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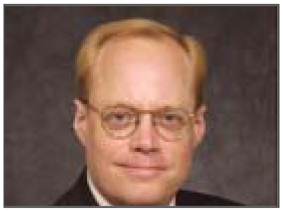

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Islamic Finance Helps Businesses, Developers, Investors Worldwide

Traditionalists pondering the Middle East may think of Lawrence of Arabia. Less traditionally, there's the world's most expensive Christmas tree, valued at over $11 million. Dubai recently lost its claim of having the world's most expensive cocktail, but it still has the world's most expensive bottle of red wine for sale at $195,000. Prince Al-Waleed even got bored with his $500 million dollar A380.

The Middle East is flush with cash, and wherever there is cash, people want to invest it to make more. Investments usually mean taxes, especially when the money travels to developed countries. The wealthy in the Middle East may not be content with the most expensive car in the world (crafted from over 1000 pounds of gold) or the world's tallest building.

Dubai Mosque (Photo credit: Florian Martys)

They also want investments–preferably Islamic investments that combine a nice return with an appropriate degree of religious compliance–to rake in even more money. The line between Islamic finance and traditional finance is blurring. Some may argue that Islamic finance is a ruse, or a denial of reality like an indoor ski slope in 120 degree weather.

Maybe, but big dollars are involved and the West wants some of them. Islamic financial assets totaled more than $1.3 trillion dollars in 2011 and are thought to now be in the range of $1.8 trillion. Dow Jones created an index to track Islamic investments. With wealth from the Middle East and Southeast Asia rapidly spreading to other countries around the globe, tax authorities worldwide are trying to get their cut.

Charging of interest is strictly banned for Islamic investments. But if you can't charge interest under s*hari'a* law, you can surely take a piece of the equity that might approximate the foregone interest and produce nearly identical risk profiles and returns.

Many countries in Europe would like to take advantage of this huge influx in cash, but there is a vexing problem with the taxation of these investments. How should one tax the unique structure of Islamic financial transactions? The U.K. is leading this discussion and has issued sovereign debt in an Islamic format.

Prime Minister Cameron's government has recognized that even if it isn't ***called*** interest, it should be taxed like interest, regardless of what an investor terms the money being paid. ("If it looks like a duck and quacks like a duck....") This doesn't mean that Islamic investments are subject to different laws or that the rights and remedies of the parties will be radically different from the usual non-Islamic deal.

Of course, taxes are already a somewhat artificial concept. The tax laws are used to hybrids and synthetics, and there are broad tax doctrines such as substance over form and economic substance. Thus, tax systems can doubtless adapt.

Indeed, many countries are already rushing to make their tax laws consistent with these investments. What market could pass up on an investor with ready cash ripe for placement? Hungry economies, developers and governments from Australia to Hong Kong to Ireland have already hopped on the bandwagon.

We should expect to see further policy adjustments of this sort as Islamic finance becomes less a curiosity and more just another mousetrap for use anywhere in the world.

Special thanks to Rafi W. Mottahedeh, who contributed to this post. You can reach me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.