PwC Middle East
Financial Services
Tax & Legal Update

October 2021

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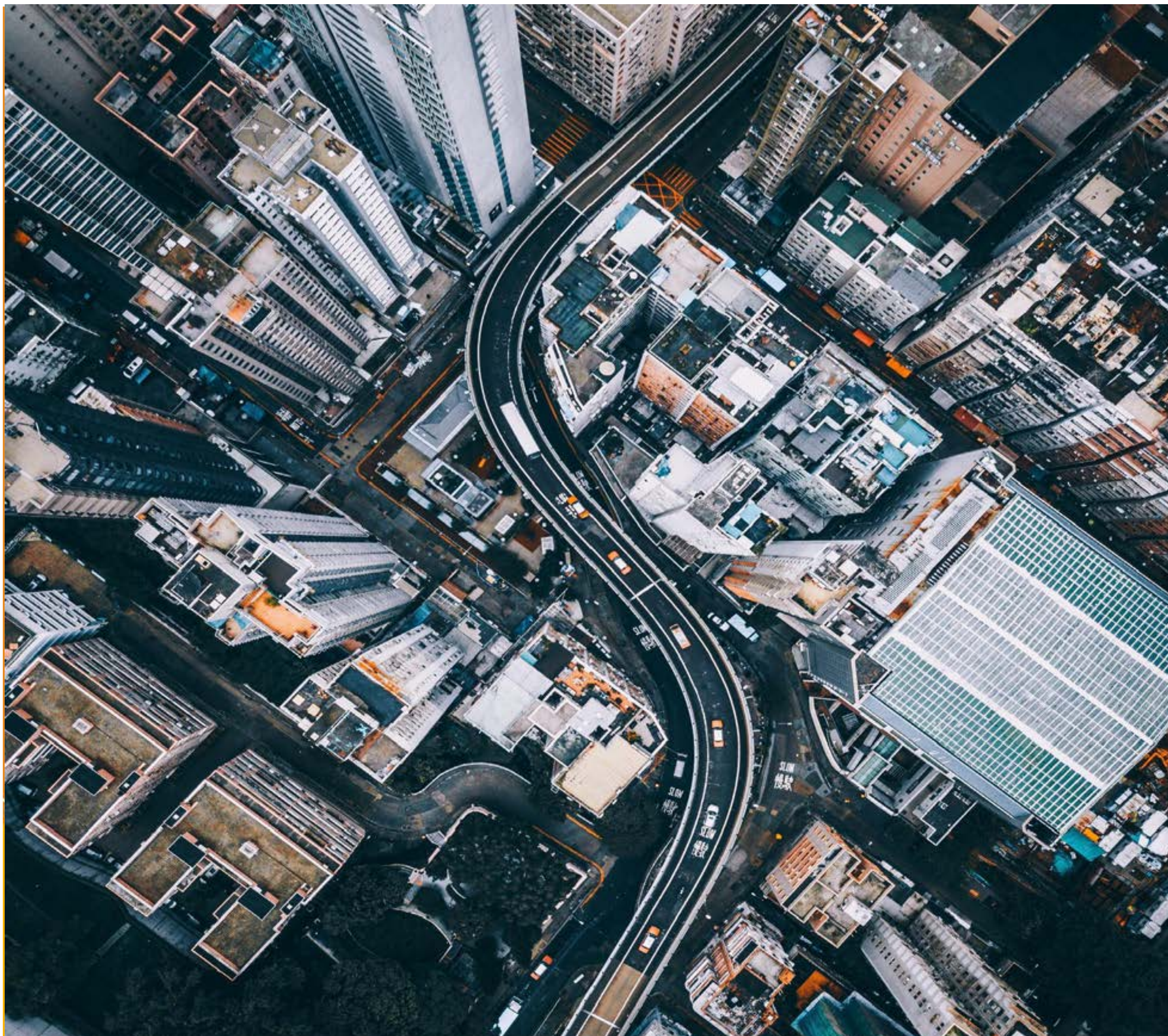

Introduction

Welcome to the sixth edition of our Middle East Financial Services Tax and Legal update, picking up on a range of current hot topics relevant to the financial services industry. The rate of change in the tax and legal area for FS businesses continues to accelerate. This is demonstrated in our updates below, which reflect national, regional and global changes.

In this edition, we have five articles covering the following areas:

1. Update on BEPS 2.0: Pillar One and Pillar Two;
2. VAT rate increase in Bahrain;
3. E-invoicing in KSA;
4. Economic Substance in the UAE; and
5. Retail Payment Services and Card Schemes Regulation in the UAE.

I hope you find the articles relevant and informative. Please get in touch with me or your regular PwC contacts if there is anything that you would like to discuss further.

Also, please let us know if there are any topics that you would like us to cover in upcoming editions. And we are keen to hear your feedback on this newsletter so would welcome any thoughts or comments.

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Update on BEPS 2.0: Pillar One and Pillar Two

In brief

On October 8, 136 out of the 140 countries of the OECD Inclusive Framework on Base Erosion and Profit Shifting ("Inclusive Framework") have politically committed to potentially fundamental changes to the international corporate tax system. This statement was further endorsed by the G20 during the 15 October meeting of the G20 finance ministers.

In detail

Pillar One

The Inclusive Framework agreed that under Pillar One, a formulaic share of the consolidated profit of certain multinational enterprises ("MNE") will be allocated to markets (i.e., where sales arise). Pillar One will apply to MNEs with profitability above 10% and global turnover above EUR 20bn. The profit to be reallocated to markets will be calculated as 25% of the profit before tax in excess of 10% of revenue.

Two sectors remain carved out from Amount A of Pillar One: extractive industries and **regulated financial services** (emphasis added).

Pillar Two

Under Pillar Two/Global Anti-Base Erosion ("GloBE"), the Inclusive Framework members have agreed to enact a jurisdictional-level minimum tax system with a minimum effective tax rate of 15%. Companies with global turnover above EUR 750m will be within the scope of Pillar Two, with headquarter jurisdictions retaining the option to apply the rules to smaller, domestic MNEs.

Exclusions from the GloBE rules are available for pension funds or investment funds that are Ultimate Parent Entities of an MNE Group or any passive holding vehicles used by such entities, organisations or funds.

What is still to be agreed?

The latest statement is still very general with respect to some of the key design features of the two Pillars. This implies that the Inclusive Framework will continue to work in an effort to reach agreement on some of the key features of both Pillar One and Two until November 2021 for some designated items, with other elements intended for early, mid, or the end of 2022.

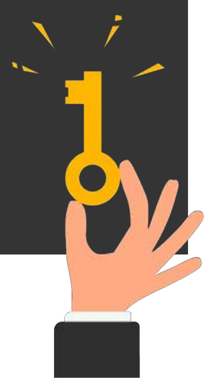
Timeframe

The latest statement still maintains that both Pillar One and Two will come into effect in 2023, with the multilateral convention for the former developed and open for signature in 2022 and legislation for the latter brought in 2022 via national, domestic legislation.

The takeaways

- The recent announcement further emphasises the support for the measures around the Inclusive Framework member countries.
- The measures will introduce two very new and very considerable sets of changes to the international corporate tax system.
- Whilst Pillar One is expected to apply to less than 100 corporate groups such that many MNEs will not be in scope, Pillar Two has a much broader application and many MNEs will have to comply with the rules.

If you wish to discuss how these proposed rules may impact your organisation, please get in touch with us. Alternatively, further details in respect of the latest Inclusive Framework agreement can be found in our Tax Policy Alert, Middle East newsalert, dedicated Middle East BEPS 2.0 site or our global BEPS 2.0 site.



VAT rate increase in Bahrain

In brief

The government of Bahrain has initiated steps to increase the current standard VAT rate. In September 2021, the Council of Ministers approved an increment of the standard VAT rate from 5% to 10%. This forms part of efforts to re-stabilise the government's Fiscal Balance Program which has been impacted by Covid-19 is expected to become effective from January 2022.

In detail

Whilst it is expected that the VAT exemption for certain transactions relating to Financial Services and Real Estate will prevail, taxpayers in the Financial Services industry should take steps to assess the impact of the proposed VAT rate increment in order to manage the implications on their business operations.

Potential impact on taxpayers in the financial services industry

- **Cost increase**: Taxpayers in the Financial Services industry whose sales are generally partially or fully exempt from VAT shall experience an increase in costs of business operation as a direct effect of the VAT rate increase.
- **Contracts and invoices**: Taxpayers in the Financial Services industry who mostly carry on continuous or periodic supplies of services have to review their existing contracts and documentation to take into account the transitional rules (once published).
- **Cash flow:** The time gap between the payment and recovery of VAT may impact the cash flow for taxpayers thereby raising the significance of cash flow planning activities.
- **IT systems enhancement**: Taxpayers should review their ERP systems and processes to reflect the VAT rate increment including possible automation of transitional rules (once published).

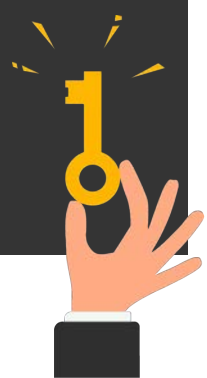
What next

We expect the government in the coming months to release further details/guidance surrounding transitional rules on the expected VAT rate change on supply of services which have been contracted for and to be performed on 1 January 2022 or after. Taxpayers should in the meantime start assessing the impact on their business in terms of contracts, VAT compliance, IT system enhancement.

The takeaways

- Current standard VAT rate in Bahrain is expected to change from 5% to 10% starting January 2022.
- Taxpayers should initiate steps to assess and manage the impact of the VAT rate increment on their business operations.
- Further details surrounding transitional rules expected to be issued by the relevant authorities in the coming months.

During 2020, we helped clients in all major business sectors manage the VAT rate increase in the Kingdom of Saudi Arabia. We understand the impact of VAT rate changes and can help businesses navigate all of the steps they need to take to become compliant with the change with minimal impact on business as usual.



E-invoicing in KSA

In brief

On 28 May 2021, the Zakat, Tax and Customs Authority ("ZATCA") has published the e-invoicing resolution setting out the controls, requirements, technical specifications and procedural rules covering the generation and integration phases which includes VAT invoices, debit and credit notes. A detailed set of requirements and guidelines were also published.

The generation phase will be mandated from 4 December 2021 and the integration will be implemented in phases starting from 1 January 2023.

In detail

As part of the transitional journey towards e-invoicing, ZATCA has published the final resolution and simplified guide of the controls, requirements, technical specifications and procedural rules for implementing the provisions of the E-Invoicing Regulations. The guideline aims to specify the business and technical requirements to be mandated as part of the journey toward e-invoicing.

The guideline is set to identify controls, requirements, technical specifications, or procedural rules required for the implementation of E-Invoicing Regulation provisions which are related to the following:

- Generation of Electronic Invoices (e-invoices) and Electronic Notes (e-notes), including provisions related to its processing, and record keeping, effective 4 December 2021.
- Integration phase, transmission of Electronic Invoices and Electronic Notes, and sharing them with the Authority, which shall be implemented through phases starting from 1 January 2023.

For phase 1, by 4 December 2021, taxpayers are required to:

1. Ensure that they are equipped with a system that complies with the requirements of electronic invoicing for the first stage (generation stage). Taxpayers should work internally with their IT technical team or with an electronic billing systems provider to ensure that the technical requirements are met.
2. Generate electronic invoices and store them through electronic invoicing systems and stop issuance of written invoices, handwritten or through text-editing software.
3. Generate electronic invoices in a systematic manner in accordance with the VAT legislations.
   In addition, make sure that:
   - For tax invoices: add the buyer's VAT registration number (if registered for VAT) and the QR code (optional).
   - For simplified tax invoices: add the QR code (mandatory) through a technical solution as per the e-invoicing specifications and requirements.

In addition, the resolution had two annexes attached to it that provide a detailed set of requirements which taxpayers are invited to review in detail to assess its impact on their compliance journey:

1. Annexe 1: Technical specification of the e-invoicing solution in respect of generating e-invoices and e-notes which include:
   - the type, form and structure of the e-invoice/e-note.
   - Data security features (e.g. hash, cryptographic stamp, etc.).
   - Connectivity and data requirements of the technical solution.
   - Restricted functional specifications.
2. Annexe 2: The mandatory, conditional and optional fields that should be included on e-invoices or e-notes and those fields that are required to visible on the PDF file related to the e-invoice / e-note.

The final rules issued by ZATCA provide guidance on the controls, requirements, technical specifications required for the generation and integration phases.

What next

Taxpayers should ensure that they are ready for e-invoicing generation phase by 4 December 4 2021.

In the meantime start assessing the impact on their business in terms of contracts, VAT compliance, IT system enhancement.

The takeaways

Businesses are encouraged to start assessing the impact of the e-invoicing regulations on their systems and processes and planning the journey towards a successful implementation by the set date of 4 December 2021, for the generation and storing phase.

UAE Economic Substance Regulations (“ESR”)

In brief

The UAE issued ESR introducing a requirement for UAE in-scope entities to maintain an ‘adequate’ economic presence in the UAE, relative to the activities being undertaken.

In detail

The introduction of ESR brings the UAE in line with other jurisdictions that have issued economic substance legislation (e.g. Cayman Islands, Bermuda, Mauritius, Crown Dependencies, Bahrain) and affirms the UAE’s commitment to addressing concerns around the shifting of profits derived from certain mobile business activities to “no or nominal tax jurisdictions” without corresponding local economic activities.

The UAE ESR apply to all UAE juridical persons (persons with separate legal personality) and unincorporated partnerships that undertake one or more “Relevant Activity” for financial years commencing on or after 1 January 2019.

“Relevant Activities” include Banking, Insurance, Fund Management, Lease-Finance, Headquarter Activities, Shipping, Holding Company, IP, and Distribution and Service Centre businesses.

Filing deadlines

All entities that conduct at least one of the nine Relevant Activities need to file a Notification. A Notification must be submitted within six months from the end of the financial year of an entity.

Entities that conduct at least one Relevant Activity from which income is generated need to also file a Report (and subsequently demonstrate ‘adequate’ substance) for that period. A report must be submitted within twelve months from the end of the financial year of an entity.

Exemptions from demonstrating substance in the UAE are available for certain categories of entities if they can provide sufficient documentary proof.

How ‘adequate’ substance is assessed?

To satisfy the economic substance requirements in relation to a Relevant Activity, a UAE entity must:

- Conduct the relevant “core income generating activities” in the UAE;
- Be “directed and managed” in the UAE; and

With reference to the level of activities performed in the UAE:

- Have adequate number of qualified employees in the UAE,
- Incur an adequate amount of operating expenditure in the UAE, and
- Have adequate physical assets in the UAE.

The ESR have not defined a minimum standard for “adequate” and accordingly this will need to be assessed on a case by case basis taking into account the relevant facts and circumstances.

A UAE business that only undertakes a ‘Holding Company Business’ is subject to less stringent economic substance requirements, while businesses involved in High Risk IP will have increased reporting obligations.

If a UAE business carries out more than one relevant activity, the economic substance requirements must be met for each of the relevant activities.

Consequences on non-compliance

A UAE entity that does not comply with the ESR will be exposed to various penalties, i.e.:

- Financial penalties;
- Information of the entity will be shared with the foreign competent authorities of the parent company, ultimate parent company and ultimate beneficial owner of the entity;
- Trade/commercial licence can be suspended, withdrawn or not renewed.

What next

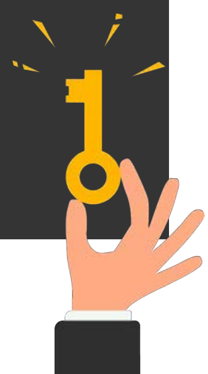
All UAE licensees should assess their ESR position on an annual basis and comply with the relevant requirements (where applicable), being:

- demonstration of ‘adequate’ substance; and
- filing obligations.

Also, the entities will need to ensure that they have relevant supporting explanation and documentation to prove the ESR position of the entity if and when challenged by the authorities.

The takeaways

- UAE ESR applies to all entities that are licensed in the UAE.
- Entities should assess their ESR position on an annual basis as this might be different from a year to another.
- It is advisable for entities to assess the position of the entities before their reportable periods in order to ensure that they will be able to demonstrate the ‘adequate’ substance to the authorities.
- Non-compliance with demonstration of ‘adequate’ substance or filing obligations will result in administrative and financial penalties.



CBUAE issues Retail Payment Services and Card Schemes Regulation

In brief

The Central Bank of the UAE (“CBUAE”) released the Retail Payment Services and Card Schemes Regulation (“Regulation”). The Regulation is the latest step taken by the CBUAE to propel the UAE towards a new era of digital payments.

In detail

The Regulation is a continuation of the CBUAE’s efforts to foster safety and soundness for consumers regarding retail payments services and the operation of payment card schemes.

The Regulation introduces a licensing regime for payment service providers operating - or wishing to provide - one or more of nine payment services or payment card schemes in the UAE. These include:

1. payment account issuance
2. payment instrument issuance
3. merchant acquiring
4. payment aggregation
5. domestic fund transfers
6. cross border fund transfers
7. payment tokens
8. payment initiation
9. payment account information services

Existing payment service providers and card schemes have a transitional period of one (1) year to secure the relevant CBUAE licence. This latest development is preceded by three other regulations by the CBUAE:

- The Stored Value Facilities Regulation (the "SVF Regulation") replaced the four distinct categories of payment service provider ("PSP") previously laid out by the SVF Framework with a single licensing category: the SVF License.
- The Large Value Payment Systems Regulations (the "LPS Regulation") and the Retail Payment Systems Regulation (the "RPS Regulation") which set standards for financial infrastructure systems that support wholesale payment activities and regulates retail payment systems that provide fund transfer, clearing and settlement services in the retail context, respectively.

Licensing

The CBUAE has opted for a four category licensing scheme for retail payment services (each a "Payments License") under the Regulation. PSPs must now apply for one of Categories I , II, III or IV Payments Licenses.

Banks, however, do not need a Payment License insofar as they engage in the provision of payment account issuance services, payment instrument issuance services and domestic and cross-border fund transfer services.

For all other retail payments services, a bank must obtain a no objection letter from the CBUAE prior to commencing the provision of such services.

Licensing categories

Each of the four categories of Payments License will allow a PSP to provide a prescribed number of the nine retail payment services, with lower categories of Payments Licenses permitting more regulated activities.

For example, a PSP that intends to provide payment account issuance services, merchant acquiring services, payment aggregation services, payment instrument services or domestic fund transfer services may apply for either a Category I, II or III Payments License.

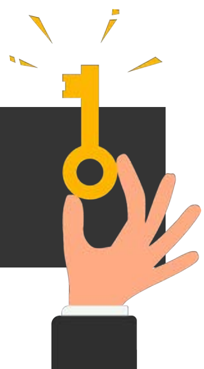
Practically speaking, this means PSPs who engage solely in one or more of the four aforementioned retail payments services will likely seek to obtain the most efficient and economical of the three Payments Licenses available. The initial capital requirements for each Payments License will likely be a major factor in this decision.

What Next

Over this period, we can expect to see many PSPs reorganizing their business and service offering in response to the new requirements under the Regulation. We may see a host of new corporate entities pop-up to facilitate the provision of ancillary services as required by the CBUAE. Alternatively, we may see PSPs abandon certain service offerings all together where the CBUAE requires a separate entity be set up for the provision thereof.

The Takeaways

- Nine payment services or payment card schemes covered by the Regulation.
- Four category licensing scheme to cater to different business models.



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