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The Implication of the Concept of Legal and Beneficial Ownership in Sukuk Structures under the Nigerian Tax Regime

Hafsat Iyabo Sa'adu*

Aishat Abdul-Qadir Zubair**

Abstract: This article investigates the meaning of the concept of ownership as obtained under the common law and Shari'ah (Islamic law) as well as the implication in *Sukuk* (Islamic bonds) structures under the Nigerian tax regime. In doing this, the article analyses the concept of both legal and beneficial ownership under the common and Islamic law. This article examines the two forms of ownership under common law, i.e., legal and beneficial, and argues that there is controversy as to the need for such distinction for the concept of ownership under Islamic law. The article concludes that for a proper structuring of sovereign *Sukuk* in any jurisdiction, Nigeria inclusive, there is the need to first address the meaning of the concept of ownership under Islamic law. The article further concludes that the present tax regime in Nigeria needs to be amended to accommodate the uniqueness of *Sukuk* structures. The article, therefore, recommends that *Sukuk* structures should accord *Sukuk* holders with absolute ownership (*malik tamm*) and the various tax laws in Nigeria be amended to suit Islamic finance products.

Keywords: Ownership; *Sukuk* Structures; Tax Regime; Nigeria; *Shari'ah* (Islamic law)

I. INTRODUCTION

The concept of ownership is an important concept as it affects a number of other important branches of law like tax, property, trust, equity and most importantly *Sukuk* . This is because; in the structuring of any *Sukuk*, the most important element, if not the only element, that is of significance is the underlying asset with which it is being structured. In fact, without an underlying asset there would be no difference between *Sukuk* and bonds which is a debt-like investment that is purely a lender-borrower relationship as against an issuer-*Sukuk* holder relationship.[1] Legal ownership simply means the person on whom the legal right of a property lies on while beneficial ownership on the other hand means the person on whom the benefits of the property accrues to.[2] For a better understanding of the various definitions given to these two distinctions of ownership under common law, it is trite to appreciate their various meanings and uses in *Sukuk* structures and its corresponding implication under the current Tax Regime in Nigeria.

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[1] Ryan Dennis and Elmaliki Fawaz, 'The Evolution of *Sukuk'*, The Annual In-House Council Survey, United Arab Emirate 2021 <https://www.inhousecommunity.com/article/the-evolution-of-sukuk/> accessed 22 August 2022.

[2] Gali Folawiyo Aka, 'Interpretation of the Concept of Beneficial Ownership: Trends, Tensions, Contradictions' (Master's Thesis in Taxation, Institute of Advanced Legal Studies, University of London 2011).

The concept of sovereign *Sukuk* is derived from various Islamic law principles one of which is the prohibition of taking and giving of interest (*riba)*[3]. *Sukuk* is an asset-backed/asset-based instrument structured in compliance with the precepts of *Shari'ah*. It is a certification or trust of ownership for an asset or usufruct. Because returns on investment in *Sukuk* are tied to the underlying asset, *Sukuk* needs to be backed by a specific asset or usufruct throughout its entire tenure. *Sukuk* therefore can be referred to as securities or certificates or articles representing rights or obligations in contracts or assets with the features of liquidity, tradability and "cash equivalent".[4] "The *Sukuk* certificate evidences this ownership interest. Monies raised by the issuance of the *Sukuk* notes are used to invest in an underlying asset, a trust is declared over that asset and thereby the certificate holder will own a beneficial interest in that asset in proportion to its investment and is therefore entitled to all the benefits that entails including a proportion of the return generated by that asset".[5] It is thus evident that the central theme to the product of *Sukuk* is 'ownership of an underlying asset'.

The Nigerian tax regime has as one of its revenue generation, the taxes levied on individuals as well as corporate bodies by virtue of their ownership status. The tax administration in the country takes this into cognizance when administering taxes on Islamic finance products, most importantly because of the unique nature of the products and the common law jurisdiction of the country. It is therefore important to understand the implication of ownership as is being depicted under common law in *Sukuk* structures as well as its implication under the Nigerian Tax Regime.

This article is structured as follows: Section II explains the concept of legal and beneficial ownership under common law, tracing its origin to English trust law. Section III explains the concept of ownership in *Sukuk* structures by understanding the meaning of the concept of ownership under the *shari'ah* and its applicability to *Sukuk* structures. Section IV then goes further to analyse the implication of ownership of *Sukuk* asset under the Nigerian Tax regime. Finally, section V gives a general conclusion stating the main findings of this research and making some key recommendations to stakeholders in the Islamic finance industry and the tax administrators in Nigeria.

II. CONCEPT OF LEGAL AND BENEFICIAL OWNERSHIP

The expression "beneficial ownership'' appeared in the Organization for Economic Cooperation and Development (OECD) Model Treaty in 1977. It has its origins in English trust law, where it was contrasted with the concept of "legal ownership." The legal owner has the title to the property, while the beneficial owner has the use of property. The "beneficial owner" was usually seen as the one who had most of the attributes of ownership, not taking into account the legal title. Although the term "beneficial owner" is currently applied in a wide variety of situations that do not involve trusts, such as *Sukuk*, the essence of the concept is referring to the person who ultimately controls an asset and can benefit from it at the same time.[6]

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[3] Al-Qur'an 30:39; 4:160-161; 3:130 and 2:275-282.

[4] Jordi Kashoggi Nazar, 'Regulatory and Financial Implications of *Sukuk's* Legal Challenges for Sustainable *Sukuk* Development in Islamic Capital Market' (a paper presented at the 8th International Conference on Islamic Economy and Finance, Centre for Islamic Economy and Finance, Faculty of Islamic Studies, Qatar 2011).

[5] Sunil Bandari, 'Islamic Finance – Theory and Practical Use of *Sukuk* Bonds' (ACCA Global, 2013). See further Securities and Exchange Commission, Nigeria '*Sukuk* At a Glance' (2019) <http://sec.gov.ng> accessed 25 May 2022.

[6] Organization for Economic Cooperation and Development (OECD) UN Model Double Taxation Convention between Developed and Developing Countries 2021

Therefore, there is no globally accepted definition of the concept of beneficial ownership according to a study. Vargas argued that the term legal and beneficial ownership was derived from common law as it is not known in the domestic law of countries other than the common law states. He further argued that the two concepts were drawn from the law of equity. He defined the term beneficial owner as when the adjective "beneficial'' is added to the word "owner'' widely used in legal contexts. To distinguish a right or power one possesses for his own use and enjoyment one possessed for the use and enjoyment of another. The study further laid a foundation for the distinction between legal and beneficial ownership by saying the distinction is found in the law of trusts since the trustee has legal title to the trust property, but he holds it for the beneficiary, who has the "beneficial interest'' in or beneficial enjoyment of the property. He further said this distinction is similar to the notional division of ownership allowed by equity.[7]

The word "interest'' is sometimes used instead of "ownership" in the concept of beneficial ownership and is defined as: "Profit, benefit, or advantage resulting from a contract, or the ownership of an estate as distinct from the legal ownership or control".[8] In another study, although they did not attach any significance to the difference between the terms beneficial interest and beneficial ownership, it is believed that whenever the legislation uses the two terms as a criterion for liability or exemption, it is focusing on the right to enjoy the property. The major confusion is that the term "beneficial interest" is often used as a synonym for an equitable proprietary interest. They emphasized on the concept of benefit between legal and equitable interests. In their opinion a person may acquire a beneficial interest by acquiring either a legal or an equitable proprietary interest. These interests, in their view, are necessary for beneficial ownership but they may not be sufficient.[9]

Furthermore, an analysis was conducted on the concept of beneficial ownership under the international tax law. These are domestic (Danish) tax law, tax treaties, and European Union tax law revealed that the notion of beneficial owner derives from the legal traditions of common law hence its meaning is clear in a few countries (such as the United Kingdom and the United States).The study finds that in its ownership right, the legal tradition of common law typically operates with a differentiation between financial and legal ownership, it was concluded that a beneficial owner relates to the financial ownership.[10]

In an attempt to investigate the meaning of the term "beneficial owner" for tax treaty purposes, a study finds that there is no universally accepted definition for the term 'beneficial ownership'. This evidently leaves the door open for interpretation.[11] The study however concludes that the findings of the court in the case of *Indofood International Finance Ltd v JP Morgan Chase*

<https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2022-03/UN%20Model_2021.pdf> accessed 25 May 2022.

[7] Carlos Vargas, 'Beneficial Ownership Lacks Proper Meaning' *International Tax Review* (20 April 2004) <https://www.internationaltaxreview.com/article/2a69q2qyut6ogmxh28u0w/beneficial-ownership-lacks-proper-meaning> accessed 27 May 2022.

[8] Bryan A. Garner, *Black's Law Dictionary* (11th edn, Thomson Reuter 2019) 897.

[9] Margaret Stone and Vanessa Lesnie, 'Some Thoughts on Beneficial Interests and Beneficial Ownership' (1996) 19 (1) UNSW Law Journal 181.

[10] Jakob Bundgaard and Niels Winther-Sorensen, 'Beneficial Ownership in International Financing Structures' (2008) 50 (7) Tax Notes International 2-4.

[11] Stefanus Phillipus Meyer, 'The Meaning of "Beneficial Ownership" and the Use Thereof for Tax Treaty Shopping and Tax Avoidance' (Mini Dissertation Submitted in Partial Fulfilment of the Requirements for M.Sc Degree in Taxation, University of Pretoria 2010).

Bank NA London Branch[12] regarding the fact that the term 'beneficial owner' should have an international fiscal meaning would be just appropriate. It might be of interest to note that the concept of beneficial ownership is agreed to be still far from being clear as a study. This article adopts the view that the beneficial ownership concept should not be interpreted by reference to domestic laws of any state as provided under Article 3(2) of the Organization for Economic Cooperation and Development (OECD) Model Convention 2019. It argues that it should take its colour from an international fiscal meaning. Contracting States may then introduce elaborate provisions when negotiating tax treaties.

According to Her Majesty's Revenue and Customs (HMRC) internal manual on Inheritance Tax published on the 20th March 2016 and updated on the 7th December, 2020 equitable and legal ownership arise where equity would allow the use and benefit of property, usually land, to be held separately from the legal ownership. In those times for instance, it might be that land was given to A on his undertaking to hold it for the use and benefit of B, whilst B was, say, away on a crusade. The common law did not recognize any relationship between A and B and thus gave B no protection. In these circumstances, the Chancellor would interfere to compel A to hold the land for the exclusive use of B. While he could not say that B was the owner, all the benefit of the land was given to B, with A simply remaining the owner of the legal title. This is why in examining the meaning, origin and status of beneficial ownership under English law, a study finds that the concepts of beneficial ownership and legal title are clearly recognized by common law.[13] In another related study, it is said that possession of an asset in most cases signifies the legal ownership of such asset. According to the study a legal owner also initially has some economic rights for which he/she will need to transfer this risk to another person who then becomes the beneficial owner. The study therefore queries whether the entire economic right of a property can be transferred by a legal owner to a beneficial owner. The study finds that the major reason why the OECD Model Tax Treaty has introduced the concept of beneficial ownership is to enable the owner to enjoy the full economic rights and benefits of the treaty. This is put more succinctly thus:

> "It was introduced in the OECD-model tax treaty to codify that the sole owner of 100% legal ownership (and no economic ownership) would not benefit from certain treaty benefits. Beneficial Ownership has been introduced in the OECD model treaty after recognizing that allocating treaty benefits to mere legal owners ("agent" or "nominee") who do not have any economic interest in an asset (which economic interest has been allocated to a non-treaty eligible person) would surpass the purpose of the treaty. Therefore, Beneficial Ownership requires 100% legal ownership and a certain degree of economic risk. Especially the term Beneficial Ownership has been introduced in the OECD-model treaty to try to eliminate the avoidance of (withholding) taxes through structured transactions."[14]

Thus, it might not be entirely wise to transfer the whole economic rights to the beneficial owner of an asset without leaving any residue to the legal owner of the same asset. In the next section, we shall consider the meaning of ownership under the *Shari'ah* and its implication in *Sukuk* structures.

[12] [2006] EWCA Civ 258.

[13] Engku Ali, Engku Rabiah Adawiah, Klopic Nermin, Muhammad Ramadhan Fitri, and Muhammad Nasir, 'Application of the Concept of Beneficial Ownership in *Sukuk* Structures: An Islamic Legal Analysis' (2015) 7 (2) ISRA International Journal of Islamic Finance 110.

[14] Catherine Brown, 'Beneficial Ownership and the Income Tax Act (2003) 51(1) Canadian Tax Journal/ Journal/ Revue Fiscale Canadienne 415-417.

III. CONCEPT OF OWNERSHIP IN SUKUK STRUCTURES

The concept of ownership in *Sukuk* structures is very significant when we consider the controversial issue on its structures. The question is whether beneficial ownership of *Sukuk* assets by its holders will be sufficient for *Sukuk* under Islamic law? Ownership is regarded as *milk* or *milkiyyah* under the *shari'ah* and has been given several meaning such as: "A legal connection (*ittisal shari*) between a person and an asset, such that he is free to transact with it and exclude others from dealing with it (the asset)".[15]

Ownership under the *shari'ah* has also been defined as:

> "A bundle of exclusive rights which entitles the owner to benefit from a property, to be compensated in case of transgression and to dispose of it, except in cases where legal hindrance exists."[16]

These exclusive rights enjoyed by a property owner under Islamic law is thus the meaning of the concept of ownership. The concept also finds its basis from the *shari'ah*, particularly, the hadith (saying) of the Prophet Muhammad (S.A.W). In one of the considered authentic hadith (saying), he said that: "The mortgaged item remains the property of the owner who mortgaged it. He (the mortgagor) is entitled to its benefits, and he is liable for its expenses (or loss)".[17] In another place the Prophet (S.A.W) said "*Al-khraj bi al-damain*" which means the right to enjoy certain rights comes with liability.[18] This simply shows that ownership comes with liability even though in some instances the only benefit of an asset is transferred to a third party while the ownership still resides with the actual owner.

In another study, while discussing the concept of ownership from the *Shari'ah* perspective and the status of beneficial ownership, it was stated that there are two consequences of ownership which are the entitlement to benefit from the asset and the liability for the asset.[19] What then is the implication of this concept of ownership in *Sukuk* structures? A number of studies have in the past tried to examine this. In an asset-based *Sukuk* to begin with, the originator typically transfers only the beneficial ownership or equitable interest in the assets to the Special Purpose Vehicle (SPV) issuer; therefore, there is no true sale. To maintain *Shari'ah* compliance there must be a transfer of assets, however, since investors have no recourse to the assets, the transaction does not focus on asset risk, but rather on the credit worthiness of the sponsors of the *Sukuk*. If the originator fails to pay any amount payable pursuant to the transaction documents, the certificate holders normally have recourse against the originator or the issuer/trustee and not the underlying asset. This is because these types of *Sukuk* do not grant the certificate holders the right to cause the sale or other disposition of any of the trust assets on default.[20] This is why in another study it is said that "*Sukuk* holders are merely creditors and

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[15] Hamad Rasool, *'Sukuk* Islamic Bonds' Academic for International Modern Studies (n.d) <https://www.iefpedia.com/english/wp-contents/uploads/2009/10/SUKUK-ISLAMIC-BONDS.pdf> accessed 28 May 2022.
[16] Ali et al (n 13).
[17] Nancy Eweiss (ed), Ibn Hajar Al-Ásqalanīy, *Bulughu Al-Maramy* (tr) (Dar Al-Manarah 2003) 470.
[18] ibid.
[19] Ali et al (n 13).
[20] Adam Hayes, 'What Is a Special Purpose Vehicle (SPV)?' *Investopedia* (29 August 2021) <https://www.investopedia.com/terms/s/spv.asp> accessed 01 June 2022.

not owners of the asset" because in asset-based *Sukuk* structures the *Sukuk* holders do not have any interest in the underlying asset.[21]

The contractual agreements are designed in a way that ownership is reduced to a symbolic rather than enforceable status. This is because the perception under *Shari'ah* has generally no legal effect unless it is substantiated in the contract not by mere reference to *Shari'ah* but by virtue of material inclusion. However, *Shari'ah* positions may be taken into consideration in examining the will of the parties. It must be remembered that asset-based structures were created due to market pressure and competition as well as legal constraints.[22] Thus, asset-based *Sukuk* (issuer of underlying asset) structures such as *Sukuk murabahah* (cost-plus-profit margin sale), *Sukuk al-ijarah* (transfer of ownership or benefit in lease), *Sukuk al-wakalah* (Islamic trust asset) etc. are the products of contemporary *Shari'ah* scholars who felt the need to have an equivalent of bonds in the market.[23]

Alternatively, in an "asset-backed" *Sukuk* (profit and loss sharing bond), legal title to the underlying assets will typically pass by way of a true sale from the originator to the SPV. Examples of *Sukuk* structured in this form are *Sukuk al-musharakah* (joint venture bond), *Sukuk al-mudarabah* (business venture bond) etc. On default by the issuer, *Sukuk* holders are able to exercise certain rights of ownership and control over such assets. The elements of true sale, fundamental to securitization, must be present in an "asset-backed" *Sukuk* (profit and loss sharing bond). An asset-backed *Sukuk* is similar to a securitization in that it is a non-recourse obligation and credit risk performance is determined solely by the underlying asset.[24] In essence it is generally believed that asset-backed *Sukuk* structures usually evidence full ownership of the underlying asset by the *Sukuk* holders.[25]

It is thus agreed that asset-backed *Sukuk* involve full transfer of legal ownership of the underlying asset while asset-based *Sukuk* involve recourse to the originator or the issuer (but not the asset). This is in line with the definition given by Islamic Financial Services Board (IFSB) thus:

> "Certificates with each *sakk* (bond) representing a proportional undivided ownership right in tangible assets, or a pool of predominantly tangible assets, or a business venture (such as a *mudarabah*). These assets may be in a specific project or investment activity in accordance with *Shari'ah* rules and principles."[26]

Therefore, unlike a true sale, which produces legal ownership of the asset sold, the sale that "falls short of the true sale" gives rise to merely "beneficial" ownership. *Sukuk* that confer legal ownership of the underlying assets on the investors are known as "asset- backed," while *Sukuk* that confer merely beneficial ownership on the investors are known as "asset-based." In a sale

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[21] Asyraf Wajdi Dasuki and Shabnam Mokhtar, 'Critical Appraisal of *Shariáh* Issues on Ownership in Asset-Based *Sukuk* as Implemented in the Islamic Debt Market' (2010) 8 International *Shariáh* Research Academy for Islamic Finance <https://www.iefpedia.com/english/wp-contents/uploads/2011/02/B108.pdf> accessed 27 May 2022. See also Ryan and Elmaliki (n 1).

[22] Mohammed Rafe Md. Haneef, 'Recent Trends and Innovations in Islamic Debt Securities: Prospects for Islamic Profit and Loss Sharing Securities' (IBIR, 22 October 2019) <https://sukuk.ir/en/academic-papers-and-documents/item/218-recent-trends-and-innovations-in-islamic-debt-securities-prospects-for-islamic-profit-and-loss-sharing-securities> accessed 01 June 2022.

[23] ibid.

[24] Ryan and Elmaliki (n 1).

[25] ibid.

[26] The Islamic Financial Service Board <https://www.ifsb.org> accessed on 15 August 2022.

that "falls short of a true sale" and thereby produces only "beneficial ownership," only some but not all rights to an asset are transferred by sellers to buyers. These rights include the right to use the asset or obtain revenues from it. But one important right – some would say the most important right – is not transferred to the buyers in this type of sale. This is the right of the new owner to sell the asset he purchased to a third party. The inability to sell an asset acquired by way of sales that "fall short of true sales" imposes a significant restriction on all investors who buy assets in this way. Without the right to sell the asset, the buyer becomes effectively unable to "liquidate" his asset, in other words to recover the money he paid for it by selling it. Without the ability to liquidate (sell) the asset purchased, the monetary (cash) value of any asset thus purchased becomes significantly lower.[27]

Sukuk certificates signify absolute ownership of the underlying assets. But investors who purchase assets by way of sales that "fall short of true sales" in other words investors in "asset-based" *Sukuk* - acquire merely the right to a cash flow but not to the assets generating the cash flow. It is for this reason that the *Sukuk* certificates that signify merely beneficial ownership of the underlying assets – the asset-based *Sukuk* – effectively become less tradable in the secondary markets, unlike their counterparts that offer legal ownership of the underlying assets to investors, the asset-backed *Sukuk*.[28] Interestingly Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has raised concern that *Sukuk* must not represent mere debts except if in the process of selling the assets, debts are mixed with the assets unintentionally because ideally *Sukuk* holders are not expected to stand in the line of creditors because they are owners of underlying assets. It thus creates a bankruptcy remoteness situation for the *Sukuk* holders such that even if the originator goes bankrupt, the *Sukuk* holders' payment will not be affected as long as the underlying asset keeps generating returns. This is why it defined investment *Sukuk* as:

> "Investment *Sukuk* are certificates of equal value representing undivided shares in ownership of tangible assets, usufruct and services or of the assets of a particular project or specific investment activity; however, this is true after receipt of the value of the *Sukuk*, the closing of subscription and the employment of funds received for the purpose for which the *Sukuk* were issued."[29]

The definition given above suggests actual ownership by the *Sukuk* holders in all *Sukuk* structures. However, the type of ownership the *Sukuk* holders have in the underlying asset is the main crux of this study. Thus, there are arguments as to the existence of dual ownership (i.e. legal and beneficial) in Islamic law or to put succinctly, the arguments are with regards whether or not there exists a dichotomy between the two concepts i.e. legal and beneficial ownership under Islamic law. The proponents of its existence bring forth very strong evidence as the other group also proffered evidence why there can only be one single owner to an asset. The first group regard as permissible the registration of title of Mr. A's property in the name of Mr. B who is not the actual owner. This is possible in cases where the legal regime of the jurisdiction permits or requires this for certain purposes. The proponents of this group include the *Shari'ah* Committee of Rajhi Bank, Kingdom of Saudi Arabia, *Shari'ah* Advisory Council of Bank Negara Malaysia as well as the AAOIFI *Shari'ah* Standard 2010. This group also permits the

[27] Abdulkarim Abdullah, 'Islamic Finance: Legal and Beneficial Ownership' (February 2018) <https://iais.org.my/publications-sp-1447159098/dirasat-sp-1862130118/economic-finance-zakat-awqaf/item/download/266_51ebc796bb5eb9bd643e3b35f36f653f> accessed 5 June 2022.
[28] ibid.
[29] Accounting and Auditing Organization for Islamic Financial Institutions, *'Shari'ah* Standards' (2010) Standard No. 17 (2) <https://aaoifi.com/shariaa-standards/?lang=en> accessed 5 June 2022.

usage of beneficial ownership in transactions in Islamic finance.[30] The second group, on the other hand, views the legitimacy of applying beneficial ownership in transactions as alien to Islamic law and as such does not permit it. Scholars that fall under this second group include Hussain Hamid Hassan and Bashir Al-Amine.[31]

This study aligns with the second group because as explained above the concept of ownership in Islamic law does not recognize the division into legal or beneficial ownership. What is often termed as beneficial interest in form of incomplete ownership (*milk naqis*) would better be explained as either lease (*ijarah*) which is mere enjoyment of the usufruct of the asset for a certain period and not necessarily having beneficial ownership or incomplete ownership as it is being categorized by the proponents of the argument that indeed there exist a dichotomy between the two concept (legal and beneficial ownership) under Islamic law. This study therefore concludes that Islamic law only recognizes absolute ownership and this is reflected in the asset-backed *Sukuk* structures.

A look at some of the decided cases of *Sukuk* in the court of law further testifies to the significance of the twin concept of legal and beneficial ownership where the courts were made to decide on whether or not the *Sukuk* holders actually own the underlying asset. This is because one of the objectives of this study is the need to ascertain whether a true transfer of ownership occurred in the *Sukuk* issuance and thus whether the structure is truly *shari'ah* compliant. For example, the East Cameron Gas Company asset-backed *Sukuk* (profit and loss sharing bond) of $165.6 million issued in 2006 which is to mature in 2019, reiterates this position. In October 2008, the East Cameron Gas Company approached the U.S. Bankruptcy Court for bankruptcy protection under its Chapter 11 because the *Sukuk* assets could no longer yield the expected return which was as a result of the hurricane which damaged its offshore walls.[32] The main question before the court was whether or not the *Sukuk* holders are part owners of the company's oil and gas royalties i.e. whether they had actual ownership. The company's argument was that there had been no transfer of ownership of royalties to the Cayman SPV which was formed to issue the *Sukuk* and thus the *Sukuk* holders had no right in the ownership of the royalties. They submitted that the transaction was in reality a loan secured on those royalties suggesting that *Sukuk* holders would have to share the royalties with other creditors in the event of liquidation. However, the bankruptcy court rejected this argument and held that: "holders invested in the *Sukuk* certificates in reliance on the characterization of the transfer of the royalty interest as a true sale". This case was however resolved through settlement rather than through a judicial verdict.[33] This in our view is the correct position because the main characterization of an asset-backed *Sukuk* is the feature of true sale that transfers the ownership of the asset to the *Sukuk* holders through the SPV.

In another case of a near default, the Nakheel *Sukuk*– a member of Dubai World and one of the UAE's largest property, the question before the court was whether there was an actual transfer of the underlying asset from the issuer to the SPV. Although from an initial look at the prospectus it appears that a purchase agreement exists between the issuer and the SPV, the effect of which was the sale and delivery of the *Sukuk* asset to the SPV. However, by virtue of

[30] Nik Abdul Rahim Nik Abdul Ghani, 'Developing; *Shari'ah* Parameters for Beneficial Ownership in Islamic Finance' (2015) 11 (27) Asian Social Sciences Journal 155.
[31] Muhammad Al-Bashir Muhammad Al-Amine, *Global Sukuk and Islamic Secularization Market* (Brill's Arab and Islamic Law 2011)109.
[32] Maram Ahmed, 'Islamic Project Finance: A Case Study of the East Cameroon Project' (2015) 20 (4) Journal of Structured Finance 52-65.
[33] ibid.

the structure of the *Sukuk*, which is the *Sukuk al-ijarah* (lease), the asset were leased back to the issuer for a period of 50 years which simply means there was only a transfer of leasehold rights and not a proprietary transfer of ownership rights in the assets. This position of the court further reiterates the position of this study that there can only be an absolute transfer of ownership under Islamic law and not a partial transfer of the benefit of an asset in form of lease which in some quarters is referred to as transfer of beneficial interest or ownership.[34] Also, in the default case of Investment Dar USD100 million *Sukuk al Musharakah (*joint venture bond*),* the *Sukuk* investors could not have recourse to the asset because it is an asset-based *Sukuk*.[35]

These cases, apart from showing the effects of ownership of *Sukuk* assets by the *Sukuk* holders in the event of defaults, the true intentions of the issuers were demonstrated which is not to transfer ownership of the underlying assets to the *Sukuk* holders but to secure a loan. It is established that in the asset-based *Sukuk* structures the *Sukuk* holders could only have recourse to the issuer and have to stand together in line with other creditors while in the asset-backed *Sukuk* structures *Sukuk* holders would have recourse to the asset in case of default. It therefore becomes imperative to analyze the implication of all these under the existing Nigerian Tax Regime.

IV. IMPLICATION OF OWNERSHIP OF SUKUK ASSET UNDER THE NIGERIAN TAX REGIME

To start with, *Sukuk* are often referred to as Islamic bonds under the Nigerian Law. This characterization is a product of the current state of the market.[36] *Sukuk* are legally regulated in Nigeria and serve as an alternative source of funding for government programmes, running concurrently with the conventional bond instruments.[37] It is treated as such in this country because Nigeria is not an Islamic State and is operating common law. The concept of *Sukuk* is as old as Islam. Islamic communities had used *Sukuk* as "paper'' to represent financial commitments that originate from trade and other economic transactions. Historically, the first *Sukuk* transaction is stated to have taken place in Damascus, Syria, in the 7th century CE.[38]

The modern resurgence of *Sukuk* has been propelled by the renewed recognition of the concept by the Islamic Fiqh Academy of the Organisation of Islamic Countries, and the Accounting and Auditing Organisation of Islamic Financial Institutions (AAOIFI). These institutions are standard- establishing organisations in the Islamic finance industry and have enabled *Sukuk* structures to be developed leading to the first successful modern issuance of *Sukuk* by the Malaysian government in 1983.[39]

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[34] Nurul Aini Muhammed and Rafisah Mat Radz, 'Implication of *Sukuk* Structuring: The Comparison on the Structure of Asset Based and Asset Backed *Ijarah Sukuk*' (a proceeding of the 2nd International Conference on Business and Economic Research 2011) 446.

[35] *The Investment Dar Company v Blom Development Bank SAC* (2009) EWHC 3545 (CH).

[36] Hafsat Iyabo Sa'adu, 'Taxation of Capital Market: A Comparative Analysis of Nigerian and United Kingdom Tax Law' (A Dissertation in Partial Fulfilment of the Requirements for Ph.D in Tax Law, University of Ilorin 2014).

[37] Shafiu Ibrahim Abdullahi, 'Sukuk as an Alternative Source of Funds for Nigerian Government' in K. I. Dandago, A. D. Muhammad, and U. A. Oseni (eds), *Essentials of Islamic Banking and Finance in Nigeria* (Benchmark Publishers Limited 2013) 9-10.

[38] Ayodeji Oyetunde, Oyetunde Kareemat Ijaiya, and Ayomide Ogunsesan, 'Understanding Sukuk in Nigeria' *Lexology* (26 April 2022) <https://www.lexology.com/commentary/banking-financial-services/nigeria/aluko-oyebode/understanding-sukuk-in-nigeria> accessed 15 August 2022.

[39] ibid.

Under the Nigerian law, *Sukuk* are regulated by the provisions of the Securities and Exchange Commission Rules 2013 (as amended) (the SEC Rules) and the Investment and Securities Act, 2007, while the primary regulator is the Nigerian Stock Exchange which has also prescribed rules governing the listing of *Sukuk* and debt securities on its exchange.[40]

There are four specific *Sukuk* structures provided by the SEC rules. These are: *Sukuk al-ijara* (transfer of ownership or benefit in lease), *Sukuk al-musharakah* (joint venture bond), *Sukuk Murabahah* (Islamic trust asset) and *Sukuk al-istisnah* (build-to-order) and they are all specific asset financing structures.[41] Be that as it may, the Sec Rules gives the Securities and Exchange Commission the discretion to approve other *Sukuk* structures including asset-backed and asset-based Sukuk.[42] The SEC rules provide that public companies (including SPVs), State and Local Governments, and government agencies as well as multilateral agencies are eligible to issue, offer or make an invitation of *Sukuk.*

Furthermore, *Sukuk* is structured in Nigeria through Islamic financing which is predominantly an asset-backed financing, and is thus best suited to financing specific asset or good-based needs of the originator, as opposed to general liquidity needs of the originator (which are typically financed by conventional lending based on a "fixed cost of funds'' arrangement). Hence, the *Sukuk* structure will most often than not involve the establishment of an SPV (structured as an orphan company) by the issuers, to issue the *Sukuk* certificates to the investors. It is important to note that the ultimate structure would largely depend on the proposed utilization of the issue proceeds.[43]

The first *Sukuk* in Nigeria was issued by the Osun State Government (a subnational government) as far back as 2013. *Sukuk* have been utilized for notable infrastructure projects in Nigeria such as:[44]

a) Construction of 26 schools by Osun State Government using *ijarah Sukuk*(transfer of ownership or benefit in lease) of ₦11.4billion (US $70.6million);

b) Construction of Luxurious apartments in Ikoyi – Lagos by Lotus Capital Limited using private *Sukuk al-istisnah* (build-to-order) ₦1billion (US $70million); and

c) Construction of roads by the Federal Government of Nigeria using *ijarah Sukuk*(transfer of ownership or benefit in lease) of ₦100billion (US $326million).

The administration of tax in Nigeria cuts across the Federal and State Governments. The division of legislative power under section 4 of the Constitution of the Federal Republic of Nigeria 1999 as amended involves only the Federal and State Governments.[45] The oil and gas sector (primarily upstream) provides the bulk of funding of the three tiers of government and has become the dominant driver of the Nigerian economy until recently when Nigeria depends

[40] The Rulebook of the Nigerian Stock Exchange, 2015. See further Rules on *Sukuk* Issuance in Nigeria February 28, 2013. Investment and Securities Act, 2007, Section 313 (6).
[41] ibid.
[42] ibid.
[43] Olayinka Alao, 'A Brief on Sukuk Bonds in Nigeria Renaissance Practice' <https://www.globallawexperts.com/NewsArticle.aspx?PID=2160> accessed 13 August 2022.
[44] ibid.
[45] Hafsat Iyabo Sa'adu, 'Socio-Legal Analysis of Taxation as a Tool for Effective Governance in Nigeria' (2018) 16 (1) Maiduguri Law Journal 176-192.

on taxes as a form of revenue generation due to fall in the oil prices at the international market and the outbreak of Covid-19.[46]

The *Sukuk* markets are among the most rapidly growing in the field of Islamic finance in Nigeria. Part IV of the Nigeria Non-Interest Finance Regulations No. 1, 2012 discussed *Sukuk* and it says *Sukuk* shall be treated as bonds for the purpose of tax. It further provides that the gains arising out of any arrangement shall be treated as interest accruing to the financial institution and subject to the provisions of Companies Income Tax Act (CITA) 2007. The Companies Income Tax Act and the Nigerian tax laws generally provide for a fixed levy. The resemblance of this in Islamic law is *ushr* which is a form of tax on income in the sense that it is the value of goods (produce) that become the basis of taxable income. But Abu Yusuf proposed a model of proportional taxation and not fixed levy.[47]

Nonetheless the non-interest financial system is not provided for in the current tax regime in Nigeria hence there is the need to make regulation to accommodate the evolving tax characteristics.[48]

In 2011 the Federal Government issued the Companies Income Tax (Exemption of Bonds and Short Terms Government Securities) Order (CITEO), 2011 which was gazetted in 2012 with a commencement date of 2nd January 2012. In exercise of the powers conferred on him by section 23 (2) of CITA, President Goodluck Jonathan issued CITEO which provides inter alia that:

> "All short terms Federal Government of Nigeria securities such as treasury bills and promissory notes; bonds issued by Federal, State and Local Governments and their agencies; bonds issued by corporate bodies including supra-nationals; interest earned by holders of the bonds and short term securities are to be exempted from taxes imposed under the CITA for a period of ten (10) years."

Subsequently, the Personal Income Tax Amendment Act 2011 (PITA Amendment) made provision for the exemption of public bonds by the governments, MDAs and also corporate bonds from personal income tax, but not short term Federal Government securities. Thus, until the enactment of CITEO and Personal Income Tax (Exemption of Bonds and Short Term Government Securities) Order (PITEO), 2011 all short term Federal Government securities were subjected to tax under CITA and PITA.

Also, item 31A, Third Schedule PITA provides that interest earned by holders of corporate bonds including supra-nationals and governments and their agencies are exempted from tax under PITA. However, PITEO specifies that the personal income tax exemption on bonds would also be for ten (10) years, instead of the unlimited duration exemption in Para 31A, Third Schedule PITA.

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[46] Olaniwun Ajayi, 'Covid-19: Impact on Business and Tax Implication' (March 2020) <https://www.olaniwunajayi.net/blog/covid-19-impact-on-business-and-tax-implications/tax-implications/.> accessed on 5th June 2022.

[47] Abu Yusuf Al-Qadi and Yakub Bin Ibrahim, *Kitab Al-Kharaj* (Dar Al-Marifa 1979) 535-538.

[48] Afolabi Elebiju and Ayooluwatunwase Fadeyi, 'Implication: Analysis of Income Tax Exemption of Bonds in Nigeria' *Mondaq* (01 April 2020) <https://www.mondaq.com/nigeria/sales-taxes-vat-gst/910846/implications-analysis-of-income-tax-exemption-of-bonds-in-nigeria.> accessed 18 February 2021. See also Non-Interest Finance Regulations No.1 2012, Investment and Securities Act 2007 and SEC'S Guidelines on *Sukuk*.

Around the same time, Value Added Tax (Exemption of Bonds and Short Term Government Securities) Order (VATEO) 2011 was also issued to exempt proceeds from the disposal of:

a) Short term Federal Government's securities and bonds; and
b) Short term bonds issued by State, Local Governments and corporate (including supra-nationals) from VAT.

Paragraph 2 of VATEO provides that except for bonds issued by the Federal Government which shall continue to enjoy VAT exemption under the Value Added Tax Act, the VAT exemption on bonds shall be for ten (10) years. This provision is consistent with section 38 Value Added Tax Act (VATA), 2004 which empowers the Minister of Finance to amend, vary or modify the list set out in First Schedule VATA (VAT Exemption List). It is important to state that in practice, substantive bond transactions were never subjected to VAT in Nigeria.

The Companies Income Tax Act 2007, Personal Income Tax Act 2011 and Exemption Orders did not specifically mention that bonds will be exempted from withholding tax. However, since withholding tax is an advance payment of tax, transactions not liable to income tax are also not subject to withholding tax in Nigeria. According to Oguntade (JCA) in *7up Bottling Company v Lagos State Inland Revenue Board (LSIRB)*[49] Withholding tax is a form of tax administration which enables tax authorities to recover all sources from a taxable person's tax from payment made for certain services which such persons render to another. What is deducted by the person who pays for the services is a percentage of the payment. Now if so deducted, when taxable person's tax for the year is duly assessed, what has been deducted is credited to him in a manner that he does not pay twice on the same income accruing from that payment." This implies that if proceeds from bonds are tax exempt, bonds will not be subject to withholding tax as was upheld in the case of *Brasoil Service Company Limited v Federal Inland Revenue Service (FIRS)*.[50]

Section 30 of the Capital Gains Tax Act (CGTA) 2004 also exempts from CGT, gains accruing from disposal of Nigerian Governments (a) securities which includes: Nigerian treasury bonds, saving certificates and premium bonds issued under the Savings Bonds and Certificate Act, (b) Stocks, and (c) Shares. Capital gains tax is generally not charged on income made from disposal of bonds in line with provisions of section 30 of Companies Income Tax Act (CITA) 2007 and given the long established regulatory practice post section 30 CGTA of exempting stocks from CGT.

It is important to state that when there is a conflict between a statute and an administrative order, the former must prevail. A rule or regulation must conform to and be consistent with the provisions of the enabling statute in order for such rule or regulation to be valid. The provisions of the Personal Income Tax (Exemption of Bond and Short Term Government Securities) Order (PITEO), 2011 is consistent with the enabling statute, given that Personal Income Tax Act (PITA) allows the Minister to amend by notice, the exemptions provided under section 19 (2) of PITA. In *A.G. Abia v A.G. Federation*,[51] The Supreme Court considered the validity of the promulgation of the Revenue Allocation (Federal Account) (Modification) Order (Statutory Instrument No. 9 of 2020) and held that the President acted pursuant to section 315 of the 1999 Constitution of Federal Republic of Nigeria as amended. Thus, the promulgated order was held to be consistent with the constitution and therefore valid.

[49] (2000) 3 NWLR (Pt. 650) 565, 617.
[50] (2016) 2 TLRN 24.
[51] (2003) 4 NWLR (Pt. 809) 124, 177.

Consequently, the PITEO could validly amend paragraph 31A, Third Schedule PITA. The Federal Inland Revenue Service (FIRS) and States Internal Revenue Service must take utmost care to ensure that the person sought to be taxed is not someone who is completely outside the taxing statute or is exempted from paying the relevant tax as applicable to *Sukuk* assets under the Nigerian tax regime. In *Citi Bank v Federal Inland Revenue Service*[52] the court held that section 9 (1)(g) of Companies Income Tax Act 2007 expressly subject the profits and gains from the acquisition and disposal of short term money instruments to tax and it automatically excludes long term money instruments from tax. This is in line with the interpretative maxim *"expressio unius est exclusio alterius"* meaning that express mention of one thing excludes others not mentioned as applied by the Supreme Court in *Ojukwu v Yar'adua*.[53] The court has no power to read into a statute what is not contained therein, as judges are generally meant to interpret and not to make law.

Furthermore, where a taxpayer is aggrieved by an assessment, demand notice, action or decision made upon him by the Revenue Authority regarding applicable tax treatment of bonds, such a taxpayer may appeal against such decision, assessment or demand notice within thirty (30) days from the date a copy of the order or decision which is being appealed against is made or deemed to have been made. Section 13, Fifth Schedule Federal Inland Revenue Service (Establishment) Act (FIRSEA) 2007 and Paragraph III Tax Appeal Tribunal (Procedure) Rules 2010 provides that the Tax Appeal Tribunal (TAT) may entertain an appeal after the expiry of the period of thirty (30) days if it is satisfied that there is sufficient cause for the delay. Such appeal is made to the TAT in the required form, and accompanied by the prescribed fee. It is important to state that where a taxpayer does not object or appeal as required within prescribed timelines, the assessment or demand notices by the Revenue Authority becomes final and conclusive and the Revenue Authority may charge interests and penalties in addition to recovering the outstanding tax liabilities which remain unpaid. The court in *I-D Sam Nigeria Limited v Lagos State Internal Revenue Service*[54] stated that:

> "The Claimant clearly had a right to disagree with the assessment as being arbitrary, out of touch with reality etc. However, the only way to have communicated that disagreement was for the claimant to have filed a Notice of Objection within the 30-day period as prescribed in section 58 of PITA… Section 66 provides that where no valid appeal or objection is lodged as prescribed, the assessment becomes final and conclusive. Where the payment is not made then, at this point, section 104 comes into play."

Consequently, every eligible individual, bodies or companies are subject to tax unless specifically exempted under the Nigerian tax regime as applicable to ownership of *Sukuk* assets.

The tax exemption granted by the CITEO, PITEO and VATEO was for a fixed duration of ten (10) years which elapsed by January 1, 2022 and consequently ceases to apply. However, the exemption still covers the bonds issued by the Federal Government with no expiry date. While the exemption did not cover bonds issued by State and Local Governments, corporate bodies

[52] (2017) 30 TLRN 40.
[53] (2008) 4 NWLR (Pt. 1078) 435, 461.
[54] (2011) 5 TLRN 41, 51.

and interests earned from short term securities and bonds.[55] As a result, incomes accruing to companies and bond holders on bonds including *Sukuk* issued by corporate and supra-national bodies, State and Local Governments and their agencies shall be liable to Companies Income Tax (CIT) in the form of withholding tax (WHT).[56]

Personal Income Tax (PIT) payable pursuant to the Personal Income Tax (Amendment) Act 2011 does not apply to any bond including *Sukuk* issued by Federal, State and Local Governments and their agencies or bonds issued by corporate bodies including supra-national. In the same vein, the interests earned by the bond holders are exempted from personal income tax. As such, withholding tax will not apply to this exempted income.[57] This provision under PITA does not have an expiry period hence individuals will continue to enjoy PIT exemption on incomes from government corporate and supra-national securities.

Under the Capital Gains Tax Act, 2004 (as amended by the Finance Act 2021), gains accruing to a person from disposal of Nigerian government securities and bonds including *Sukuk* or any other long term securities are exempted from capital gains tax.[58] Also, Value Added Tax will not apply on disposal of securities as it is expressly excluded from the definition of goods under the Value Added Tax Act (As amended).[59]

Despite the above analysis, there is yet to be adequate guidelines for the taxability of Islamic finance products in Nigeria. This is because there is no provision in all the tax laws for the taxability of Islamic finance products such as *murabahah, mudarabah, wakala* etc.[60]
The taxability of *Sukuk* becomes important where it is asset backed or asset based as the case may be.

V. CONCLUSION AND RECOMMENDATIONS

After a careful and detailed analysis of the meaning of legal and beneficial ownership under the Common law and *Shari'ah* as well as its implication in *Sukuk* structures, the study found the implication of the concept in some analyzed case laws showed that the concept of legal and beneficial ownership has a significant impact on *Sukuk* structures in any jurisdiction, Nigeria inclusive. With the issuance of three sovereign *Sukuk* so far by the Federal Government of Nigeria (FGN) and one by a sub-sovereign, the importance of this cannot be overemphasized.

The study concluded amongst other things that the concept of ownership (legal and beneficial) under Common law is not much different from the concept of ownership under Islamic law as depicted in *Sukuk* structures such as asset-based *Sukuk* and asset-backed *Sukuk*. The major difference lies in the consequence of such ownership with regards to the risk and liability that accrues to the holder of such asset. The article also concluded that the concept of ownership under Islamic law comes in different forms but not divided according to the division under Common law (legal and beneficial ownership).

[55] Companies Income Tax (Exemption Order Bonds and Short Term Government Securities Order) 2011, Section 1.
[56] Companies Incomes Tax Act, 2007, Section 78.
[57] Third Schedule Personal Income Tax Act, item 31A.
[58] Capital Gains Tax Act (as amended by the Finance Act 2021).
[59] Value Added Tax Act (as amended by the Finance Act 2020), Section 46.
[60] Saka Muhammed Olokooba, 'Taxation of Islamic Banking Products under the Nigerian Laws: Issues, Problems and Prospects' (2014) 4 (1) Ilorin Journal of Religious Studies 71-82.

The article hereby recommended that:

1. *Sukuk* be structured in conformity with *Shari'ah* rules to ensure that they are truly asset-backed and there is indeed a true sale between the originator and the *Sukuk* holders such that the *Sukuk* holders have absolute right and control over the asset.
2. The ten (10) year period stipulated by CITEO, PITEO and VATEO elapsed by effluxion of time on January 1, 2022 and consequently ceases to apply. However, the exemption still covers the bonds issued by the Federal Government with no expiry date while the exemption did not cover *Sukuk* and bonds issued by State and Local Governments, corporate bodies and interests earned from short term securities and bonds.
3. It is indeed overdue to amend the Nigerian law to suit taxation of Islamic finance products most especially *Sukuk*.