

PwC Middle East Financial Services Tax & Legal Update

September 2022



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Introduction

Welcome to the ninth 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. We have a packed offering this month as the rapid rate of change in the tax and legal area for FS businesses continues. This is demonstrated in our updates below, which reflect national, regional and global changes.

I hope you find the articles relevant and informative. Please get in touch with me or your regular PwC contact for further information or if you would like to discuss how these changes impact your business.

As always I am keen to hear your feedback on this newsletter so would welcome any thoughts or comments.

Peter

In this edition, we have 5 articles covering the following areas:

1. Update on KSA transfer pricing ByLaws;
2. Recent updates on Pillar Two - Global Minimum Tax;
3. Update on KSA - FATCA/CRS Audit Requirement;
4. Update on the introduction of UAE Corporate Tax; and
5. Update on KSA - Zakat rules for investment funds.




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Update on KSA transfer pricing ByLaws

In brief

On 4 July, Zakat, Tax, and Customs Authority (ZATCA) released a public consultation paper with proposed amendments to the Transfer Pricing (TP) Bylaws in the Kingdom of Saudi Arabia (KSA).

Under the proposed regulations, the TP Bylaws would be extended to Zakat payers having related party transactions. This would be a significant change from the current provisions whereby 100% Zakat payers are not subject to the TP Bylaws. Zakat payers would thus need to ensure the arm's length nature of their related party transactions and meet annual compliance and documentation requirements.

In detail

Financial institutions that are impacted are those with zakat payers that have controlled transactions with related parties. A related party is considered to be a person or entity with either (i) greater than 50 percent common ownership or (ii) control (e.g., significant influence, member of board, voting rights, etc.).

Controlled transactions typically fall under one of the below categories:

1. Provision of **services** including cost recharges
2. Sale of **tangible goods**
3. License of **intangible property** (e.g. brand or technology license)
4. **Financial transactions** such as intercompany loans or guarantees

Zakat payers that are in scope will then need to prepare the following:

1. **Controlled transaction disclosure form (CTDF):** Filed with the zakat return and contains details of the related party transactions (e.g. amounts, transfer pricing method, counterparty, etc.).
2. **TP Affidavit:** Filed with the zakat return and is a certification from a licensed auditor that the Group's TP policy is consistently applied.

3. **Master file:** Provides overview of global operations, including value chain, intangibles, TP policy and financing (subject to materiality threshold of SAR6m gross value of related party transactions).
4. **Local file:** Contains support for arm's length nature of controlled transactions including benchmarking, functional and industry analyses (subject to materiality threshold of SAR6m gross value of related party transactions).
5. **Country-by-Country reporting (CBCR):** Provides financial and tax data aggregated on a country by country basis such as revenues, taxes paid, headcount, etc. CBCR requirement is not new to zakat payers and continues to apply for groups with a consolidated revenue over SAR3.2bln.

When ZATCA first introduced transfer pricing rules in the KSA in 2019, they applied the rules retroactively. Thus, it is likely that ZATCA will require the transfer pricing requirements to apply for fiscal years beginning on or after January 1, 2022.

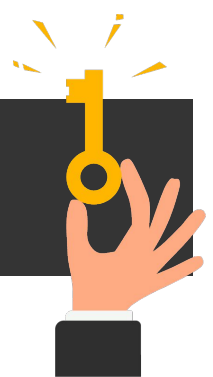
On the basis of the above, we recommend that financial institutions that are impacted start reviewing their controlled transactions with related parties and identify any potential gaps. FS groups have already started requesting health checks be performed on their transfer pricing policy and readiness to comply with the new rules including the following elements:

- Identification of related parties and controlled transactions
- Identification of any gaps in pricing, agreements, or benchmarking
- Recommendations to the gaps and make pricing adjustments
- Road map with required steps and timeline to comply with new rules

Such health checks should be performed by year end to allow for any necessary adjustments before the books are closed.

Key takeaway

It is critical that Zakat payers would thus need to ensure the arm's length nature of their related party transactions and meet annual compliance and documentation requirements.



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Recent updates on Pillar Two - Global Minimum Tax

In brief

A number of jurisdictions have started to take steps towards the implementation of the OECD's Global Minimum Tax rules (**"the GloBE Model Rules"**). We expect this trend to continue in the coming months as the 2023 implementation date approaches.

In detail

During the summer months, we have started to see the first draft legislation implementing the OECD's GloBE Model Rules. Specifically, each of the UK and South Korea have issued draft legislation. In addition, the Swiss Federal Council has also launched a public consultation concerning the draft ordinance, laying out the material aspects of the Pillar Two implementation in Switzerland.

More recently, the governments of France, Germany, Italy, Spain and the Netherlands have also issued a joint statement to express their full commitment to implementing the OECD's GloBE Model Rules.

According to the joint statement, the five EU Member States are determined to introduce the rules to implement the OECD's Pillar Two Model Rules in 2023, by any possible legal means.

The statement builds on the German government's announcement on the intention to start with the implementation process at a national level in order to partially finance a new package of measures to provide relief from rising inflation and energy prices.

More generally in Europe, the Economic and Financial Affairs Council, which is responsible for tax policy in the European Union will meet on 4 October 2022. However, Pillar Two is no longer on the agenda for this meeting. As understood at the time of writing, Hungary remains unwilling to support the EU Directive that implements the GloBE Model Rules in EU Law.

The Implementation Framework in respect of the GloBE Model Rules is also expected to be issued by the OECD in the coming months. It is likely that this process will be a staggered process.

The Implementation Framework will facilitate the implementation and administration of the OECD's GloBE Model Rules.

Some points that will be covered by the Implementation Framework include, but are not limited to:

- Administrative procedures, such as filing obligations;
- Safe-harbours to facilitate both compliance by multinational groups and administration by tax authorities;
- Possible simplifications on some computational aspects; and
- Identification of tax regimes which will be considered to be 'compliant' from a Pillar Two perspective.

On the basis of the above, we recommend that financial institutions should:

- Kick off their assessments of the impact of the Global Minimum Tax, in order to determine how the Model Rules will apply and identify the expected impact;
- Identify the required information and iron out any issues with collecting the data; and
- Continue to monitor the announcements / actions from tax government / authorities.

Key takeaway

It is strongly suggested that financial institutions undertake an assessment of the impact of the Global Minimum Tax rules to identify the expected impact. Financial institutions should also be on the lookout for announcements / actions from governments / tax authorities in respect of how and when jurisdictions will implement the OECD GloBE Model Rules in to their domestic law.



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Update on KSA - FATCA/CRS Audit Requirement

In brief

The Zakat, Tax and Customs Authority (“**ZATCA**”), in accordance with the provisions of the agreements to which the Kingdom of Saudi Arabia is a party issued pursuant to Ministerial Resolution No. (131) dated 20/1/1444 AH, recently issued a publication announcing the relevant audit arrangements and procedures required to be implemented by KSA Reporting Financial Institutions (“**KSA RFIs**”) to determine compliance with the Foreign Account Tax Compliance Act (“**FATCA**”) and the Common Reporting Standard (“**CRS**”).

Businesses in the KSA will be required to ensure they are prepared to comply with these new requirements and increased scrutiny from the ZATCA.

In detail

- **Background:** The CRS, developed by the Organisation for Economic Co-operation and Development (“**OECD**”) and approved by the G20 in February 2014, is a global reporting standard for Automatic Exchange of Information (“**AEOI**”). The KSA signed up to the CRS in 2017 with a go-live date of 8 September 2017. Royal Decree No. M/125 of 1/12/1438 H. was ratified into domestic law in November 2017 and information has been exchanged since 2018 for calendar year 2017 onwards, on a reciprocal basis. The Foreign Account Tax Compliance Act (“**FATCA**”) is the first of the AEOI regimes developed by the United States (“**US**”) Internal Revenue Service (“**IRS**”) to combat tax evasion by U.S. persons holding financial accounts in other countries. Effective 1 July 2014, all KSA RFIs are required to comply with the provisions of FATCA legislation ratified by Royal Decree No. (M/52) dated 10/5/1438 AH in relation to the Intergovernmental Agreement (“**IGA**”) between the Government of the United States of America and the Government of the Kingdom of Saudi Arabia to Improve International Tax Compliance and to Implement FATCA (“**KSA-US IGA**”).
- **Existing requirements:** FATCA and CRS both require all in scope KSA RFIs to perform enhanced onboarding and due diligence procedures (including reviewing and collecting data on their account holders) in order to identify reportable account holders for FATCA and CRS purposes and report certain financial account information to their local jurisdiction

(or directly to the IRS in certain instances) which will be exchanged with foreign authorities and the IRS, on an annual basis. Reporting under FATCA and CRS in the KSA is to ZATCA on an annual basis.

- **New increased compliance requirements:** ZATCA, as the competent authority for both the FATCA and CRS regimes in the KSA, is responsible for ensuring that KSA RFIs are compliant with the requirements set-out in the provisions of the KSA-US IGA and CRS by establishing an effective FATCA and CRS compliance programme to monitor activities and ensure compliance with the regimes.
- **Mandatory audit certification:** On 26 August 2022, ZATCA issued a publication mandating KSA RFIs to conduct annual audits and issue an annual certificate of compliance (“**Annual Audit Certificate**”) for both FATCA and CRS. KSA RFIs are required to submit a separate certificate of audit, for FATCA and CRS.

Deadlines and Compliance Actions

The deadline to submit the Annual Audit Certificate is 1 August of each year and we understand the first deadline to be 1 August 2023 in respect of calendar year 2022 (reporting period 1 January 2022 - 31 December 2022). As part of the Annual Audit Certificate, KSA RFIs are required to provide the following information:

- Confirmation of the classification of the concerned entity as a Reporting Financial Institution;
- Ensure the KSA RFI has in place appropriate internal systems and procedures to enable it to comply with the provisions; and
- Conduct a sample test with respect to new accounts, existing accounts, reported accounts and unreported accounts.

The Annual Audit Certificate is likely to be required to be an extensive and detailed disclosure, enabling the ZATCA to assess whether there have been any violations of the FATCA and CRS legislation in the KSA.

Furthermore, in the event that KSA RFIs commit any of the following violations, the fines indicated below shall be applied:

Update on KSA - FATCA/CRS Audit Requirement (cont'd)

| Offence | Financial Penalty |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Non-delivery of CRS and/or FATCA tax reporting on or before May 31 of the year following the calendar year to which the tax reporting relates. | A fine of (500) five hundred Saudi riyals for each day of delay after the end of the period specified for submitting the tax report, provided that the amount of the fine in its entirety does not exceed (15,000) fifteen thousand Saudi riyals. |
| Failure to file a tax information return as required under the specified CRS and/or FATCA form. | A fine of (5000) five thousand Saudi riyals for each declaration specific to each country. |
| Provide incorrect or incomplete statements about the information required to be included in the CRS and/or FATCA Declaration of Information unless that information relates to a third person and it is established that incorrect or incomplete statements were not intended. | A fine of (5000) five thousand Saudi riyals. |
| Refrain from cooperating with the competent employee during the performance of his work and the exercise of his powers according to the common reporting standard or FATCA | A fine of (3000) three thousand Saudi riyals. |

Mechanism of the Review

As part of its compliance actions, ZATCA has indicated it may further conduct the following activities:

1. ZATCA has the right to conduct audits and/or require the KSA RFI to provide information to determine its compliance with the CRS and/or FATCA as required.
2. ZATCA shall notify the KSA RFI in writing of its intention to conduct an audit and shall specify the information required for the audit twenty (20) days as a minimum.
3. As an exception to point 2 above, ZATCA reserves the right to conduct a review process without prior notice in the following cases:
 - a. Cases involving suspected actions leading to non-compliance.
 - b. Cases where the KSA RFI has already refused to cooperate with ZATCA.
 - c. Situations in which prior notice to the KSA RFI may destroy evidence.
4. KSA RFIs shall cooperate with ZATCA and provide all records, documents, information and interpretations as requested during the audits conducted by ZATCA, whether inside or outside the headquarters of the KSA RFI.

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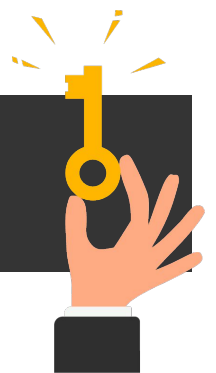
Update on KSA - FATCA/CRS Audit Requirement (cont'd)

How can PwC help?

- Businesses should perform an assessment of whether they are in full compliance with the FATCA and CRS rules as set out in the Royal Decree No. M/125 of 1/12/1438 H for CRS and Royal Decree No. (M/52) dated 10/5/1438 AH for FATCA.
- Remedial actions should be taken where compliance gaps are identified.
- Systems and processes should be reviewed to ensure they have embedded the requirements of FATCA and CRS in a business as usual environment.

Our Middle East financial services tax and legal practice works with local, regional and global financial institutions and has a deep understanding of the FATCA and CRS issues typically faced by the sector. We would be delighted to arrange an introductory call to discuss these issues in more detail and how we may be able to support you.

Key takeaway - It is critical all KSA RFIs implement, in full, the FATCA and CRS requirements and ensure they are in compliance with the account onboarding, pre-existing due diligence, monitoring for changes in circumstances, governance framework (including ensuring the appropriate processes and procedures are in place) and annual reporting requirements.



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Update on the introduction of UAE Corporate Tax

In brief

On 31 January 2022, the UAE Ministry of Finance (MoF) announced the introduction of a federal corporate tax (**CT**) in the UAE that will be effective for financial years starting on or after 1 June 2023.

This will have a substantial impact on banks, insurance companies, investment companies, brokerage firms, etc operating in the UAE.

A number of complexities can arise in relation to freezone entities operating in the UAE, UAE branches of foreign banks, and their tax position once the CT law is enacted. Financial institutions should start to consider these implications now, to identify any complexities and to prepare early for the associated compliance burden.

In detail

- UAE CT will be applicable across all Emirates and will apply to all business and commercial activities alike including financial services, except for the extraction of natural resources, which will continue to be subject to Emirate level taxation.
- 9% tax rate will apply on income exceeding 375,000 AED. A different tax rate will apply for large multinationals that meet the criteria under 'Pillar Two' of the OECD Base Erosion and Profit Shifting project.
- Exemptions will be available for capital gains and dividends earned from qualifying shareholdings and qualifying intra-group transactions.

Free zone businesses

- Free zone businesses will be within the scope of UAE CT and required to register and file a CT return, but will continue to benefit from CT holidays / 0% taxation if they comply with all regulatory requirements and do not conduct business with mainland UAE.
- It is not clear at this stage what will constitute 'conducting business with mainland'. It may mean that simply earning income from a UAE mainland source could impact the free zone tax holiday / 0% CT rate.
- When more guidance is issued, it is very important that financial institutions operating in free zones check whether they have mixed activities (within free zone and mainland) and assess the tax impact accordingly.

Branches of foreign entities operating in free zones

- Branches of foreign entities operating in free zones should also be within the scope of UAE CT and required to register and file a CT return, but will continue to benefit from CT holidays / 0% taxation if they comply with all regulatory requirements and do not conduct business with mainland UAE.

Multinational groups (MNE) / Pillar 2

- The UAE CT regime will have a different tax rate for large multinational groups that meet specific criteria set with reference to 'Pillar 2' of the OECD BEPS project. We assume this means that the UAE will adopt a minimum 15% CT rate or a Qualified Domestic Minimum Top Up Tax for entities that are part of a multinational group. It is not clear whether this will be implemented as a top up tax or a change in rate to 15%.
- To be categorised as an MNE the annual global consolidated revenues of the MNE should be above €750m and the group should operate in more than one jurisdiction (including through branches).
- There is currently no detail available on how the UAE will adopt the GloBE rules. Our expectation is that the tax rate applicable to entities that are within the scope of the GloBE rules would also apply to entities located in a free zone.
- The effective date of the 15% minimum tax rate should be the same as the CT regime (i.e. for the financial year starting on or after 1 June 2023).
- Financial institutions operating in the UAE (whether in mainland or in free zones) that are part of a large multinational group, need to assess first whether they are categorised as an MNE and accordingly assess the tax position for the UAE subsidiaries, branches, etc.

Key UAE CT considerations for financial institutions

- **Applicability of UAE CT on financial institutions:** all UAE financial institutions will be subject to UAE CT going forward.
- **Applicability of UAE CT for branches of foreign banks:** branches of foreign banks will also be within the scope of UAE CT and required to register and file a CT return.

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Update on the introduction of UAE Corporate Tax (cont'd)

- **Applicable tax rate for branches of foreign banks:** UAE CT will apply at 9% on taxable income exceeding AED 375,000, or the higher rate for large multinationals. The current Emirate level taxation (i.e. 20% tax) is expected to cease / may be repealed.
 - **Deferred tax assets (DTAs) and liabilities recognised by the branches of foreign banks:** this is a key focus area for branches of foreign banks operating in the UAE. Existing DTAs have been determined based on the Emirate level law. No transitioning law has been published yet from Emirate Law to federal CT Law and as such there is also no certainty as to whether brought forward Emirate level tax attributes (for example arising from losses or loan impairments) will be available at the Federal level. It may be the case that the existing DTAs may not be available when the federal tax law is enacted given the uncertainty around transitioning (and even if they are, we would expect an incremental reduction in the value to reflect the lower federal level tax rate).
 - **Bad debt provisioning:** there is uncertainty on whether the UAE CT law will follow the IFRS 9 rules in relation to expected credit losses. If IFRS is to be followed then the impact may be different between taxpayers depending on the nature of the loan assets, for example expected credit losses on secured vs unsecured lending. Financial institutions will need to look into this when more guidance is issued and assess the impact.
 - **Asset and wealth management:** the UAE is seeking to enhance its attractiveness as a leading asset and wealth management hub and as a leading centre for the financial services sector. In order to support this, the UAE CT regime is looking into (i) generally treating investment funds as tax neutral vehicles and (ii) including an investment management exemption ("IME"). The IME should allow UAE regulated investment managers to provide discretionary investment management services to foreign funds / customers without triggering adverse UAE tax consequences for those funds or their investors. The IME should be subject to a number of conditions which have not yet been published, however they are expected to be comparable to other leading financial centers.
 - **Transfer Pricing rules:**
 - The UAE will introduce Transfer Pricing rules and compliance requirements with reference to the OECD Transfer Pricing Guidelines for financial years starting June 2023 onwards.
 - For UAE branches of foreign banks, there are historical guidelines and restrictions in relation to related party charges. In light of this, UAE branches of foreign banks will need to consider any transitional assessments to assess the arm's length nature of such transactions from an OECD perspective.
 - For UAE headquartered banks, all related party transactions will need to be assessed to ensure compliance with the arm's length principle with reference to the OECD Transfer Pricing Guidelines and the necessary compliance documentation will need to be prepared and maintained.
- Data, systems, processes and people considerations.**
- Financial institutions tend to have a large number of IT systems and complex reporting structures, which has led to challenges when compiling VAT returns. To assess their readiness to comply with the new CT regime, financial institutions should consider the following questions:
- Do you have entity trial balance data available with sufficient **granularity** for tax purposes in your Chart of Accounts?
 - Can you track asset **depreciation for tax** values?
 - Can you **extract data** from ERP directly or can your **consolidation system** cater to tax accounting requirements?
 - Could you consider **third party technology** to combine functionalities in one platform such as data collection, processing, reporting and filing?
 - Who will be **responsible** for Tax matters within the organisation and **sign off the returns**?
 - Are there **documented policies** and **procedures** in place?
 - To what extent could you be able to **outsource** certain compliance tasks?

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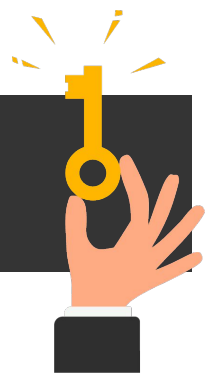
Update on the introduction of UAE Corporate Tax (cont'd)

How can PwC help?

Our financial services team works with local and global financial institutions and has a deep understanding of the UAE CT issues typically faced by the sector. We would be delighted to arrange an introductory call to discuss these issues in more detail and how we may be able to support you.

Key takeaway -

UAE CT will be applicable across all Emirates and will apply to all business and commercial activities alike including financial services, except for the extraction of natural resources, which will continue to be subject to Emirate level taxation. 9% tax rate will apply on income exceeding 375,000 AED.



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Update on KSA - Zakat rules for investment funds

In brief

As part of the Kingdom's 2030 vision in providing a safe and stable investment environment, Zakat, Tax and Customs Authority (ZATCA) introduced Zakat rules for investments funds, on August 4, in the form of a public consultation paper.

The purpose of the introduced rules is to clarify the zakat calculation mechanism and provisions for the Capital Market Authority (CMA) approved investment funds and their investors.

In detail

Applicable payers

- The rules would apply to investment unit holders of CMA-approved investment funds (other than financing funds) who engage in activities subject to zakat collection in accordance with the provisions of the Zakat By-Laws
- Financing Funds subject to CMA regulation are obligated to pay Zakat to ZATCA, and the Zakat will be calculated in accordance with the Zakat By-Laws applicable to the financing institutions.

Actions to consider

- All CMA-regulated investment funds are required to register with ZATCA. The investment fund manager is required to submit to ZATCA an informative Zakat return containing fund-related information. The fund manager must also provide ZATCA with a list of unit holders in addition to other information.
- The investment unit holders may deduct their investment in the fund from the Zakat base provided that:
 - a. The investment is not held for trading as stated in Article (5) of the Zakat By-Laws;
 - b. Zakat is calculated on the funds by virtue of a CPA certificate.

Zakat calculation on the investment funds

• Additions

Article 4 of the Zakat By-Laws stating the items to add to the Zakat base, in addition to the following:

- a. Net assets belonging to the unit holder in the value shown in the Fund's financial statement at year end;
- b. Debts payable by the fund are added in accordance with Article (4) paragraphs (3) and (10) of the Zakat By-Laws.

• Deductions

Article 5 of the Zakat By-Laws stating the items to deducted from the Zakat base, in addition to the following:

- Investment funds not held for trading should be treated the same as foreign investments stated in Article (5) of the Zakat By-Laws.
- The percentage of the investment funds not held for trading is determined using the following:
 - a. The higher from the below should be divided by the net investment value in the fund's share for the same month:
 - b. The preceding applies to all months in a year, and the highest percentage in the year is to be considered and multiplied by the investment value in the shares' ending balance as reflected in the fund's statement of financial position. According to Article (5) of the Zakat By-Laws, the result is classified as the percentage held for trading, and the remaining percentage is treated as non-trading.
 - c. The preceding paragraphs will apply to funds whose primary activity is investing in listed shares.

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Update on KSA - Zakat rules for investment funds (cont'd)

- **Other considerations**
 - a. Investment real estate that are not held for trading are subject to the same Zakat treatment as fixed assets.
 - b. Fixed assets and available for sale investment real estate are not deductible from the Zakat base.
 - c. The difference between net adjusted profit and accounting profit should be added to the Zakat base noting that fund management fee expenses, custodian, supervisory and audit fees are Zakat deductible.

Key takeaway

Once these By-Laws are enforced, which is expected soon, the Zakat impact will be significant, and companies in KSA and unit holders will be affected differently depending on whether or not these companies invest in investment funds.

It is recommended that applicable payers (investment unit holders) ensure the implementation of these By-Laws on their investments in investment funds and that Zakat be calculated by a certified CPA in order for ZATCA to accept the deductibility of these investments in these payers' zakat declarations.



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