

Tax Regimes and Incentive Policies in Sukuk Markets: A Comparative Study of Leading Islamic Finance Jurisdictions

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Abstract

This study aims to analyse the role of tax regimes and incentive mechanisms in the development of the sukuk market, one of the main instruments of Islamic finance. The study analyses Malaysia, Saudi Arabia, Indonesia and the United Arab Emirates, which are among the prominent examples of sukuk markets on a global scale. In this study covering the period 2001-2021, the tax policies, financial incentives provided for investors and issuers, and regulatory frameworks in these countries are analysed comparatively. Structural differences between countries were revealed through tables created with the support of the literature, and the relationship between the level of development of the sukuk market and tax regulations was evaluated.

The findings show that tax advantages and special regulations play a critical role in the deepening of the sukuk market. As seen especially in the examples of Malaysia and the UAE, practices preventing double taxation, stamp duty exemptions and issuance facilities have supported the growth of the sukuk market. On the other hand, limited or inconsistent regulations in some countries stood out as a restrictive factor in the development of markets. The study reveals that tax regimes should be in line with Islamic finance principles, transparent and incentivising in order to ensure stable growth in the sukuk market.

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Introduction

The evolution of financial systems has not only been limited to traditional instruments, but has also diversified to include ethical, religious and structural alternatives. Islamic finance, one of these alternatives, has become a financial model that attracts attention both in Muslim countries and in global financial markets with its structure based on interest-free banking principles. Sukuk (Islamic bonds), one of the main instruments of Islamic finance, is among the capital market products that comply with Sharia law and is positioned as an important instrument especially in terms of infrastructure investments, public financing and long-term borrowing needs of the private sector.

The sustainable development of the sukuk market is directly dependent not only on the principles of religious compliance, but also on structural elements such as the regulatory framework, tax policies and state-sponsored incentive systems. In this context, the tax regime adopted by countries for the sukuk market plays a critical role in increasing or limiting the interest of investors. In particular, factors such as double taxation, stamp tax, VAT exemptions are among the main factors affecting the cost of sukuk issuances. In addition, various incentive mechanisms implemented by governments determine the attractiveness of the sukuk market for both local and international investors.

In this study, four countries that stand out in terms of the structural and regulatory foundations of the sukuk market - Malaysia, Saudi Arabia, Indonesia and the United Arab Emirates - were selected as the sample. These countries are in an important position on a global scale in terms of the development of the Islamic finance ecosystem and the volume of sukuk issuances. The aim of the study is to comparatively analyse the tax regulations and incentive policies implemented in these countries between 2001 and 2021 and to reveal their contribution to the development process of sukuk markets. With the help of tables created in line with the information obtained from the literature, similarities and differences between countries were systematically evaluated.

Accordingly, the study aims to provide implications for policy makers, regulatory authorities and investors by analysing the role of tax and incentive policies in the development of sukuk markets at both theoretical and practical levels. It also aims to fill an important gap in the literature by contributing to the understanding of the structural reforms necessary for the sustainable growth of Islamic finance.

1. Tax Aspects of Sukuk Implementation

There are many factors affecting the demand for sukuk as a financial instrument. Tax regulations are one of these factors. Tax regulations regarding sukuk, which has not yet completed its development phase and is considered a new instrument, is also in the development phase. With the spread of sukuk, Muslim countries as well as non-Muslim countries have started to integrate legal regulations regarding the taxation of this financial instrument (Mohammed, 2014). However, the unique structure and functioning of sukuk brings along some debates on taxation. At the heart of these debates is the issue that the functioning of sukuk is different from traditional bonds. This situation necessitates that sukuk should be subjected to a number of treatments different from traditional bonds in terms of tax regulations for the development and spread of sukuk (Ulusoy & Ela, 2018: 190).

It is necessary to examine the taxation of sukuk in terms of two segments: the holder and the issuer of this financial investment. In this context, one of the two aspects to be considered in taxation is the taxation of the gains related to the sukuk in the hands of the holder; the other is the issue of whether the payments made to the investor in terms of the issuer will be deducted from the tax (Franco & Sallustio, 2017: 2).

The most important issue in the taxation of sukuk-based earnings is whether the difference between traditional bonds and sukuk is taken into account. Sukuk requires the establishment of a special purpose entity and involves multiple transfers since it is based on the underlying asset. Tax systems that ignore this functioning give rise to tax liabilities depending on the transfer of ownership at each transfer stage of the underlying asset. This situation brings about different taxes (withholding, capital gains, VAT, corporate, stamp, wealth tax, etc.) at each stage of the process (Ulusoy & Ela, 2018: 190). Although this specific structure of sukuk differs from traditional bonds, it is still treated as bonds in many countries (Financial Services Agency, 2019). This situation weakens the ability of sukuk to compete with traditional bonds and puts it in a disadvantageous position. In this respect, in order for sukuk to compete with traditional bonds, they should not be considered in the same position in terms of taxation and in this context, competitiveness equality should be ensured. In the event that tax neutrality is ensured, the orientation of potential issuers and investors towards sukuk will increase (COMCEC, 2019: 2).

One of the problems encountered in establishing the necessary legal framework for Sukuk is the different treatment between profit and interest. In terms of taxation, interest and dividend payments have different

consequences. Because in traditional bonds, interest payments offered by issuers to buyers are deducted from the taxable income of the party paying the interest. However, the amount paid to the buyer in sukuk is not interest, but dividend, i.e. profit share. In this context, the payment made, i.e. profit, will be subject to tax (Franco & Sallustio, 2017: 2).

As a result, in order to provide market players with more access to the sukuk market, to expand the volume of sukuk, to attract domestic and foreign issuers to the sukuk market, some regulations such as separating traditional bonds from sukuk, establishing a legal framework specific to this financing instrument, granting positive rights in terms of exceptions and exemptions, and granting the right to expense deduction in dividend payments will be important steps to support sukuk to be a competitive and reliable financing source (COMCEC, 2019: 3040).

1.1. Financial Ecosystem and Taxation Regime for Sukuk Market

The Islamic finance market has entered a very rapid growth trend on a global scale and this trend has provided an important financing opportunity for almost every country. In order to seize the opportunities for the development of Islamic finance markets at the global level, many countries have implemented incentive policies for the development of Islamic instruments. At this point, sukuk is one of the most prominent Islamic finance products. This instrument, which started to take place in the capital market in the 1970s, has shown an impressive growth performance from the relevant period to the present day (Abdelrahman, 2019: 2). It is possible to evaluate the fact that the growth performance is more prominent in countries with a predominantly Muslim population as an extension of Islamic sensitivities. However, it would not be correct to evaluate the development in the sukuk market only on this scale. The accuracy of this discourse will be understood when developments in the sukuk market in countries where Muslim populations are not concentrated, such as Luxembourg, the UK and the USA, are taken into consideration. Therefore, sukuk has become an instrument that has succeeded in becoming an alternative financing product for traditional investors. However, when its share in the financial system is analysed, it is seen that it is not yet in a position to compete with traditional financing instruments. The main reasons for this situation are that it is a relatively new instrument, requires a different legal and regulatory framework from conventional financial instruments due to its unique structure, and has a complex nature in terms of taxation. It is known that even the countries at the forefront of the sukuk market have some deficiencies in the above-mentioned areas. Therefore, for the development of the sukuk market and its

competition with conventional capital instruments, the financial ecosystem and taxation regime should include supportive regulations.

In order for the sukuk market to grow, the basic prerequisites for the securities market must first be established. Even if domestic Islamic financial institutions exist, it is not possible for sukuk markets to grow unless there is a favourable environment to support structured instruments such as sukuk. At this point, it is necessary to establish a securitisation process in the context of converting illiquid assets into securities that can be traded. In this context, supportive securities regulations are required, including offering and approval processes that will ensure the effective issuance of sukuk (Kusuma & Silva, 2014:10).

In order for the sukuk market to continue its development, it is important that the taxation regime is supportive as well as the legal and regulatory framework, which are the basic building blocks of the financial ecosystem (COMCEC, 2018). A supportive or non-prohibitive taxation framework will allow sukuk to compete with traditional instruments (Kusuma & Silva, 2014:10). The unique structure of sukuk necessitates a supportive taxation regime. This is because Islamic bonds involve real assets and transfers of these assets rather than operating on an interest basis. Legal structures that are not designed to address this will tax every transfer and this will create an unsustainable situation for those involved in the sukuk transaction. The main reason for this is that the ownership of the asset covered by the sukuk requires repeated transfers from one party to another. This situation will cause additional taxes and additional costs each time. Therefore, in the absence of special provisions for sukuk, a disadvantageous structure will emerge. A typical example at this point is an *icara* sukuk structure. The first transfer of asset ownership may trigger capital gains, sales tax, retention tax and stamp duty. Each transfer of ownership, which will occur at least twice, will trigger the aforementioned taxes, unlike traditional bonds, which are taxed only on capital gains (Mohammed, 2014).

When it comes to tax regulations, one of the most important elements required for sukuk is to ensure an equivalence between sukuk and traditional bond taxation. If the tax system favours one of them, an unfair market will be created where the development of the disadvantaged financial instrument is impossible. Most tax systems around the world are structured to handle conventional bonds. However, as the success of sukuk and Islamic finance has become more evident, more countries have started to integrate sukuk into their tax laws. Western countries, not wanting to miss the investment opportunities offered by the vast resources concentrated in Muslim regions,

have started to update their tax systems and financial regulations to include Shariah-compliant financial instruments (Mohammed, 2014). At this point, it is seen that some countries include sukuk within the existing tax framework, while some countries proactively create new rules for sukuk (Kusuma & Silva, 2014:20).

2. Methodology

This study was conducted using a comparative qualitative research method to analyse the impact of tax regimes and government incentives on the development of sukuk markets, one of the important instruments of Islamic finance. The sample of the study is limited to Malaysia, Saudi Arabia, Indonesia and the United Arab Emirates, four countries where sukuk markets are strong both historically and in terms of volume. These countries constitute an appropriate sample for the purpose of the study due to both the amount of sukuk issuance and the development of Islamic finance infrastructures at the institutional level.

Within the scope of the study, the twenty-year period between 2001-2021 was examined; this periodic preference is important in terms of covering the time period when sukuk markets started to institutionalise and tax and incentive regulations developed in the relevant countries. In the research, the legislation of the official regulatory bodies, central banks, tax authorities and capital market regulations of the relevant countries were scanned in detail and comparative tables were created. In addition, international organisations (IFSB, IMF, World Bank), country-based reports, academic articles and sectoral analyses were used as literature support.

The data were collected through document analysis and then systematically categorised through content analysis. The information obtained was compared in terms of tax policies (e.g. income tax exemptions, stamp tax exemptions, double taxation agreements) and direct/indirect incentive mechanisms (e.g. public issuance supports, legal facilities, sharia compliance mechanisms) applied by countries towards sukuk markets and presented in tables. Thus, the similarities, differences and structural impact areas between countries are clearly demonstrated.

Although the study does not include a quantitative econometric analysis, it aims to evaluate the effects of regulatory and fiscal policies on the development of sukuk markets from a qualitative and comparative perspective. Thanks to this approach, countries' practices that support sukuk markets have been made more visible and future policy recommendations have been developed.

3. Findings

3.1. Malaysia

Malaysia is one of the most exemplary countries in the field of Islamic finance. Although the country has approximately 2 per cent of the global Muslim population, it has more than 20 per cent of global Islamic financial assets (WB, 2020:19). It is possible to see Malaysia's leadership in many studies on the Islamic finance sector. For example, Malaysia ranks first in the Islamic Finance Development Indicator (IFDI), which measures the development of Islamic finance in 136 countries (ICD, 2022: 12), and second after Saudi Arabia in the Islamic Finance Country Index (IFCI), which was developed by Edbiz Consulting in 2011 and examines the role of countries according to Islamic banking and financing status (Cambridge GIFR, 2022: 56). Another main indicator of Malaysia's success in Islamic finance is its global dominance in the field of sukuk. As a matter of fact, the country has 55% of global sukuk issuance as of 2021 (IFM, 2021: 80).

Table 1: Sukuk Potential in Malaysia (2001-2021)

Evaluation Criteria	Indicators Regarding Sukuk Issuance			Worldwide Ranking			
Export Type	Number of Issued	Issuance Amount	Total Share in (%)	2001 2021	2019	2020	2021
Short Term Global Sukuk Issuance	4.066	436,423	78.46	1	1	1	1
International Sukuk Issuance	214	102,053	26.73	1	1	1	1
Domestic Sukuk Issuance	8,361	775,357	63.07	1	1	1	1
Total Sukuk Issuance	8,575	877,410	54.46	1	1	1	1

Source: IFM (2021). Sukuk Report 2021: 53-80. Retrieved from <https://www.iifm.net/sukuk-reports> on April 28, 2028.

As can be seen in Table 1, Malaysia is the leading country in the sukuk market on a global scale. Although the share of the country, which was the sole representative of this market in the early 2000s, has declined as a result of the activities carried out by other countries in this field, it is still the country with the highest sukuk issuance as of today. When the data in Table 1 are analysed, it is seen that the country ranks first in all relevant indicators. When the last three-year periods are evaluated separately, it is seen that Malaysia maintains its leadership in terms of the acceleration in the recent period as well as in the long term. The total value of more than

8,500 issuances in the relevant period exceeded USD 877 million. In 2021, a total of 775 sukuk issues worth approximately USD 77 million were issued (IIFM, 2022: 84).

Looking at the distribution of sukuk issuances according to sukuk types, it is seen that the most popular and accepted sukuk structures are commodity murabahah (tawarruq) and mudaraba types (Lexology, 2022). In 2020, murabahah ranked first with a share of 61.05% in the distribution of sukuk issued according to their types. Following Murahaba, the highest share is Hybrid sukuk with 23.66%. Mudaraba ranked third with 10.52%. As of the same period, the sukuk types with the lowest share are ijara sukuk with 0.18%, vakala sukuk with 0.56% and musharaka sukuk with 4.3%, respectively (IIFM, 2021:185.)

One of the points to be mentioned regarding the sukuk market in Malaysia is its leadership in sustainable sukuk issuance. As a matter of fact, the first green sukuk in the world was launched in Malaysia on 27 June 2017. The sukuk issued was categorised as a green Islamic bond as its proceeds were used to finance an environmentally sustainable infrastructure project (construction of renewable energy generation facilities). This innovative channel was created to address the global financing gaps in the field of green financing and was introduced under the sustainable and responsible investment (SRI) sukuk framework. The SRI framework is the result of collaboration between SC, BNM and the World Bank Group to develop an ecosystem to facilitate the growth of green sukuk and provide innovative financial instruments to tackle global infrastructure needs and green finance (Lexology, 2022). As of November 2021, Malaysia is one of the only countries in the ASEAN-6 countries (Malaysia and its five ASEAN neighbours, namely Indonesia, the Philippines, Singapore, Thailand and Vietnam) SRI realised 56 percent of the sukuk issuance (D'Cruz and Aziz, 2022).

3.1.1. Taxation Regime for the Sukuk Market in Malaysia

One of the main reasons behind the leadership of Malaysia, the world's most important sukuk issuer, is the tax incentives offered to sukuk. The country, which ranks first in many indicators in the field of sukuk, is also the first country to offer tax incentives for sukuk (Özcan & Elitaş, 2015: 579).

In fact, it would not be wrong to state that tax regulations were not at sufficient levels for Islamic financial instruments, including sukuk, to compete with other traditional instruments in Malaysia until 2003 (Hassan & Majid, 2022: 371). However, the growth volume experienced in the sukuk market has led the Malaysian government to take steps in this regard. Tax

regulations have started to be made at the point of growth and sustainability of this financing instrument, which is considered an important part of future economic development plans. In this context, firstly, regulations for neutral taxation were taken in order for sukuk to compete with traditional financing instruments, and then, since it is a new instrument, positive privileges were started to be recognised against other financial instruments (Mohammed, 2014).

There is no special tax legislation on Islamic financial products and sukuk in Malaysia. Therefore, conventional and Islamic financial products are governed under the same taxation regime. However, there are tax incentive mechanisms for sukuk in various tax laws (D'Cruz & Aziz, 2022). The most important of these is the regulations made under the Income Tax Law. Enacted in 2003, special incentives were provided in favour of Sukuk issuers, originators, Special Purpose Vehicles (SPV) and investors (Hassan & Majid, 2022: 374). According to the amendment made in the Malaysian Income Tax Act (1967/2003), profits from Islamic financial transactions such as sukuk income are subject to the same treatment as conventional transactions such as interest. Section 2(7) of the Malaysian Income Tax Act. Section 2(7) of the Malaysian Income Tax Act states that *“Any reference in this Act to interest shall, with the necessary modifications, apply to gains or profits received and expenses incurred in lieu of interest in transactions conducted in accordance with the Shari’ah”*. According to this article, the legislator aims to ensure tax neutrality between sukuk income and interest income in the country (Okur, 2020: 59). In this respect, it is understood that Malaysia, which has the world’s largest sukuk market, has early grasped the importance of neutral taxation (Ulusoy & Ela, 2018: 194). The only regulation made by the Malaysian government in the Income Tax Act based on sukuk transactions is not limited to neutrality. Table 2 shows the tax incentives provided for sukuk in the Income Tax Act.

Table 2: Tax Incentives Based on Sukuk Transactions I

Incentive Beneficiary	Incentives	Legislation
Issuer	Deduction of expenses or additional expenses incurred in the issuance of Sukuk from the tax base: - Sukuk issuances based on mudaraba, musharakah, istisna, murabaha and tawarruq issued within the scope of Shariah principles and deduction of additional expenses from the tax base until 2020 - Until 2025, the expenses of a sukuk or retail sukuk structured under the Wakalah principle will be deducted from the tax base	Income Tax (Expenditure Deduction on Sukuk and Retail Sukuk Issuance Structured in Accordance with Wakalah Principle) Rules 2021- P.U. (A) 5
Issuer	- To ensure neutrality with conventional financing instruments, gains, profits and expenses incurred on the disposal of an asset or lease approved by the originating organisation (SC) are exempt from tax, provided they comply with Shariah principles	Income Tax Act 1967 (Revised 1971) - Section 2(7) and (8)
Issuer/ Special Purpose Vehicle (SPV)	- Any source and income of an SPV established solely for the purpose of issuing Islamic securities (other than asset-backed securities) is treated as a source and income of the company/ founder. Income derived by the SPV from the issuance of Islamic securities is exempt from income tax.	Income Tax Act 1967 (Revised 1971) - Section 60I Income Tax (Exemption) (No.14) Order 2007 - P.U. (A) 180
Sustainable and Responsible Investment (SRI) Sukuk issuer	- Effective from 2016 to 2023, a tax deduction is provided for expenses incurred for the issuance or offering of SRI sukuk approved or authorised by or submitted to the SC. The deduction applies to SRI sukuk where ninety per cent of the proceeds from the issuance or offering of the SRI sukuk are used solely for the purpose of financing SRI projects specified by the SC in the guidelines.	Income Tax (Deduction of Expenditure on Issue or Offering of Sustainable and Responsible Investment Sukuk) (Amendment) Rules 2021 P.U. (A) 2
Founder/ Originator	- In order to comply with Shariah principles in the issuance of Islamic securities, the company establishing the SPV is entitled to a discount on the cost of sukuk issuance.	Income Tax (on Islamic Securities Issuance Costs Related Discount) Rules 2007 - P.U. (A) 176

Investor	- Profits paid to non-resident companies under RM-denominated sukuk (except convertible loan stock) approved by the SC are exempt from income tax.	Income Tax Act 1967 (Revised 1971)- Schedule 6 - Exemption from Tax: Section 33A
Investor	- Profits paid to any person in respect of sukuk (other than convertible loan shares) approved by the SC and not originating in Malaysia are exempt from income tax.	Income Tax Act 1967 (Revised 1971)- Schedule 6 - Exemption from Tax: Section 33B
Investor	- Profits paid to any individual, trust and fund under sukuk (except convertible loan stock) approved by the SC are exempt from income tax.	Income Tax Act 1967 (Revised 1971) - Schedule 6 - Exemption from Tax: Section 35
Fund Management Companies	- The income of companies that are managed in accordance with Shariah principles and approved by the SC and provide fund management services to domestic and foreign investors is exempt from tax until 2023. This exemption also applies to organisations providing fund management services within the scope of SRI sukuk.	Income Tax (Exemption) (No.7-8- 5) Instruction 2021

Source: SC. Incentives. Retrieved 28 April, 2025 from <https://www.sc.com.my/development/icm/incentives>.

As can be seen in Table 2, there are various tax incentives for sukuk transactions, primarily for issuers, source institutions and investments. These tax incentives are mainly in the form of deductions on expenses incurred for sukuk issuance. On the other hand, with the amendments made to the Malaysian Income Tax Law in 2001 and 2003, various exemptions were granted for the Real Estate Gains Tax arising from sukuk transactions. Within the scope of the relevant regulation detailed in Table 3, gains accrued from the disposal of any liable asset related to the issuance of private debt securities on Islamic principles are exempt from Real Estate Gains Tax. This exemption also applies to the disposal of any taxable asset related to Sukuk (Okur, 2020: 59).

Table 3: Tax Incentives Based on Sukuk Transactions II

Incentive Beneficiary	Incentives	Legislation
Issuer	Any person is exempt from payment of real estate gains tax in respect of gains accrued on the disposal of any chargeable asset in connection with the issue of private debt securities under Islamic principles.	Property Profit Tax (Exemption) (No.3) Instruction 2003
Issuer	Taxable gains accrued on the disposal of any chargeable asset are exempt from payment of real estate gains tax.	Property Profit Tax (Exemption) Order 2001 - P.U. (A) 227

Source: SC. Incentives. Retrieved 28 April, 2025 from <https://www.sc.com.my/development/icm/incentives>.

As can be understood from the statements above, in the Malaysian tax system, interest income and sukuk income are taxed on the same basis, but asset transfers realised in sukuk transactions exempt from real estate income tax. The reason for this is that sukuk transactions in Islamic Finance based on asset transfers are disadvantageous against conventional transactions. This regulation aims to ensure tax neutrality (Okur, 2020: 59).

Another incentive mechanism for sukuk issuances in Malaysia is the regulations made under the Malaysian Stamp Duty Act of 1949 (D’Cruz & Aziz, 2022). Table 4 shows the incentive mechanisms provided under stamp duty.

Table 4: Tax Incentives Based on Sukuk Transactions III

Incentive Beneficiary	Incentives	Legislation
Issuer	All documents relating to the issue of bonds approved by the SC, the offer to subscribe or purchase or invitation to subscribe or purchase, and the transfer of such bonds are exempt from stamp duty.	Stamp Tax (Exemption) (No.23) Order 2000 - P.U. (A) 241
Issuer	To ensure neutrality with conventional financing schemes, any tax levied on the additional instrument pursuant to a financing scheme approved by the SC is exempt from stamp duty provided that the scheme complies with Shariah principles and the instrument in question complies with those principles.	Stamp Act - Schedule 1 "General Exemptions"
Issuer / Founder /SPV of an asset-backed sukuk	All of the following documents issued on or after 1 January 2001 for the purpose of securitisation transactions are exempt from stamp duty: • A special purpose vehicle any instrument which operates to transfer, convey, assign, authorise, enforce or perfect any legal or equitable right or interest in or to, or title or alteration or mortgage to, any asset in favour of or in favour of a special purpose vehicle. • Any instrument that operates to create or effect any charge, assignment, deed of trust or letter of credit or any other instrument or document for the purpose of raising credit. • Any instrument which operates to transfer, convey, assign, delegate, authorise, give effect to or complete the disposition of any of the rights relating to the recovery of rights from a special purpose vehicle to or in favour of the person from whom the rights were acquired. • Any other document or document to which a special purpose vehicle is a party.	Stamp Duty (Exemption) (No.12) Order 2001

Source: SC. Incentives. Retrieved 28 April, 2025 from <https://www.sc.com.my/development/icm/incentives>.

Considering the tax incentives mentioned above, it is seen that important incentive mechanisms have been established for special purpose organisations, institutional investors and individual investors for the dissemination of sukuk

in Malaysia. One of the main points that distinguishes Malaysia from other countries in terms of incentives for sukuk is the incentive mechanism offered for green sukuk to support environmental projects . The support mechanism for green sukuk, a new and sustainable instrument of the country, which has a voice in the international market in terms of sukuk issuance, is an important step towards expanding and diversifying the sukuk volume.

3:2. Saudi Arabia

In Saudi Arabia, which adopts the absolute monarchy form of government and applies Islamic Sharia law, the financial sector is also governed according to Islamic principles. Saudi Arabia, one of the bogeyman countries of the Islamic finance sector, ranks first in the Islamic Finance Country Index (DDCAP, 2019: 56). In the Islamic Finance Development Index, it ranks second after Malaysia (ICD, 2022: 12). These indicators in the field of Islamic finance are also reflected in the Islamic capital market. As a matter of fact, Sukuk, the most important component of the Islamic capital market, is considered among the leading debt financing instruments for economic and industrialisation steps in Saudi Arabia (Alsaced, 2012: 12). The country has approximately 14 per cent of global sukuk issuance. In terms of this indicator, it ranks second in total global sukuk issuance after Malaysia (IFM, 2022: 84).

Table 5: Sukuk Potential in Saudi Arabia (2001-2021)

Evaluation Criteria	Indicators Regarding Sukuk Issuance			Worldwide Ranking			
Export Type	Issuance Count	Issuance Amount	Total Share in (%)	2001 2021	2019	2020	2021
Short Term Global Sukuk Issuance	6	1,301	0.23	8	-	-	-
International Sukuk Issuance	88	80,353	21.05	3	2	3	2
Domestic Sukuk Issuance	220	136,402	11.10	2	2	4	2
Total Sukuk Issuance	308	216,755	13.45	2	2	2	2

Source: IFM, 2022: 39-84.

As seen in Table 5, a total of 308 sukuk issuances were made in Saudi Arabia in the relevant period. The total value of these issuances is approximately USD 217 Million. Looking at 2021 specifically, 47 issuances

worth approximately USD 42 million were realised. Here, what distinguishes Saudi Arabia from countries that have a say in the sukuk market is the low number of issuances. The country, which ranks second in terms of its share in total sukuk issuances, has issued less than countries such as Gambia, Indonesia, Bahrain and Turkey, which follow it at this point (IIFM, 2022: 83). However, the total value of the issuances has the highest amount after Malaysia. Therefore, it is understood that sukuk issuances are realised at high prices. One of the striking points in the table is that sukuk issuances are long-term. In other words, the share of short-term sukuk issuances is quite low.

3.2.1. Taxation Regime for the Sukuk Market in Saudi Arabia

Despite the huge Islamic investment funds in Saudi Arabia, there is no legislation specifically regulating the implementation of Islamic sukuk (Al-Shamrani, 2014: 107). This situation is also valid in terms of tax regime. In this context, there is no separate or special taxation regime for Islamic finance products and structures in Saudi Arabia. In fact, in terms of the general tax regime, there are practices close to the zero tax regime, similar to other Gulf countries. However, considering the taxes associated with sukuk in other countries, it is useful to draw a general framework in terms of income tax, corporate tax, stamp tax (applied in the country) and VAT in the country.

Income tax in Saudi Arabia varies according to citizenship status. Income tax is collected only from persons who are not Saudi citizens or who cannot be recognised as residents of the country. Therefore, there is no income tax liability for the citizens of the country (these persons are held responsible for Zakat, which is one of the compulsory taxes of Islam, provided that they meet certain conditions) (Sariso, 2011: 264). When the taxation of income derived from capital gains for non-residents is analysed, an exemption provision is encountered. In this context, according to Article 10 of the Income Tax Law, capital gains derived from the disposal of securities traded on the stock exchange are exempt from tax (Income Tax Law, 1950: Art. 10).

As in the case of income tax, taxation in the corporate tax is based on the distinction between foreign and domestic investors. In this context, the corporate tax rate for foreign investors is 20%. Domestic investors are taxed at the rate of 2.5% under the name of Zakat. In terms of capital gains, an advantage is offered for dividend withholding. In this context, a reduced withholding tax rate (5%) is applied for dividend payments to non-resident beneficiaries (PwC, 2012: 19).

VAT, another tax that is important for Sukuk, is a tax that has been in effect as of 2018. While the VAT rate was 5% until 2020, the rate was increased to 15% after the relevant date. There is no special regulation for Islamic finance products in terms of VAT. In this context, Islamic financial products are subject to the same VAT rate as a conventional financial product (Lexology, 2023).

3.3. Indonesia

Indonesia, one of the leading countries in the field of Islamic finance, has the largest Muslim population in the world. The country ranks behind Malaysia and Saudi Arabia in the Islamic Finance Development Index (ICD, 2022: 12), and behind Saudi Arabia and Saudi Arabia in the Islamic Finance Country Index (IFCI).

It ranks third after Malaysia (Cambridge, GIFR, 2022 p. 56). As of 2021, its share in global sukuk issuance is approximately 9%. In this respect, it is criticised in the literature for lagging behind its peers in the Islamic finance sector despite having one of the largest Muslim populations in the world (Balibek, 2017:10).

Table 6: Sukuk Potential in Indonesia (2001-2021)

Evaluation Criteria	Indicators Regarding Sukuk Issuance			Worldwide Ranking			
	Issuance Count	Issuance Amount	Total Share in (%)	2001 2021	2019	2020	2021
Short Term Global Sukuk Issuance	135	14,207	2.55	5	3	4	5
International Sukuk Issuance	27	24,203	6.34	4	5	7	5
Domestic Sukuk Issuance	607	124,092	10.09	3	3	2	3
Total Sukuk Issuance	634	148,295	9.20	3	3	4	3

Source: IFM, 2022: 39-84.

Looking at the distribution of sukuk issuances by sukuk types, it is seen that ijarah sukuk is the most dominant type of sukuk issued in the Indonesian market. Approximately 68% of the corporate sukuk in circulation were issued under this type (ADB, 2021: 58). One of the important points for the sukuk market in the country is innovative sukuk issuances. Indonesia is one of the leading countries in terms of sustainable sukuk issuances. At this

point, there have been significant developments in the field of green and blue sukuk in the country. Indonesia attaches great importance to the use of green sukuk in line with its commitment to reduce carbon emission levels and build more environmentally friendly projects (Rusydiana and Irfany, 2021: 101). The issuance of this type of sukuk is almost the same as other Government Sukuk. Existing Government Sukuk are mostly used to finance infrastructure. In green sukuk, the infrastructure (underlying assets) to be used as the basis for issuance must meet the green infrastructure criteria. Another alternative in this type is blue sukuk. The concept of Blue Sukuk is not very different from Green Sukuk. The difference is that Blue Sukuk is more focused on financing the marine economy (Rusydiana & Irfany, 2021: 102). The first green sukuk issuance in the country was carried out on 1 March 2018. The volume of this issuance was IDR 16.75 trillion (USD 1.25 billion), with all proceeds going exclusively to eligible green projects based on the Green Bond and Green Sukuk Framework. This issuance was made in *wakalah* type with a profit rate of 3.75% and a maturity of 3 years (ADB, 2021:26). Following the first issuance, a large number of green bonds/green sukuk were issued by both the state and companies. In particular, most of the issuances by the government are green sukuk. The country ranks first among ASEAN countries in terms of the amount of green bond issuance (Prisandy & Widyaningrum, 2022: 263).

3.3.1 Taxation Regime for the Sukuk Market in Indonesia

Indonesia, which ranks at the forefront of the sukuk market on a global scale, is one of the countries that has been subjected to criticism in terms of the taxation regime for sukuk. While many other countries dominating the market encourage the development of Islamic Capital Markets by providing tax exemptions for both demand and supply side, the Indonesian government applies the principle of tax neutrality. In other words, the government subjects Islamic financial products to the same taxation regime as conventional financial products. This policy makes it difficult for Islamic Capital Markets to compete with conventional capital markets (CFA, 2022: 20).

The most important step taken in terms of ease of taxation for the sukuk market in Indonesia is the tax incentives provided to non-resident investors with the regulations introduced in 2020. As an extension of the development of Islamic finance in recent years and the importance given to foreign investors in this process, the Indonesian Government enacted the first Omnibus Law (Law No. 11 of 2020, also referred to as the Job Creation Law) on 2 November 2020, which includes the taxation of bond interest

for non-resident investors. Regulations on the relevant implementation were also published on 2 February 2021 (Government Regulation No. 9/2021) and 18 February 2021 (Ministry of Finance Regulation No. 18/PMK.03/2021) (ADB, 2021: 55). With these regulations, reduced income tax rates were determined for the taxation of sukuk income (Hassan & Majidd, 2021: 375).

It has been decided to apply the income tax rate of 15% for domestic taxpayers and 20% for foreign taxpayers for the taxation of income derived from bond interest in the country as 10% for income derived from sukuk as of 2021. This revised rate is effective from 1 August 2021 and applies to interest from government, quasi-government and corporate bonds and bills, including those issued through private investment, as well as profit sharing from Sharia-compliant instruments of such issuers or offerors. The reduction of the standard withholding tax rate from 20 per cent to 10 per cent represents a concession for non-resident investors and reflects the Government of Indonesia's policy objective to broaden the investor base, including through active participation of non-residents in the bond market (ADB, 2021: 55). The areas that will benefit from the reduced tax rate are infrastructure, real estate, asset-backed securities and investment funds registered by the Financial Services Authority (OJK) (jdih.kemenkeu.go.id). Outside these areas, sukuk and other financial instruments are subject to similar taxation treatments within the scope of the neutral taxation approach (COMCEC, 2018: 133).

The country, which does not include any tax incentives for sukuk in other taxes other than income tax, is criticised in many sources on the grounds that the tax incentives offered in the field of Islamic finance, especially sukuk, are not sufficient compared to other sectors. In the report published by the Fiscal Policy Agency of the Ministry of Finance of Malaysia (Badan Kebijakan Fiskal Kementerian Keuangan Republik Indonesia) on the results of the field research on sukuk, it makes recommendations for the urgent implementation of tax incentives related to sukuk. At this point, it has been stated that the type of Sukuk that should be considered primarily is Sukuk Ijarah (icâre sukuk), where there is double tax due to the application of value added tax (Hassan & Majidd, 2021: 374). Similarly, in the Indonesian Islamic Economy Master Plan (2019-2024) published by the Ministry, the inadequacy of tax incentives is shown as one of the five main problems in front of the development of sukuk (Indonesian Ministry of National Development Planning, 2018: 204).

3.4. United Arab Emirates

The United Arab Emirates (UAE), home to the first commercial Islamic Bank to adopt Islamic principles in all its activities (Duabai Islamic Bank - 1975) and many of the most valuable and powerful banks in the Gulf countries, is among the leading countries in Islamic finance. Dubai in particular is regarded as the regional centre for Islamic finance and the leading financial centre in the Middle East (PWC, 2012: 18). The country sixth in the Islamic Finance Development Index after Malaysia, Saudi Arabia, Indonesia, Bahrain and Kuwait (ICD, 2022: 12). In the Islamic Finance Country Index, the country ranks ninth after Saudi Arabia, Malaysia, Indonesia, Iran, Pakistan, Sudan, Bangladesh and Brunei (DDCAP, 2019: 49-56). Despite hosting the first Islamic bank and strong Islamic financial institutions, the country has been criticised for not achieving sufficient success in sukuk issuances due to the late maturity of the capital market (Dhaidan, 2019: 12). As of 2021, the UAE has approximately 6% of global sukuk issuance. In this respect, it ranks seventh in global sukuk issuance (IFM, 2021: 80).

Table 7: Sukuk Potential in the United Arab Emirates (2001-2021)

Evaluation Criteria	Indicators Regarding Sukuk Issuance			Worldwide Ranking			
	Issuance Count	Issuance Amount	Share in Total (%)	2001 2021	2019	2020	2021
Short Term Global Sukuk Issuance	1	100	0.02	13	-	-	-
International Sukuk Issuance	145	93,564	24.51	2	3	2	4
Domestic Sukuk Issuance	17	8,631	0.70	10	-	13	-
Total Sukuk Issuance	162	102,195	6.34	4	5	5	7

Source: IFM, 2022: 39-84.

As mentioned earlier, the UAE is in the background in the sukuk market compared to equivalent Islamic countries. It is possible to see this situation in Table 7. As a matter of fact, as of 2021, the country ranks seventh in total global sukuk issuance. One of the noteworthy points at this point is that the country's ranking in terms of this indicator has been declining in recent years. While it ranked fourth in the average of the 2001-2021 period, it dropped to fifth place in 2019 and fell to seventh place in 2021.

As can be seen from Table 7, domestic sukuk issuances in the UAE are at very low levels. The country's low debt to the domestic market is shown as the main reason for this situation. As of 2021, the UAE is not included in the ranking made by IIFM due to low domestic sukuk issuance. Finally, one of the events that can be clearly observed in the table is the country's place in the ranking in terms of international sukuk issuance. As a matter of fact, the most positive ranking is realised in terms of this item. However, it is also observed that there has been a decline here in recent years.

With the impact of recent initiatives on Sustainable and Responsible Investment (SRI) in Islamic Capital Markets, the United Arab Emirates has been making an intensive effort to develop green sukuk to finance renewable and clean energy projects. The Dubai Energy Supreme Council announced a partnership with the World Bank to develop a green energy strategy, including a sukuk financing instrument. The United Arab Emirates Securities and Commodities Authority has recently developed reforms to incorporate green sukuk into the regulatory framework. Sustainable sukuk issuances in the country are expected to increase in the coming periods (Mohamed Ali, 2016: 143).

3.4.1. Taxation Regime for the Sukuk Market in the United Arab Emirates

In the United Arab Emirates (UAE), a constitutional federation, each emirate retains autonomy over its oil resources, fiscal policies and debt issuance, and manages its own budget. A significant portion of the country's GDP is based on oil revenues. This situation causes the UAE to differentiate from other countries in terms of the need for public revenues and the tax system. Considering the taxes applied in the country, it is seen that a zero tax regime is adopted in many areas (COMCEC, 2018: 110).

Although the UAE Constitution authorises the federal government to tax, the federal government did not use this authority for a long period of time. Until 2017, no systematic taxation scheme was established at the emirates level, except for corporate taxation covering limited sectors and subjects (foreign banks and oil companies) (DIFC, 2009: 76). The general decline in oil prices in recent years and the associated financing needs have led the country to enact many taxes that constitute the building blocks of today's modern taxation. In this context, SCT was introduced in 2017, VAT in 2018 and corporate tax in 2023 to be implemented on a federal scale. Currently, basic taxes such as individual income tax, motor vehicle tax, inheritance and transfer tax are not applied (FTA, 2023).

When we look at the taxation on capital market instruments and sukuk in particular, it is seen that as an extension of the existing tax system, tax obligations in other countries are not encountered. No stamp, registration, transfer, withholding or other similar taxes are paid on the issuance of a debt instrument (including Islamic financial instruments) in the UAE (DLA, 2023: 37).

Looking at the importance of post-2017 tax regulations in terms of sukuk, it is seen that new taxes other than corporate tax exclude sukuk from the scope. In this context, the SCT, which first came into force, does not include a tax obligation for the sukuk market, as it does not cover any resources other than products harmful to human health and the environment. In terms of VAT, it is seen that Islamic financial products that are approved to be in compliance with Islamic Sharia, and therefore sukuk, are counted among the tax-exempt items (FTA, 2023). In terms of taxation of sukuk income, it was stated that individual investors are not subject to any tax. In terms of corporate earnings, the new corporate tax law stipulates that Islamic finance operations will be taxed at a rate of 9%. Dividend/interest payments related to sukuk and other securities are allowed to be deducted from tax (IFAC, 2023). As a result, it would not be wrong to consider the state of the tax system in the country before 2017 as a natural incentive mechanism for sukuk. In the post-2017 regulations, it is seen that incentive mechanisms have been established in VAT and corporate tax.

4. Conclusion And Discussion

This study aims to analyse sukuk, one of the main instruments of the Islamic finance system, through tax regimes and incentive policies affecting its development in four Islamic finance pioneer countries (Malaysia, Saudi Arabia, Indonesia and the United Arab Emirates). By comparatively analysing the regulations implemented in these countries in the period covering the years 2001-2021, the structural relationship between the depth of sukuk markets and fiscal policies was evaluated.

The findings of the analysis show that tax exemptions, transparent regulatory frameworks and investor-friendly incentives play a critical role in the sustainable development of sukuk markets. Malaysia, in particular, has achieved its pioneering position in the development of the sukuk market largely thanks to its early tax reforms and proactive government policies. Income tax and stamp duty exemptions brought sukuk issuances on an equal footing with conventional debt instruments and provided liquidity to the market. In addition, Malaysia has developed an effective Sharia supervision

mechanism for sukuk compliance and a financial infrastructure that supports the investment environment.

Similarly, the United Arab Emirates has implemented comprehensive incentive packages, tax free zones and flexible issuance regulations to create an attractive environment for international investors in the sukuk market. This has facilitated the country to become a centre for global sukuk issuance and Islamic capital markets. In addition, the legal regulations established within the framework of Dubai's global Islamic finance vision have been supportive of the sukuk market.

In the cases of Saudi Arabia and Indonesia, the development process observed in the sukuk market has been more gradual and controlled. Despite the high weight of Islamic finance in the system in both countries, tax incentives have been limited from time to time or have been uncertain for market actors. Especially in Indonesia, the institutionalisation of Sharia compliance mechanisms and more systematic tax exemptions had a positive impact on the pace of development of the sukuk market. Saudi Arabia, on the other hand, has recently increased incentives for the sukuk market within the scope of its Vision 2030 strategy and aims to deepen the market with public sukuk.

The findings of the study are also in line with the literature. Various studies emphasise the importance of not only religious compliance but also a competitive tax environment, liquid markets and institutional arrangements for the development of sukuk markets (Çizel, 2020; Al-Amine, 2012; IFSB, 2021). When sukuk markets are subjected to the same tax burden as conventional bond markets, they lose their investor preference, hence special regulations are needed to increase the efficiency of these markets.

In this context, countries need to establish both sharia-compliant and competitive tax systems in order to further deepen sukuk markets. In addition, mechanisms to reduce the cost of sukuk issuance will encourage issuers, while tax transparency and legal stability will increase investor confidence.

As a result, the success of the sukuk market is possible not only with religious principles, but also with rational fiscal policies and effective incentive strategies. The study reveals that this integrated approach is indispensable for the sustainability of Islamic finance. In future research, it is recommended to conduct micro-level impact analyses for these policies and to examine the causal relationships between financial performance indicators and sukuk growth.

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