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Abstract

The current legal system in Afghanistan provides for commercial and financial dealings through the Civil Code (Qanuni Madani) and covers several Islamic financial transactions, such as the contract of sale which can be found under articles 1035 to 1123 of the Civil Code[1] and the contract of Future Commodity Sale (salam) which is under articles 1124 to 1132 of the Civil Code[1]. In Afghanistan, while the Islamic finance sector is still in its nascent stage, there is still a growing demand for it. Its potential, therefore, remains untapped. One such Islamic finance instrument that is underutilized is Sukuk (an Arabic term, which denotes a financial instrument similar to the issuance of a bond). While the central bank of Afghanistan has taken the initiative to develop and standardize the Islamic banking sector by issuing guidelines on various Islamic finance contracts that are meant to regulate the activities of Islamic banks, it has yet to issue Sukuk regulations. The main purpose of this paper is to examine the current law on Domestic and Foreign Private Investment in Afghanistan (2005) and to consider the issuance and regulation of Sukuk as part of such investments. It also briefly assesses the Malaysian legislation on Islamic Capital and Sukuk to serve as a guide for Sukuk legislation in Afghanistan. This paper proposes the introduction of new Sukuk provisions and the amendments of existing articles within the current investment law to cover different aspects of Sukuk issuance, structures and investment. This research is the latest effort in developing the Sukuk industry in Afghanistan through Sukuk legislation and serves as a guide for initiating efforts for incorporating provisions related to Sukuk issuance into the current law. The methodology used is purely doctrinal and will make use of examining the law and regulations that are relevant to Sukuk.

Keywords: *Sukuk, regulations, Afghanistan legal system, Malaysian legislation, Islamic finance, investments*

Introduction

Afghanistan is a Muslim-majority country and its main sources of laws are Islamic, statutory, and customary. Islamic finance In Afghanistan is still a developing sector. Currently, at least 7 of the country's 16 licensed financial institutions provide Islamic financial services in some manner. Due to decades of instability, Afghanistan's stock exchange market, banking system, and financial institutions weren't able to function effectively and efficiently. With an absence of a strong legal and regulatory environment, the Islamic banking and finance industry as a whole did not develop and flourish. For *Sukuk* in particular, the lack of legal *Sukuk* provisions within Afghanistan's investment law, mainly the existing Domestic and Foreign Private Investment Law (2005)[1], has hindered the development of *Sukuk* and deterred investors from investing in *Sukuk* projects. There were efforts being made to draft a *Sukuk* law by the former government however it was still in its very early stages and has been stalled due to the recent political crisis.[2] The government of Afghanistan has been seeking an alternative *Shariah* compliant model of financing as the economy is largely aid dependent. To support local banks to manage their funds, the government sells short-term securities that are not *Shariah* compliant[3]. The government sought to find *Shariah* compliant investments that will foster economic growth, its stability and revival. The government turned to *Sukuk* as a way to raise financing and to stabilise Afghanistan's capital market. However, due to the lack of laws guiding *Sukuk* issuance, the government has not yet issued *Sukuk*. Hence, the incorporation of *Sukuk* provisions into the current investment law is of great necessity as it will strengthen the *Sukuk* and capital market in Afghanistan as well as to help to boost the economy. By definition, *Sukuk* (singular Sakk) refers to a document or a financial certificate. *Sukuk* represents the holder's proportionate ownership in an undivided part of an underlying asset where the holder assumes all rights and obligations to such asset.[4] The Bahrain Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) defines Sukuk as "certificates of equal value representing undivided shares in ownership of tangible assets, usufruct, and services, or in the ownership of the assets of particular projects or special investment activities.[5]

The main difference between a conventional bond and *Sukuk* is that the latter represents a share of ownership in an asset, whereas the former represents the borrowing of cash. Sukuk are financial certificates that adhere to Shariah law via which investors can acquire a portion of an issuer's assets up until the Sukuk maturity date. Bonds, on the other hand, are financial certificates that allow investors to lend money to the issuer with the promise of repayment at the maturity date with interest.[6] According to the Security Commission of Malaysia in its guidelines on issuance of Private Debt Securities and *Sukuk* to retail investors[7] *Sukuk* is defined by a certificate of equal value which evidence undivided ownership or investment in assets that are Shariah compliant and it must be endorsed by the *Shariah* Advisory Council (SAC) of the central bank of Malaysia. *Sukuk* is a direct source of financing and is more cost effective than other forms of investment. Varieties of contracts are also used to structure different types of *Sukuk*. These are *Sukuk al-murabahah*, *Sukuk al ijarah*, *Sukuk al-mudharabah*, *Sukuk al-intifa'*, *Sukuk al-salam*, *Sukuk al-istisna'*, and *Sukuk al-musharakah*.[8]

In all of the types of *Sukuk,* there are three main parties involved. The first party is called the originator, also It is called the issuing entity or the owner of the assets intended to be utilized in a *Sukuk,* and can comprise individuals, groups, or countries. The second party is known as the Issuance Agent that undertakes the management of

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[1] Private Investment Law, 21 December 2005, *World Trade Organizations*
[2] Center for Preventive Action, Instability in Afghanistan, *CFR,* October 19, 2022.
[3] Kimball, Jack. Harooni, Mirwais. Afghanistan mulls Islamic bonds, fearing western cash cutback, *Reuters*, May 17, 2012.
[4] Shariah Standard No. 17, Sukuk, *AAOIFI*.
[5] *Ibid*
[6] Sukuk and bonds, *Saudi Exchange*. Accessed 27 August 2022.
[7] Guidelines on issuance of corporate bonds and sukuk to retail investors, *Security Commission Malaysia,* 15 June 2015. Accessed on 28 August 2022.
[8] Ayub, Muhammad. *Understanding Islamic Finance*. Gramedia Pustaka Utama, 2013.

the owned assets for the *Sukuk* holders and on their behalf. Usually it is a company of special purpose known as a Special Purpose Vehicle (SPV) that undertakes the issuance process. To ensure transparency and defend the rights of the *Sukuk* holders' investors, the SPV may have a variety of duties assigned to it, such as issuance manager or investment trustee. It must also be legally and financially independent from the authority from which it originated. The third party in a *Sukuk* are the *Sukuk* holders, those who have invested in purchasing *Sukuk* certificates, they can be financial institutes, local or international banks, or individuals or governments.[9]

2. Legal Challenges for the *Sukuk* industry in Afghanistan

Sukuk has great potential in generating revenue and developing the infrastructure of Afghanistan. Revenue derived from *Sukuk* can be redistributed to finance public expenditure, bring idle cash into circulation and promote economic growth. However, for *Sukuk* to reach its full potential, there is a need for its regulatory framework. At the moment, there are no legal provisions and neither are there any guidelines or regulations issued by the Da Afghanistan Bank (Central Bank of Afghanistan) on *Sukuk*. Without a national law on *Sukuk*, many legal and regulatory issues will arise before and after *Sukuk* issuance. Investors are unwilling to invest in *Sukuk* in Afghanistan as the absence of a law on Sukuk contributes to the lack of transparency in identifying a Shariah compliant investment and accountability when it comes to default in payments by the issuers of *Sukuk*. *Sukuk* must also be *Shariah* compliant, meaning that its operation must be in line with Islamic principle, as such, the most distinctive feature of *Sukuk* is their compliance with the Shariah in order to be considered as 'Islamic', all *Sukuk* transactions must comply with the Shariah. Shariah compliance must be observed in primary issuance, secondary trading as well as on the redemption of *Sukuk*. For *Sukuk* transactions to be Shariah compliant, there are certain elements to avoid. The first element is that 'Riba' or interest must be avoided. Secondly, 'Gharar' or uncertainty must not be present. In addition to the prohibition of interest and uncertainty, the *Sukuk* transactions should also avoid the other prohibitions in Islamic law, such as transactions involving gambling and the sale or production of pork and liquor. In summary, this paper will be discussing several issues and problems related to *Sukuk* issuance in Afghanistan and will mainly focus on the legal issues related to *Sukuk.* In a nutshell, there is an absence of a law on *Sukuk* within the existing investment laws in Afghanistan. The *Sukuk* industry remains unregulated as there are no regulatory authorities overseeing it. There are no legal protection provided to *Sukuk* investors who intend to initiate *Sukuk* based projects in the country. Finally, the Afghan capital market is in a fragile state[10] and needs to be strengthened through *Sukuk*.

3. Research methodology

The primary method for this research will be doctrinal in nature, whereby primary sources regarding the main provisions of the current investment law on Domestic and Foreign Private Investment in Afghanistan (2005) will be analyzed extensively and the Malaysian legislation relating to *Sukuk* will be briefly overviewed. Secondary sources such as books and journal articles will be referred to supplement and aid the research. The paper employs Afghanistan as its case study being an Islamic nation and in need of mobilizing additional revenue to finance its development needs, an examination of

[9] Zolfaghari, Pegah. "An introduction to Islamic securities (Sukuk)." (2017).
[10] The world bank in Afghanistan, *The World Bank*.

Sukuk as a form of financing that can be made available to the state justifies the research. The paper adopts a discursive approach in its examination and is purely qualitative.

4. An overview of the current global *Sukuk* market

According to Ali, in his book "Sukuk and Islamic Capital Markets: A Practical Guide"[11] the *Sukuk* industry globally is growing, in particular, due to the developments within the Islamic Finance industry. The first global *Sukuk* was issued by Malaysia in 2002, and since then there have been numerous global *Sukuk* issuances. Along with Malaysia, the next Southeast Asian *Sukuk* market is Indonesia, which together with Saudi Arabia and Malaysia tops local currency issuances and benefits from a sizable economy.[7] In the article, "The Determinants of the development of the *Sukuk* Market in GCC Countries"[12] the collapse of the regional real estate markets resulted in the cancellation of a number of *Sukuk* plans in the Gulf Cooperation Council (GCC) region. Large real estate businesses were among the major *Sukuk* issuers in the GCC before 2008. Nonetheless, due to investor demand for Sharia-compliant securities and the need to fund billions of dollars in infrastructure projects over the next decade, the GCC remains an important *Sukuk* market. The *Sukuk* market has hardly scratched the surface of its potential as a capital development tool for infrastructure. According to a non-rating action commentary by Fitch Ratings, the total amount of *Sukuk* issued in 2021 increased by 36.1 percent year on year to USD 252.3 billion. The issuance was controlled by central banks, governments, and international entities.[13] Despite obstacles with the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) regulations, Covid-19 disruptions, and increasing oil costs, this was achieved. *Sukuk* issued in local currencies accounted for 80% of total issuance. In 2021, the GCC's primary jurisdictions, Malaysia, Indonesia, Turkey, and Pakistan, released USD 230.2 billion in sukuk. Sukuk were also issued by non-core market sovereigns such as the United Kingdom, Maldives, and Nigeria.[14]

4.1 The Importance of Sukuk legislation for the capital market

Nazar in his article, "Regulatory and financial implications of *Sukuk*'s legal challenges for sustainable *Sukuk* development in Islamic capital market"[10] explored the importance of having a strong regulatory framework for *Sukuk* and the need to develop an Islamic capital market. He discussed the various legal issues and problems facing *Sukuk* in different jurisdictions. He highlighted some of the legal problems in the lack of success of *Sukuk* in Indonesia was that there was an insufficient legal basis for Islamic financial development as a whole as it still relied on conventional banking laws and regulations. He also discussed the possible dispute between civil law and *Shariah* law when it comes to enforcing *Sukuk* contracts. In the article, "Regulation, Performance and Future Challenges of Sukuk: The Evidence from Asian Markets"[15], the author, Farouk examined several jurisdictions across Asian countries and concluded that a

[11] Ali, Rahail. "Sukuk and capital markets: A practical guide." *Globe Law and Business, London* (2011).
[12] Grassa, Rihab, and Kaouthar Gazdar. "The determinants of the development of the Sukuk market in GCC countries." In *International Conference on Islamic Capital Markets, Bapepam-LK and IRTI–IDB*. 2012.
[13] Nazar, Jhordy Kashoogie. "Regulatory and financial implications of Sukuk's legal challenges for sustainable Sukuk development in Islamic capital market." *Ethics, Governance and Regulation in Islamic Finance* 135 (2015).
[14] Promising outlook for global sukuk market following robust 2021, *Fitch Ratings,* 11 January 2022.
[15] Ahmad, Abu Umar Faruq. "Regulation, performance and future challenges of Sukuk: The evidence from Asian markets." In *Advances in Islamic Finance, Marketing, and Management*, pp. 27-48. Emerald Group Publishing Limited, 2016.

legal regulatory framework as required by and demanded by *Sukuk* is lacking and that it is often treated under conventional regulations for capital markets. This poses a serious legal issue for *Sukuk* regulation as compliance with *Shariah* is imperative. The author is of the view that either new regulations on *Sukuk* should be issued or the current regulations be amended to cater for *Sukuk.* Hence for *Sukuk* issuances to be Shariah and legally compliant, developing or amending the current capital market regulations and laws are necessary.

The authors, Ghezala et al in their article "Legal and Regulatory Requirements to Implement Sukuk In Algeria: Learning From Malaysian Experience"[16] highlighted several legal issues that impede the development of *Sukuk.* Among others, the lack of *Sukuk* legislation in Algerian commercial law and the absence of *Sukuk* regulation in the capital market were obstacles that prevented the establishing a sound legal regulatory framework for regulating *Sukuk*. Due to the legal impediments, the issuance of *Sukuk* has been affected and it has also affected investors' confidence in *Sukuk.* Hence, there is enough literature to suggest the importance of having *Sukuk* laws for the development of *Sukuk*. The importance of establishing a proper legal framework can be seen in the article authored by Mohammed on "Sukuk, Taxation, and its Necessary Legal Structures"[17]. According to the author, the usage of sukuk necessitates the employment of proper legal frameworks for a variety of reasons. Due to the fact that Islamic bonds are backed by actual assets rather than acting on the premise of interest, they frequently require several transfers. Legal frameworks that are not built to handle this will tax every transfer, putting individuals participating in the sukuk transaction in an unsustainable predicament. The fundamental reason for this is that sukuk frequently require ownership of the sukuk's covered asset to be transferred from one party to another on a regular basis.

In another article, "The Role of Islamic Sukuk "Bonds" in Providing Government Investment Needs"[18], the author, Nasser stresses on the importance of a legal framework for *Sukuk*. According to him, *Sukuk* is a public vessel in which the money of the society is invested, as it collects money from a wide range of individuals, businesses, and institutions. It should be safeguarded in a way that is consistent with its nature and the overall nature of its interactions with individuals and institutions. For the sake of community funding, the public vessel must be legally safeguarded. Furthermore, he states that the characteristics of Islamic *Sukuk* vary depending on the categories on which they are founded, as well as the goal of use, recruitment, and other factors. As a result, it's critical to establish a basic legal framework for regulating *Sukuk* transactions.

4.2 The need for Sukuk legislation in Afghanistan

In the article "Afghan Laws on Islamic Finance: Lessons from Malaysia"[19] Saleem states that Afghan laws on contracts are contained within the Afghan Civil Code. The code

[16] Ghezal, Mohamed, Rusni Hassan, and Ahcene Lahsasna. "Legal and regulatory requirements to implement sukuk in Algeria: Learning from Malaysian experience." *Journal of Islamic Finance* 10 (2021): 030-044.
[17] Mohammed, Naveed. Sukuk, Taxation, and its necessary legal structures, *Islamic Finance Foundation*, 09 August 2014.
[18] Shawaqfeh, George Nasser. "The role of Islamic sukuk bonds in providing government investment needs, vol. 7 No. 2 (2019).
[19] Saleem, Muhammad Yusuf. Afghan laws on Islamic finance: Lessons from Malaysia, No 5, *Hamida Barmaki Organization for The Rule of Law* (2015).

lays down commercial and financial laws that govern Islamic financial transactions. Saleem highlights the need for a comprehensive Islamic Banking Act modeled after the Islamic Financial Services Act 2013 in Malaysia. He is of the view that the proposed Islamic banking law would help increase the peoples' confidence in Islamic banks and enable them to mobilize funds and channel them to various sectors of the economy. This consequently will have a positive impact on economic development and job creation as the country is in dire need of reviving its economy after decades of war and destruction. Saleem also stresses on the need for guidelines and regulations to regulate the application of Islamic banking and financial practices by Islamic banks in Afghanistan to ensure that there is standardization of Islamic banking practices. In 2005, the government of Afghanistan enacted the "Domestic and Foreign Private Investment Law in Afghanistan".[20] This law provides provisions on taxes, custom duties, renting of land, transfer of capital and profits, sale, purchase and sale of shares and access to banking. This law was enacted to encourage and safeguard private investment both domestically and internationally. The purpose of the law is to promote economic development, increase the labor market, boost national prosperity, raise people's living standards, and aid in the reconstruction of Afghanistan. Article 18[21] states that an approved enterprise with foreign ownership can sell its shares to Afghans citizens or the government of Afghanistan. Article 4[22] states that the equity in a joint venture investment between the government of Afghanistan and the private sector, whether domestic or foreign shall be determined by the parties involved. The law does provide for the sale and purchase of shares as well as for investment between foreign/private ventures and the government of Afghanistan. Therefore, there is a framework for *Sukuk* provisions that can be incorporated as a separate chapter with its own unique articles.

Marwah and Ladhani in "Financial Sector in Afghanistan: Regulatory Challenges in the Financial Sector of Afghanistan"[23] shed light on the financial sector system that exists in Afghanistan. Their discussion provides readers with a quick overview of Afghanistan's financial background, rules, and regulations. Furthermore, they have attempted to make a few recommendations in order to bring Afghanistan's economy up to par with that of other emerging countries around the world.[24] One of the suggestions is the development of a comprehensive legal regulatory framework for the stock exchange and capital market in Afghanistan. This further highlights the need for strengthening *Sukuk* through legal provisions. According to author Karimi, in his case study "Moving Away from Foreign Aid: A Case Study of Afghanistan"[25] the lack of a stock exchange market creates challenges for the issuance of *Sukuk*. There is however an absence of an Islamic capital market as well as regulations on *Sukuk* in Afghanistan. It is important for Afghanistan to overcome the legal issues and move towards establishing legal provisions for *Sukuk*. *Sukuk* markets have great potential for developing infrastructure in Afghanistan, however the absence of legal

5. An Examination of the law on domestic and foreign private investment in

[20] Domestic and foreign private investment law in Afghanistan, 2005 (Official Gazette No. 869)
[21] Article 18, Domestic and Foreign Private Investment Law in Afghanistan 2005
[22] Article 4, Domestic and Foreign Private Investment Law in Afghanistan 2005
[23] Marwah, G. S., & Ladhani, V. (2016). Financial sector in Afghanistan: Regulatory challenges in financial sector of Afghanistan. In *Financial Market Regulations and Legal Challenges in South Asia* (pp. 224-262). IGI Global.
[24] *Ibid*
[25] Karimi, Abdul Matin. "Moving away from foreign aid: A case study of Afghanistan." (2020).

Afghanistan (2005)

This section seeks to examine the provisions of the current law on Domestic and Foreign Private Investment in Afghanistan with a purpose of discovering where and how *Sukuk* provisions can be incorporated within its provisions as well as to reveal gaps within the provisions that can be amended to support and encourage *Sukuk* in its various forms.

5.1 Purpose of the legislation

The main purpose of the legislation is enshrined in article 1 which states that it was enacted to encourage and protect private investment from both domestic and foreign sources. The purpose of this legislation is to promote economic development, expand the labor market, improve national prosperity, raise people's living standards, and aid in the reconstruction of Afghanistan. This means that the act plays an important role in developing the economy and infrastructure of Afghanistan. The purpose of the legislation as stated under article 1 reflects the outcome of *Sukuk*, which is to promote development, investment and to further aid in economic growth, as well as developing infrastructure. [26]

5.2 Interpretation

Article 2 defines the meaning of investment and the meaning of approved enterprise. It states that "Investment" means " Utilization of tangible and intangible capital in the form of cash, credit, material goods, services or other types (i.e. patent, intellectual property, trademark and copyright) in an enterprise approved by the High Commission on Investment.[27] Whereas an "Approved Enterprise": refers to Investment by a domestic or foreign real or legal entity as proscribed under this law. The interpretation part is brief and only contains two definitions and states the types of investment but does not further define those investments. Although article 2 defines the meaning of an investment, it does not provide a definition on *Sukuk* investment, its structure and its types for the purpose of investment.

5.3 Entities that qualify for investment

According to article 3, which is based on the provisions of the law and the commercial law, qualified domestic or foreign entities, real or legal, may invest in any sector of the economy, whether manufacturing or providing services. It can be seen that there are no restrictions on entities that qualify for investment as well as the activities that they can invest in. The article is sufficient for the operation of *Sukuk* as it outlines the types of qualified entities that can invest in different sectors of the economy.

5.4 Forms of domestic, foreign and joint venture

The form of investment relates to the percentage amount of foreign and domestic private equity. According to article 4, private equity can either be one hundred percent domestic or foreign. It can also be any form of private equity combination between domestic and foreign entities as well as the Joint venture between the Government of Afghanistan and the private sector, whether domestic or foreign. For the percentage of

[26] Saddique, Akmal, and Shahzad Anwar. "Challenges and prospects of establishing stock exchange market in Afghanistan." *Kardan Journal of Economics and Management Sciences* 2, no. 1 (2019): 74-87.
[27] Sukuk in Afghanistan (2017).

the combination of private equity between domestic and foreign entities as well as between the government of Afghanistan and the domestic and foreign sector, it must be done by way of mutual consent. This article discusses the percentage of equity ownership between domestic and foreign entities. This is important to consider when the type of *Sukuk* is based on partnership, either through Mudharabah or Musharakah.[28] In the Mudharabah *Sukuk* structure, the issuer, who is the *Sukuk* certificate issuer, will call the investors to participate in a Mudharabah contract, whereby the issuer will act as the manager of the investment amount and the investors will be the capital providers. The issuer will then invest the capital into projects, and after the project starts to generate profits, the issuer will apply the profit-sharing ratio and pay the profit share of the investor periodically. Based on the above explanation, Mudharabah *Sukuk* are conceptually equity-based and are not debt instruments. The Mudharabah *Sukuk* represents the *Sukuk* holders' proportionate rights over the Mudharabah project and revenue.[29] In the second type of *Sukuk* Musharakah, both the issuer and investor will contribute to the capital of the project and the project is normally managed either by the issuer or a third party.[30] Therefore, article 4 can be amended to include the percentage of equity ownership between the issuer, and the investor in a partnership *Sukuk* in order to specify the percentage ratio to either be fixed or to be determined by the issuer and investor as agreed between them.

5.5 Benefits, waivers and obligations of approved enterprises Taxes

According to article 11, there are three types of tax benefits, namely short, medium, and long-term. The short-term provides a tax waiver for four years from the date of licensing or three years from the start of production. The medium-term provides a tax waive for six years from the date of licensing or five years from the start of production. Whereas the long-term tax waiver is for eight years from the date of licensing, or seven years from the start of production. This article can be amended to include tax exemptions for issuers of *Sukuk* as well as on the income received by investors from *Sukuk*. In *Sukuk* investment, the common question that is asked by investors is: ‘will a particular *Sukuk* attract tax implications that are heftier than their conventional counterpart?’, to answer this, it is imperative to refer to the Value Added Tax Law 2016[31]. In analyzing its provisions, there are no tax exemptions provided for Shariah transactions that deal with assets. There are also no provisions for issuers to receive tax deductions on expenditure incurred on the issuance of *Sukuk*. Furthermore, there are no provisions in Income Tax Law 2009 [32] for the profits paid to investors who invest in *Sukuk*. All these discourage issuers from issuing *Sukuk* and investors from investing in *Sukuk*.

5.6 Renting of Land

Article 14 relates to the provisions on the leasing of real estate. Foreign investors may lease real estate for ten, twenty, or thirty years, depending on whether their Approved Enterprise is short-term, medium-term, or long-term as described in article 11. The project's implementation is contingent on the lease of land. This article is relevant when it comes to lease-based *Sukuk* (Ijarah). Under ijarah *Sukuk* structure, the issuer who needs financing will first sell its asset to investors for the financing amount. The same

[28] CFI Team, Sukuk, *Corporate Finance Institute,* December 21, 2022.
[29] Sukuk contracts in Malaysia, *Bond and Sukuk Information Exchange*, March 27 2019.
[30] *Ibid*
[31] Value added tax (VAT) regulation, *Afghanistan Revenue Department Ministry of Finance*, December 24 2019.
[32] *Ibid*

asset is then leased back to the issuer for a lease rental. The rentals will constitute a distribution to the investors. The issuer will then issue *Sukuk* ijarah which evidence undivided proportionate ownership of the leased asset as well as the right to the lease rentals. The *Sukuk* ijarah will be traded in the secondary market whereby investors can purchase the right to rentals from the investors.[33] Hence, article 14 can be amended to regulate the lease of assets in a *Sukuk* ijarah.

5.7 Sale of Enterprise and Purchase and sale shares

According to article 16, private investors may sell their approved enterprises after settling their legal accounts and obtaining the High Commission's approval. They can sell their approved enterprises to anyone. As for the purchase and sale of shares, article 18 states that an approved enterprise with foreign ownership can sell its shares to Afghans citizens or the government of Afghanistan. Article 19 states that the purchase, sale and use of patents and trademarks, and proprietary information by the investor in the approved enterprise will be executed according to a legal agreement. The sukuk is not a debt obligation. Investors can purchase certificates from the issuer after they are issued. After that, the asset is bought using the money from the certificates, giving investors a portion of the asset. A portion of the earnings made by the asset must go to the investors as well. The certificates issued by the issuer can be sold in the secondary market to other investors. The article can be amended to include provisions for the sale of *Sukuk* certificates, issued either by the government of Afghanistan or by foreign approved entities on the secondary market such as the stock exchange. This provision will regulate the sale and purchase of *Sukuk* certificates to the general public.

6. Important *Sukuk* regulations in Afghanistan

The Afghanistan Stock Exchange (ASE), also known as the Afghan Stock Exchange, is part of Afghanistan's planned economic development. It will run Afghanistan's first liquid exchange, offering the most diverse range of financial products and services. It will bring together cash equities exchanges and foreign exchanges in order to be the leader in listings, trading in cash equities, equity and interest rate derivatives, bonds, and market data distribution in Afghanistan. Although a stock exchange market is supposed to have four types of deals: cash, mutual funds, stocks, and bonds, AFX is only capable of Forex transactions. The ASE is essentially a private equity exchange in terms of initial listing, investing in private placements, and secondary trading of securities in admitted companies. In terms of naming shares, private equity ownership shares are 'named' as opposed to public shares, allowing for a complete record of ownership in relation to shares on offer. A comprehensive digital registry is kept up to date in order to keep all issued shares of publicly traded companies securitized. The Kabul Chamber of Commerce and Industries oversees the Central Business Registry of Afghanistan, which serves as a "custodian" of traditional exchanges. ASE has begun efforts to obtain a license from the Afghan financial market regulator, the central bank of Afghanistan (Da Afghanistan Bank).[23]

7. An overview of *Sukuk* legislation in Malaysia

The Malaysian financial system consists of Islamic banking, Islamic capital market, and *takaful*. The Islamic capital market forms part of the Malaysian financial system. The Islamic capital market runs as a parallel market to the conventional capital market. In

[33] Sukuk Al-Ijara, *Islamic Markets*.

Malaysia, the sole regulator for the capital market for both Islamic and conventional is the Securities Commission (SC). The general legislation that also governs *Sukuk* includes the Securities Commission Act 1993, Capital Markets and Services Act 2002, Securities Industry Act 1991, and Companies Act 1965.[24] The capital regulatory framework in Malaysia is based on a two-tier system. General regulatory requirements apply to both conventional bonds and *Sukuk* issuers in the first tier of regulation. It has to do with disclosure, governance and licensing. The second tier of regulation applies to ICM products, particularly *Sukuk*, Islamic security. On the other hand, when it comes to the trust deed and obligatory rating, SC specifies the uniform regulatory need for both bonds and *Sukuk*. *Sukuk*, however, has particular needs when it comes to the Islamic stock exchange.[34]

In order to reinforce Malaysia's regulatory framework as a strong capital market in South East Asia, the Capital Market and Services Act (CMSA) was introduced in 2007. But it was passed specifically to combine the two branches, the conventional capital market and the Islamic capital market under a single piece of legislation. The *Sukuk* regulation in Malaysia is mainly subjected to the Guidelines on *Sukuk*.[35] The relevant legislation and regulations regarding *Sukuk* issuance in Malaysia include CMSA 2007, Guidelines on *Sukuk*, Guidelines on the Trust Deed, Prospectus Guidelines, Registration of Shariah Advisers Guidelines, and tax incentives.[36] To supplement the acts, the SC has issued guidelines on *Sukuk* issuance. In accordance with section 377 of CMSA[37], the SC has the authority to regulate Islamic capital market products through the issuance of guidelines specific to Islamic securities such as *Sukuk*. The Guidelines on *Sukuk* set out the main terms and conditions related to the issuance of, buying or sale of *Sukuk* which need approval from SC. Besides guidelines on *Sukuk*, SC issues guidelines on trust deeds under section 258 of CMSA[38]. The guideline on trust deed requires every issuer of *Sukuk* to enter into a trust deed, appoint a trustee, and comply with the provisions of a Trust Deed under division 4 of Part VI of CMSA.[39]

In addition to enactments, Malaysia has a comprehensive *Shariah* governance framework that oversees the activities of Islamic financial institutions to ensure they are *Shariah* compliant. The development of Islamic finance in general, including sukuk, has been greatly aided by Malaysia's clearly defined Shariah governance framework. The aim is to establish an appropriate regulatory framework for IFIs to operate within the necessary Sharia framework, which will boost confidence among foreign investors in the nation's rapidly expanding Islamic finance industry. To accomplish this goal, however, the IFIs must provide the necessary infrastructure to properly implement the framework's objectives.[40] The central bank of Malaysia had issued a guideline on Shariah Governance Framework for Islamic Financial Institutions in 2010[41] Shariah advisors at the respective originating financial institutions must authorize sukuk issuances. Additional approval from the Securities Commission's Shariah Advisory

[34] Vivien, C. H. E. N. "Law and society in the evolution of Malaysia's Islamic capital market regulation." *Asian Journal of Law and Society* 4, no. 1 (2017): 133-156.
[35] Al-Ali, Salim. *Raising Capital on Ṣukūk Markets: Structural, Legal and Regulatory Issues*. Springer, 2019.
[36] *Ibid*
[37] Capital markets and services act 2007, *Securities Commission Malaysia.*
[38] *Ibid*
[39] Hassan, Rusni, Khariyahbinti Mat Yaman, Ahmad Azam Othman, and Adnan Yusoff. "The role of a trustee in Sukuk: The Malaysian perspective." (2012).
[40] Hasan, Zulkifli. "A survey on Shari'ah governance practices in Malaysia, GCC countries and the UK: Critical appraisal." *International Journal of Islamic and Middle Eastern Finance and Management* (2011).
[41] Guidelines on shariah governance framework for Islamic financial institutions, *Bank Negara Malaysia,* 26 October 2010.

Council, which provides the Commission with guidance on issues relating to Islamic capital markets, is necessary for issuances containing novel concepts or structures. The Councils work to ensure adherence to the Shariah principles that make up the cornerstones of Islamic finance, alongside the Shariah Advisory Council of Bank Negara Malaysia (which serves as the authoritative body on Shariah matters for financial institutions regulated by the Bank). They also support innovation by making pronouncements regarding the Shariah compatibility of novel structures.[42] Malaysia has devised a two-tier system for SAC, with one level dedicated to Islamic banking and the other to capital market products. The central bank of Afghanistan had also issued a National Shariah Governance Framework (NSGF)[43] in 2017. Similar to the Malaysian Shariah governance framework, the NSGF

According to Ries, Amran and Aminul in their article "*Sukuk* documentation and legitimacy: The Role of *Shariah* Supervisory Board as a Moderator"[25] the Malaysian Securities Commission amended its Islamic Securities Guidelines to provide a comprehensive direction regarding *Sukuk*, covering topics such as the applicable Shariah rulings, the approval process, disclosure requirements and ratings for Sukuk issuance. Malaysia's regulatory framework includes core legislations that govern Sukuk issuance, such as the Capital Market Services Act 2007 (CMSA) (amendment 2012), the Securities Commission Act 1993 (SCA) (amendment 2015), the Securities Industry (Central Depository) Act 1991 (SICD), and the Companies Act 2016, which repealed the Company Act 1965. (CA). In order to create an Islamic capital market where Sukuk can be issued, Malaysia evolved its legal system over four decades. The strong laws and rules in place today were developed over a long period of time. The Securities Industry Act of 1983, which had been repealed, the Islamic Bank Act of 1983, and the Takaful Act of 1984 had made it easier to establish the regulatory framework for Islamic finance in Malaysia. The second stage, the founding of the Securities Commission in 1993 in accordance with the Securities Commission Act of 1993, had raised the bar for Islamic financing, particularly following the establishment of SAC in 1996, and finally, the groundbreaking CMSA 2007 law, which was enacted in the third stage, provided clear legislation to structure Sukuk through clear terms like section 212(2) and section 213. (1). The Securities Industry Future Act of 1993 and Part IV of the Securities Commission Act of 1993, together known as the CMSA 2007.[44] These conclusions have significant ramifications for creating a sound legal foundation to adopt Sukuk in Afghanistan using lessons learned from Malaysia. Afghan regulators can use the Malaysian case as a guide when deciding whether to include Sukuk in the investment law and when modifying the current contract rules in the commercial code. Additionally, the Afghan regulator can gather information from the Malaysian SC's approach to regulating Sukuk issuance through the publication of distinct rules and the establishment of an independent SAC under a capital market authority.

8. Findings and Discussions

In analyzing the literature above, there are enough sources that generally cover the area of the study. However, there is no specific literature that focuses on legislations for *Sukuk*. Most of the literature cited above on Afghanistan is concentrated on the absence

[42] Sukuk: Efficient diversification mechanism and new asset class, *Development of the Financial Sector*.
[43] National Shariah Governance Framework, *Da Afghanistan Bank*.
[44] Muhammad, Marjan, Beebee Salma Sairally, and Farrukh Habib. "Islamic capital markets: Principles & practices." Isra, 2015.

of provisions on regulating the capital market and very briefly touches on some of the challenges for the development of the *Sukuk* industry without emphasizing on the need for specific legal provisions for *Sukuk*. Understanding the existing laws and regulation on investment in Afghanistan and studying how *Sukuk* legal provisions can be incorporated is imperative. There are many legal and regulatory issues[45] and challenges for the issuance of *Sukuk* in Afghanistan. The main obstacle is the absence of provisions, regulations and guidelines that will supplement and assist the issuance of *Sukuk*. Bonds and shares that are traded on the stock exchange are done through the capital market. Afghanistan does not have any laws or regulations that regulate the capital market, it only has a stock exchange that is not supported by sound legislations.[46] This may be another major impediment for *Sukuk* issuance as it depends on the soundness of the capital market regulation. The ministry of finance and the central bank of Afghanistan should work together to develop regulations and guidelines to further strengthen the *Sukuk* industry, at the moment there are no guidelines or regulations for *Sukuk*. The incorporating of *Sukuk* provisions into the current investment law should include provisions on the offering of *Sukuk* and its issuance. There should be provisions that empower the Shariah Supervisory Board of the central bank of Afghanistan to issue guidelines on *Sukuk* issuance, private debt security offerings, trust deeds, and on the creation of a special purpose vehicle (SPV) for issuing *Sukuk* certificates. These guidelines will supplement the proposed amendments to the investment law in Afghanistan.

As for the incorporation of *Sukuk* provisions into the investment law, several recommendations for amendments can be proposed to Afghan legislators to revise.The interpretation section of the investment law article 2 should be amended to define *Sukuk* statutorily as an Islamic security as well as the types of Islamic investment such as shares, Islamic unit trust, bonds and Islamic structured securities. The definition of *Sukuk* has the function of distinguishing it from conventional bonds. There needs to be provisions that provide for the structuring of *Sukuk* under the underlying Islamic finance contracts that tally with the Islamic finance contract guidelines issued by the central bank of Afghanistan.[47] *Sukuk* can either be structured under the Musharakah, Mudharabah, Ijarah, BBA or Wakalah model. The creation of a Special Purpose Vehicle (SPV) is required for *Sukuk* structures. SPV would issue *Sukuk* certificates that represent either ownership of an asset, debt or rental income entitlement, or even the accumulation of returns from various Sukuk (a hybrid *Sukuk*), at present there are no such provisions for its creation. It is recommended that there be provisions for establishing SPV pursuant to the company law of Afghanistan. *Sukuk* must be Shariah compliant, the current body that oversees Islamic banking activities is the Shariah supervisory board of the central bank of Afghanistan,and they must be the sole body to decide on the Shariah compliance of *Sukuk*. The current investment law provides provisions for the sale of shares and bonds by private and foreign entities, it is recommended that article 16 should be amended to include the sale of Sukuk and Islamic securities such as shares as well as include provisions for the issue, offer for subscription or purchase, or the making of an invitation to subscribe for or purchase, any Islamic securities. Article 14 provides for the leasing of real estate by foriegn

[45] Marwah, Gunit Singh, and Vishal Ladhani. "Financial sector in Afghanistan: Regulatory Challenges in financial sector of Afghanistan." *Financial Market Regulations and Legal Challenges in South Asia*, pp. 224-262. IGI Global, 2016.
[46] Saddique, Akmal, and Shahzad Anwar. "Challenges and prospects of establishing stock exchange market in Afghanistan." *Kardan Journal of Economics and Management Sciences* 2, no. 1 (2019): 74-87.
[47] Islamic banking regulations, *Da Afghanistan Bank*.

investors upon the completion of projects. It is recommended that there be amendments in the article to include provisions for Ijarah Sukuk structure investments whereby Sukuk holders in a leased asset can obtain the right to receive a portion of the rent according to his proportional ownership in the leased asset, while he bears losses to the extent of his ownership. The current tax laws of Afghanistan do not provide any incentive for issuers and investors of *Sukuk*, this lack of incentive can discourage the development of the *Sukuk* industry. It is necessary therefore to amend the current tax law provisions and include provisions that provide tax relief on expenditure of *Sukuk* issuance and on the profits made by investors in *Sukuk* inorder to promote the *Sukuk* industry in Afghanistan. Malaysia has made provisions for a reliable Sukuk taxation structure. Since its creation, the Income Tax Act of 1967 has undergone numerous revisions to provide recipients involved in the Sukuk structure with deductions or exemptions. In a similar vein, the Afghan government may consider revising the current tax law.

9. Conclusion

This paper discussed and examined the Law on Domestic and Foreign Private Investment in Afghanistan (2005) in order to allow the issuance of Sukuk. The examination of existing laws reveals some legal and regulatory impediments that may be an impediment to the issuance of *Sukuk* in Afghanistan. These concerns are related to existing legislation. Furthermore, regulated *Sukuk* are not subject to capital market or central bank regulations. Other challenges to overcome include the lack of *Sukuk* regulation, the need for Shariah supervision in the capital market, and specific Sukuk legal provisions. Furthermore, it outlines the need for the government of Afghanistan to amend the investment law and incorporate *Sukuk* provisions for the purpose of bolstering the *Sukuk* industry. Although the Islamic financial system in Afghanistan is still developing, *Sukuk* has the potential to transform the Islamic finance environment and boost investors' confidence. Furthermore, it will lead to the development of infrastructure and projects in the country. It can support the financing of infrastructure projects in Afghanistan including but not limited to dams, irrigation systems, power generation, railways, highways, airports, gas pipelines, electricity supply, oil refineries, and oil extraction.

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