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Beyond The Classical Tax Incentives, Morocco Should Offer an Attractive Islamic Finance Package

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According to a McKinsey's study on Islamic Finance, Middle East investors' wealth is estimated at 1,500 billion U.S. Dollars. Almost 30 percent of these investors opt exclusively for Islamic Finance products and 60 percent of these investors favor *Sharia* compliant financing, which demonstrates performance equivalent to that of "conventional" financing.

This statement emphasizes the importance of the growth of Islamic Finance within the Middle East region.

Sharia compliant products should always satisfy the following fundamental pillars:

- prohibition of any kind of interest payments *(Riba);*
- no remuneration without risk: the *Sharia* forbids any separation between risks and rewards;
- prohibition of any speculation (*Gharar*); derivatives and classical insurance are not allowed;
- any transaction should concern assets considered as *Sharia* compliant (*Halal*). Transactions dealing with unacceptable assets such as alcohol, prostitution, pork, and gambling-related items are not allowed.

Morocco has an annual growth of above 5 percent. This growth generates massive investment flows. Tourism, real estate and projects are the three main assets attracting Middle East investors, such as *Emaar*, *Sama Dubai*, *Kingdom Hotel Investments* and many others. Therefore, to be competitive within North Africa, it is necessary to offer a strong and complete range of Islamic Finance tools.

Thus, in October 2007, the Moroccan central bank, Bank Al Maghrib (BAM), authorized Moroccan banks to market Islamic finance products. Nevertheless, for the time being, the authorization is limited to three products:

- an "*ijara*", the *Sharia*-approved equivalent of a conventional lease. An *ijara* is a contract under which the bank finances equipment, construction, and so on in exchange for a rental payment together with (or without) an agreement by the bank or the owner that the ownership will be transferred to the lessee at the end of the lease period;
- a "*musharakah*", the *Sharia*-approved equivalent of a joint ownership arrangement between a financial institution and another party to share profits and losses. The bank provides funds, as does the business, and profits are distributed in pre-agreed ratios. Losses are allocated in proportion to the allocation of capital;
- a "*murabaha*", a sale with deferred payment terms. In a *murabaha,* clients ask the bank to purchase an item for them at a defined price, which includes a profit. The purchase is repaid in installments, and the ownership passes to the client, but the bank holds the collateral.

Since 2007 year end, Moroccan banks have started to commercialize these alternative products. However, as of today, only two banks seem active, specifically in the retail banking sector.

Another *Sharia*-approved product, *Sukuk* bonds*,* are not yet mentioned in the BAM recommendations, but will be developed. As stated during the First International Forum on Islamic Finance held in Paris in December 2007, *Sukuk* bonds are among the most frequently used Islamic finance instruments. For example, the London Stock Exchange listed US$10 billion worth of 14 *Sukuk* bonds in the last 18 months; on February 13, 2008, the Bahrain Stock Exchange listed a US$1 billion *Sukuk* bond for a Saudi real estate developer; and the Qatari REIT *Alaqaria* last week announced its intention to finance its growth through a US$825 million issuance of *Sukuk* bonds.

Although the tax regime is essential to the attractiveness of these products, the Moroccan tax administration has not yet commented on these alternative products.

Examples of tax issues:

- in both *Ijara* and *Mourabaha* schemes, the transfer of assets (firstly acquired by the bank and then transferred when the call option is exercised) leads to the payment of registration duties and notary fees;
- in a *Mourabaha* scheme, the banker's alternative return could be considered as non-deductible from the borrower's taxable base as the payment is not an interest;
- the proceeds paid to the *Sukuk* bonds holder would not allow the issuer to deduct these proceeds from his taxable results.

To conclude, only a complete reform of the tax legislation in Morocco could correct these different obstacles. This would depend on the Moroccan government's desire to develop these financial tools. For example, London City has already answered the question on how to attract massive Middle East investment and liquidities: a tax reform offered a very attractive package of alternative products to Gulf investors.

Let's assume that Morocco will follow the same path and will become the North African *El Dorado* to the Gulf's investors. Meanwhile, tax advisers offer ideas on how to best satisfy the most hurried investors.

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