



BUYING REAL ESTATE IN GERMANY IN KEEPING WITH THE KORAN

Sharia-compliant, but still tax-optimised

Islamic finance, i.e., financial business deemed as being in keeping with the Koran, is a growing market. Reports say that there are 250 Islamic mutual funds operating with USD 300 billion of assets, 300 Islamic financial institutions holding USD 250 billion of assets and USD 200 billion of assets held in "Islamic windows" (Sharia-compliant subsidiaries of conventional banks). More and more investors from the Islamic world are reflecting on traditional values and adhering strictly to the tenets of Islamic belief. The number of investors is growing constantly, and with it the importance of "Islamic Finance". Profits resulting from crude oil production in the Far and Middle East are waiting to be reinvested and the number of affluent second and third-generation Mus-

lims is on the increase in Europe. The accumulated wealth of the approximately 2.4 billion Muslims worldwide is estimated at EUR 1.9 trillion. Over the last few years, we have seen that Islamic banks are especially looking for real estate investments in Germany. This correlates with a current general high interest of foreign investors in all types of real estate in Germany and is creating special challenges both for the Islamic investors and their advisors, because all property transactions must be in line with Islamic canonical law ("Sharia") and at the same time have to take into account German legal and tax regulations.

The decision on whether an investment is Sharia-compliant is not up to the investor. Instead, it is at the discre-

tion of the Islamic advisory committee, or "Sharia Board", of the investing bank. Depending on the tradition of the various schools of thought ("madh-hab"), the attitudes of Islamic legal scholars ("ulamat") may be more liberal or more conservative. Whatever the case, the parties involved have to reckon with a delay in the transaction, as the committee generally only meets once a month and only to a very limited extent during Ramadan, the month of fasting. Advisors should inform the bank's Sharia Board in good time on the nature of the planned legal and tax arrangements and should be prepared to make allowances for changes requested by the legal scholars.

The most important rule is the ban on interest on loans ("riba"), as the Islamic

understanding is that profit must be in return for something which has been provided. But Islamic investors also expect something for their money when they inject capital into real estate transactions. Provided, however, that the investors participate in the risk by acquiring a (direct or indirect) shareholder position or equivalent in the project company, the profits generated are deemed as Sharia-compliant.

Structuring this is largely not a problem under German commercial and corporate law. The challenge lies in creating a tax-optimised structure. The aim is, among other things, to ensure that income from the real estate company is not subject to trade tax despite the involvement of a company instead of a (limited) partnership. This means that the company (limited by shares) should be located abroad.

In addition, the structure should be organised properly in order to avoid repeated payments of the real estate

transfer tax which may be incurred when a share is acquired. For example, it is advisable for the Islamic investor to invest through profit participation rights or a silent partnership to minimise the level of taxable income at the real estate company.

Apart from the prohibition on interest, it must be borne in mind that the Sharia excludes a range of investment products and investment targets. If an undertaking is associated with products such as alcohol, tobacco, pork, armaments, pornography or gambling – branches which are taboo under Sharia law – then it is a no-go for an Islamic investor. This is why investors should make particularly sure that they obtain the Sharia Board's consent in advance where hotels are concerned. In the light of this, office complexes and selected commercial properties tend to be considered as good targets for real estate investment. Again, this involves a balancing act between the requirements of Islamic law



and those set by German civil and tax law, as the task is to manage the investment so as to achieve the best tax results while still in keeping with the Koran.

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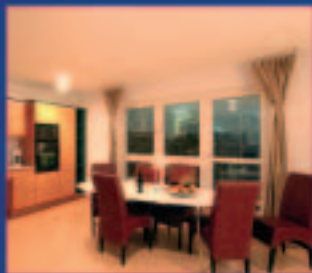
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