., private and corporate income tax, municipal business tax and net worth tax) are concerned, Luxembourg tax law is generally based on an economic approach that can to a great extent accommodate Islamic finance transactions with a limited need for specific additional legislation.

The Luxembourg tax administration published two guidelines on Islamic finance, covering in particular the Luxembourg direct and indirect tax treatment of murabahah and sukuk transactions.

A Luxembourg fully taxable company is generally subject to corporate taxation at a combined rate of (for 2017) 27,08%¹⁷ and to an annual net wealth tax, which is generally levied at a rate of 0.5 on a company's total net assets up to EUR 500 million and 0,05% on total net assets of EUR 500 million or more (subject to certain minimum net worth tax requirements), but an exemption from, or reduction of this tax may be available¹⁸.

The Luxembourg tax system provides for a favourable environment for financing and holding activities:

- There is an extensive participation exemption regime, under which a Luxembourg fully taxable company may, under certain conditions, benefit from a 100% exemption on dividends and capital gains derived from qualifying Luxembourg and foreign subsidiaries.

¹⁷ This comprises corporate tax, solidarity surtax and municipal business tax for Luxembourg City. A reduction of this combined rate to 26,01% will apply as from 2018. There may be slight variations to this combined rate as the municipal tax that is levied by other communes outside Luxembourg City may be different.

¹⁸ Please also note a minimum net worth tax is applicable as from fiscal year 2016 (replacing the formerly applicable minimum income tax). Luxembourg collective entities that own qualifying holding and financing assets exceeding 90% of their total balance sheet, and whose total balance sheet exceeds EUR 350.000, are subject to a minimum net worth tax of EUR 4.815; the minimum net worth tax is EUR 525 where the total balance sheet is up to EUR 350.000. Other Luxembourg companies are subject to a progressive minimum net worth tax, depending on the total balance sheet asset value. The tax ranges from EUR 535 (for a total balance sheet up to EUR 350.000) to EUR 32.100 (for a total balance sheet exceeding EUR 20 million). For tax-consolidated Luxembourg collective entities, all entities in the group are subject to the minimum net worth tax (payable by the parent entity). However the aggregate amount due by a tax-consolidated group is capped to EUR 32.100. The minimum net worth tax is reduced by the corporate income tax due the previous year.

- Dividends (including hidden dividends) paid by a Luxembourg company are generally subject to a 15% withholding tax, which may be exempt under the Luxembourg dividend participation exemption or be reduced under an applicable tax treaty.
- Interest expenses are generally deductible and are not subject to Luxembourg withholding tax.
- The distribution of liquidation proceeds by a Luxembourg company is generally not subject to withholding taxes in Luxembourg.
- Capital gains derived by non-resident shareholders on the disposal of shares in a Luxembourg company are not subject to Luxembourg tax unless the shareholder has held a substantial stake of at least 10% and the disposal (or the liquidation) takes place within six months of the acquisition of the stake. Where the shareholder benefits from double tax treaty protection, Luxembourg will in general not be entitled to tax this gain.

TAX TREATMENT OF THE MUHARABAH CONTRACT

In accordance with the guidelines issued on 12 January 2010 by the Luxembourg direct tax administration (ACD), the murabahah profit (i.e., the consideration for the deferred payment) realised by a Luxembourg company may, subject to certain conditions to be fulfilled at the level of the transaction documents, be taxed on a linear basis over the period of the murabahah transaction, regardless of the actual payment dates of the murabahah profit. This is important as the Luxembourg vehicle would otherwise immediately be taxed on the difference between the acquisition price of the murabahah asset and its marked-up sale price under the murabahah contract, while the actual payments would be made on a deferred basis.

Furthermore, the Luxembourg indirect tax administration (AED) clarified in its guidelines dated 17 June 2010 that a murabahah contract on a real estate asset located in Luxembourg may, subject to certain conditions, only be subject to a reduced rate of real estate transfer tax. The guidelines confirm that such real estate transfer taxes are not levied on the murabahah profit (i.e., the consideration for the deferred payment).

As far as VAT aspects are concerned, the guidelines of the indirect tax administration clarify that a Luxembourg vehicle entering into murabahah transactions should be considered as a VAT taxpayer.

TAX TREATMENT OF THE SUKUK

The guidelines of the Luxembourg direct tax administration clarify that the tax treatment of sukuk is identical to the tax treatment of debt instruments in conventional finance (although the income is linked to the performance of the underlying asset) and the remuneration of sukuk is considered as interest payment.

Accordingly, payments made under a sukuk transaction should generally be deductible, provided such expenses are incurred in the corporate interest of the enterprise of the sukuk issuer. Furthermore, no withholding tax should apply on payments to foreign holders of sukuk issued by a Luxembourg issuer.

In an international taxation context, payments of returns under a sukuk transaction should qualify under the interest article of the tax treaties concluded in accordance with the OECD Model Convention.

TAXATION OF INVESTMENT FUNDS

Luxembourg is an attractive jurisdiction for setting up tax efficient fund structures, thanks to its favourable rules on the taxation of investment funds and to its extensive tax treaty network. In this respect, some of the tax treaties concluded by Luxembourg extend their benefits to Luxembourg based undertakings for collective investment (UCIs).

Specific beneficial tax regimes have been introduced in Luxembourg for the fund industry. For example, UCIs and SIFs (and RAIF modelled as a SIF) benefit from an exemption from Luxembourg corporate income tax, municipal business tax and net wealth tax. However, an annual subscription tax (taxe d'abonnement) ranging between 0.01% and 0.05%, assessed on the total net assets of the undertaking, applies depending on the form adopted. Under certain circumstances a full exemption may apply.

Payments made by a UCI or a SIF are in principle not subject to withholding tax in Luxembourg. Capital gains on the disposal or redemption of UCI and SIF shares held by a non-resident investor are generally not subject to income tax in Luxembourg.

VENTURE CAPITAL: THE SICAR REGIME

A SICAR (or a RAIF modelled on a SICAR) may exist in the form of a fiscally opaque limited corporation or in the form of a tax transparent limited partnership (SCS).

An opaque SICAR is subject to corporate income tax on its worldwide profits and should thus qualify as a tax resident for Luxembourg tax treaties. It benefits from an exemption on income generated by transferable securities invested in venture capital and private equity investments and capital gains on the disposal of such securities. Temporarily idle cash pending investment will equally benefit from the exemption, provided the cash is invested in venture capital and/or private equity projects within a 12 month period. All other income is fully subject to Luxembourg corporate income tax. A SICAR is exempt from the annual 0.5% net wealth tax.

THE SECURITISATION VEHICLE

A securitisation vehicle (SV) organised as a corporation is fully subject to Luxembourg corporate tax. However, distributions made or committed to be made to its investors (such as dividends or other income) are considered as deductible for corporate tax purposes. The SV is exempt from the annual net wealth tax. Payment of dividends or other income is not subject to withholding tax.

A securitisation fund is transparent for tax purposes and will not be subject to corporate or net worth tax in Luxembourg.

Distribution of profits is not subject to Luxembourg withholding tax. Due to the lack of legal personality of the securitisation fund, investors may, where applicable, claim treaty benefits from the jurisdictions in which the securitised assets are located.

EXTENSIVE TAX TREATY NETWORK

As at January 2017 Luxembourg has 79 double tax treaties in force. These include tax treaties with Malaysia, Indonesia, Saudi Arabia, Bahrain, the United Arab Emirates, Qatar, Tunisia and Morocco. An additional 18 are in negotiation or pending signature or ratification; these include tax treaties with Kuwait, Egypt, Lebanon and Oman.

VALUE ADDED TAX (VAT)

Neither the EU VAT Directive, nor the Luxembourg VAT law provide for specific rules regarding Islamic finance. General VAT principles are thus applicable.

Regarding UCIs, SIFs (and RAIF modelled as a SIF), SICAR (or a RAIF modelled as a RAIF), and securitisation vehicles, the Luxembourg VAT law provides a favourable and flexible environment. Indeed, most services supplied in relation to the management of these funds and vehicles can benefit from VAT exemption.

The VAT exemption mainly covers administrative services and portfolio management services, including portfolio advisory services and risk management services. Services that do not qualify for VAT exemption nevertheless benefit from the lowest VAT rate applicable in the EU (the standard VAT rate in Luxembourg is 17%, to be compared with an average of 21.5% in the EU). Other vehicles, e.g. a "normal" fully taxable company, may also be used. In this case, the VAT exemption for management services mentioned above will not be applicable.

Usually, these two categories of vehicles (i.e. those eligible to receive VAT exempt management services and those not eligible) perform exempt activities that do not allow input VAT recovery and have only limited VAT compliance obligations in Luxembourg (simplified annual VAT return). However, these vehicles may have the right to recover input VAT when they perform taxable transactions such as transactions on real estate or commodities. In this case, these vehicle might be faced with more extensive VAT obligations (periodical VAT returns, regular annual VAT return, issuing of invoices, EC sales listing, etc.).

Taxable transactions performed by these vehicles will not necessarily be liable to Luxembourg VAT. For instance, should these transactions be performed outside Luxembourg, they will, in most cases, be outside the territorial scope of Luxembourg VAT. However, even if the transaction itself is outside the scope of Luxembourg VAT, it does

not mean that VAT should be ignored. For example, a *murabahah* transaction on foreign real estate properties will not be in the scope of Luxembourg VAT but in the scope of VAT, if any, of the country where the property is located. Moreover, if this transaction is made by a Luxembourg company, this company may have some VAT compliance obligations in Luxembourg. An analysis of the underlying transactions on a case by case basis is necessary.

Without analysing all details of the transactions, the following could be said of *murabahah* and *sukuk*:

- *Murabahah*: If they relate to commodities, these transactions would most likely be defined as transactions relating to goods and therefore be liable to VAT combined with a facility to defer payment. However, unallocated metals could be treated as a supply of services and not as a supply goods. It is also worth noting the existence of a specific regime for investment gold in Luxembourg.
- *Sukuk*: in general, these transactions could be regarded as transactions related to securities and therefore may benefit from a VAT exemption; however, due to the diversity of underlying contracts, a case by case analysis is necessary.

10

GLOSSARY

GLOSSARY

2004 Securitisation Law: The Law of 22 March 2004 on securitisation, as amended

2004 SICAR Law: The Law of 15 June 2004 on the investment company in risk capital, as amended

2007 SIF Law: The Law of 13 February 2007 on specialised investment funds, as amended

2007 SPF Law: The Law of 11 May 2007 on the family wealth management company, as amended

2010 UCI Law: Law of 17 December 2010 on undertakings for collective investment, as amended

2013 AIFM Law: The Law of 12 July 2013 relating to Alternative Investment Fund Managers, as amended

ACD: Administration des Contributions directes

AED: Administration de l'Enregistrement et des Domaines

CAA: Commissariat aux Assurances, the Luxembourg insurance supervisory authority

CLP: Common limited partnership (introduced by the 2013 AIFM Law)

Companies Law: Law of 10 August 1915 on commercial companies, as amended

CSSF: Commission de surveillance du secteur financier, the Luxembourg financial supervisory authority

FCP: Fonds commun de placement, an unincorporated co-ownership of assets

iJARAH: Lease based financing, hire-purchase

MTF: Multilateral trading facility

MUDARABAH: Agency partnership: one partner provides capital and the other effort, typically used for asset management accounts

MURABAHAH: Cost plus financing, typically used for house purchase schemes

MUSHARAKAH: Partnership whereby each partner contributes capital, typically used for private equity

PARENT-SUBSIDIARY DIRECTORY: EU Directive of 7 January 2012

RAIF: Reserved alternative investment fund

2016 RAIF Law: Law of 14 July 2016 on reserved alternative investment funds, as amended

Registered AIFM: AIFM under the thresholds of the 2013 AIFM law with a lighter regulatory regime

SA: Société anonyme (public limited company)

Sàrl: Société à responsabilité limitée (private limited company)

SCA: Société en commandite par actions (partnership limited by shares)

SCS: Société en commandite simple (limited partnership)

SCSp: Société en commandite spéciale (special limited partnership)

SICAR: Société d'investissement en capital à risque (investment company in risk capital)

SICAV: Société d'investissement à capital variable (investment company with variable capital)

SIF: Specialised investment fund

SLP: Special limited partnership (introduced by the 2013 AIFM Law)

SOPARFI: Société de participations financiers

SPF: Société de gestion de patrimoine familial (family wealth management company)

UCI: Undertaking for collective investment

UCITS: Undertaking for collective investment in transferable securities: these funds qualify for an EU passport

VAT: Value added tax

11

USEFUL CONTACTS

Ministry of Financewww.mf.public.lu**Luxembourg for Finance**www.luxembourgforfinance.lu**Luxembourg Financial Sector
Regulator (CSSF)**www.cssf.lu**Association of the Luxembourg
Fund Industry (ALFI)**www.alfi.lu**The Luxembourg Bankers'
Association (ABBL)**www.abbl.lu**Insurance Commission**www.commassu.lu**Insurance Companies Association**www.aca.lu**Luxembourg Finance Labelling
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Luxembourg for Finance (LFF) is the Agency for the Development of the Financial Centre. It is a public-private partnership between the Luxembourg Government and the Luxembourg Financial Industry Federation (PROFIL). Founded in 2008, its objective is to develop Luxembourg's financial services industry and identify new business opportunities.

LFF connects international investors to the range of financial services provided in Luxembourg, such as investment funds, wealth management, capital market operations or advisory services. In addition to being the first port of call for foreign journalists, LFF cooperates with the various professional associations and monitors global trends in finance, providing the necessary material on products and services available in Luxembourg. Furthermore, LFF manages multiple communication channels, organises seminars in international business locations, and takes part in selected world-class trade fairs and congresses.

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