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United Arab Emirates**VAT in the UAE - Outlook****Guiding Principle**

The UAE and the other member states of the Gulf Cooperation Council (GCC) are planning to introduce Value Added Taxes (VAT) by 2018. An Outlook:.

A. Background

The International Monetary Fund (IMF) has recommended for years that the GCC member states introduce VAT and for quite a few years, there have been similar talks here in the UAE. Up until now, as we all know, no VAT has been introduced in the UAE. The reason can be found in the general economic and political situation in the Gulf throughout the more recent past. For quite a long time the oil price has been comparatively high while the Arab Spring has seen a number of long-standing political leaders being toppled by their respective people at the same time. Hence, while the economic pressure of introducing VAT was low, given generous income that was generated by very lucrative oil sales, the political pressure not to introduce anything that is likely to be less than popular with the people was high.

The recent boom in shale oil and gas production that has led to significantly lower oil prices, and presumably also the aftermath of the Arab Spring have changed matters dramatically, however. Even some of the GCC member states are now struggling to contain their budget deficits. The exploration of new sources of income, such as the introduction of VAT, has suddenly become more of a priority.

B. What to Expect

Up until now, not too much information on the details of how VAT will be introduced has been made publicly available. VAT is expected to be introduced starting 1st January 2018, and the VAT rate is likely to be set at 5%.

Even without more detailed information being available, however, the introduction of VAT is likely to have a significant impact on the UAE economy, which most probably will reach far beyond the fact that products and services will become more expensive.

I. Businesses as Tax Collectors

One of the corner stones of the VAT system generally is that VAT is a tax that is collected by businesses, as opposed to being collected directly by the government. Businesses are required to add the appropriate amount of VAT to their invoices and charge their customers accordingly. Subsequently, businesses are required to pay all amounts of VAT charged to the UAE Federal Tax Authority. While it is not yet clear how the UAE's VAT system will be structured in detail, in most jurisdictions applying VAT, businesses are required to pay to the tax authority the total amount of VAT they have charged their customers with in regular intervals. This applies even if corresponding payments from their customers have not been received. In practice, this may very well mean that a business will have to front VAT for its customers. This, in turn, may create a significant burden on a business' cash flow, which should not be underestimated. Hence, businesses are well advised to use the time up until 1st January 2018 to create additional cash

reserves in order to prepare for the likely impact of VAT on their cash flow.

II. VAT Tax Credits

In most, if not all jurisdictions that levy VAT, businesses can offset the VAT they have paid for business related expenses from their VAT liability towards the tax authority. The purpose of this general rule is that VAT should ultimately only be paid (in a sense of being paid without option to reclaim such VAT) by the end-consumer.

Some businesses, such as those who operate in a low margin environment with comparatively high production costs, are even likely to generate tax credits in a sense that the amount of VAT such businesses have paid for their business related expenses is higher than the amount of VAT they have charged their respective customers. Such businesses would usually qualify for a tax credit from the tax authority.

In practice, administering such tax offsetting / tax credit regime requires a tax authority to employ experienced personnel that can rely on guidance on which expenses exactly qualify as being “business related” (and hence, tax deductible). Needless to state that businesses will have a significant interest in having ideally all their expenses recognized as being “business related” in order to minimize their tax burden.

In the UAE, as in any other jurisdiction introducing a VAT system, it is rather questionable whether the UAE Federal Tax Authority (being a newly created authority) will have the benefit of experienced personnel and/or reliable guidelines. This, in turn, will almost

inevitably result in a certain period of time during which businesses will have comparatively little certainty as to which expenses are acceptable and which are not. Similarly, it is likely that those businesses who qualify for a tax credit will have to wait longer for their cheque from the tax authority than they would in other jurisdictions where VAT have been levied for a longer period of time.

This, too, is likely to create uncertainty and uncertainty is generally not good news for businesses.

III. Traceability

Another possible impact of the VAT system that should not be underestimated is traceability. Up until now, the commercial activities of businesses in the UAE are subject to relatively little governmental control. The introduction of the VAT system is likely to change this dramatically.

As briefly described above, businesses can decrease their tax burden by offsetting VAT they have paid for business related expenses from their VAT liability towards the tax authority. This is done by presenting all relevant invoices to the tax authority. Presenting such invoices, however, means that the tax authority will be able to trace who is doing which type of business with whom. Hence, the commercial activities of a commercial entity become the subject of governmental scrutiny.

The commercial reality in the UAE is such that it is not uncommon that probably a comparatively large fraction of all businesses does not 100% comply with all applicable rules and regulations. The reasons for this are manifold:

An increasing number of authorities in the UAE, the regulations of which quite often interfere with one another, are leaving those who are supposed to be governed by such regulations somewhere in between;

Unawareness of legislation, a large part of which is still often treated as being of a “confidential” nature; or simply certain customs that, while never having been “legal” in a strict sense, have never faced serious governmental investigation, such as free zone entities doing business “onshore”, for example.

In light of the above, it should be expected, in the medium term at least, that UAE authorities will take a closer look at UAE businesses’ commercial operations. Hence, at the very least, UAE businesses should expect significantly more interactions with various authorities.

C. Conclusion

As mentioned before, not many details of the proposed VAT system have been made public, so none of the above is certain to occur. However, the purpose of this article is to demonstrate that the introduction of VAT in the UAE is likely to have much more of a practical impact than just making goods and services a little more expensive.

Bottom line, we strongly encourage our clients to carefully follow all VAT related developments and to gauge the possible impact on their businesses.

Dr. Michael Krämer
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United Arab Emirates

New Bankruptcy Law in the UAE

Guiding Principle

After several years of scrutiny by a series of committees, the UAE’s Cabinet approved the new law on September 4, 2016. Upon receiving the President’s signature, the law will be published in the UAE’s official legal gazette, coming into effect three months later. Therefore, it may come into effect as early as the first quarter of 2017.

Previously, business owners and managers could be criminally penalized for business failure. This possibly included jail terms. It resulted in many people actually fleeing the UAE and leaving debts and unpaid loans in their wake.

There were in fact already previously many articles in UAE laws that dealt with issues of insolvency in the UAE, but they were better suited to smaller companies.

The new law now provides a comprehensive legal framework to help distressed companies in the UAE to avoid bankruptcy and liquidation. The law seeks to safeguard the rights of both creditors and debtors in insolvency situations, including measures that prioritize secured creditor rights and enable companies to restructure without unanimous creditor approval.

The law applies to companies established under the Commercial Companies Law, companies that are fully or in part owned by the federal or

the local government, and companies and institutions established in free zones that are not governed by existing bankruptcy provisions. The new law does not apply to companies registered in the DIFC and the Abu Dhabi Global Market, as both financial free zones have their own internal legislation covering insolvency and bankruptcy. The new law contains provisions related to senior employees and directors of insolvent companies, but does not cover private individuals. It also applies to companies rather than individuals as the government is drafting additional legislation to cover personal insolvency over the next 12 months.

Under the existing regulations it is difficult to liquidate companies; individuals can face criminal action if they default on debts, causing expatriates to flee the Middle East's business hub rather than face prison.

The law will be overseen by a new regulatory body, the committee of financial restructuring, which will receive applications from troubled companies looking for protection, as well as creditors seeking to enforce debt repayments after 30 days of non-payment.

The new law sets out four broad pathways for insolvent companies to avoid bankruptcy:

- (1) Financial reorganization, an initial solution available to financial entities regulated by the Central Bank and/or the Securities and Commodities Authority;
- (2) A pre-emptive settlement, overseen by the courts, which allows a bona fide debtor to agree a settlement

with creditors, which will be nullified if the debtor fails to abide by the settlement terms agreed;

- (3) Financial restructuring, whereby the company's debts are restructured to the satisfaction of a majority of creditors holding at least two-thirds of the outstanding debt, in a process overseen by the courts;
- (4) The raising of new funds, according to criteria determined by the courts.

It is widely believed that this change will make business in the UAE an even more attractive proposition for investors eyeing the region as a base. It is also expected that it will bolster the confidence of businesses already trading in the country.

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United Arab Emirates

DIFC Wills and Judgments Enforceable by Courts in Ras Al Khaimah

Guiding Principle

The Ras Al Khaimah Courts and other RAK government entities have signed a series of agreements on December 12, 2016 with the Dispute Resolution Authority of the Dubai International Financial Centre (DIFC) that will allow court judgments and orders (including Probate Orders) to be directly enforced by the Ras Al Khaimah Courts. This development is the latest step in a series of measures

introduced in RAK to promote economic growth and to continue its efforts to boost investor confidence and its standing as an investment destination and encourage companies to setup operations.

A. Dispute Resolution:

Based on these agreements, RAK government bodies, companies, investors and individuals are now free to opt-in for DIFC jurisdiction in their contracts and to use DIFC Courts and the DIFC Arbitration Centre to resolve disputes.

This move should be highly welcomed in the business community according to Mark Beer, CEO of the Dispute Resolution Authority (DRA) at DIFC Courts as “through working together, we have reached a major milestone on the road to the UAE’s 2021 Vision of efficient and swift commercial justice. It is further proof of how the DIFC Courts’ strategy of building strong connections with jurisdictions nationally and internationally supports economic growth”.

Consequently, judgements issued by Dubai International Financial Centre’s (DIFC) English-language courts are then directly enforceable by courts in Ras Al Khaimah.

“For those who invest, work and live in Ras Al Khaimah, the additional choice of this proven English-language legal system offers more prospects for future progress. For investors, we speak the language of international commerce, and for businesses we offer greater certainty and confidence in a legal system recognisable around the world ,” said His Highness Sheikh Saud bin Saqr Al

Qasimi Member of the Supreme Council and Ruler of Ras Al Khaimah.

B. DIFC Wills and Probate Orders

As a further result of these agreements personal wills signed by individuals and registered with the DIFC Wills & Probate Registry may now include both Dubai and Ras Al Khaimah assets. Previously it was only possible to include assets located in the Emirate of Dubai.

This development shows that “Individual residents can have even greater trust that their property and assets will be secure here.” (His Highness Sheikh Saud bin Saqr Al Qasimi Member of the Supreme Council and Ruler of Ras Al Khaimah).

The DIFC Wills & Probate Registry is currently drafting a Practice Direction to implement this change in the DIFC Wills & Probate Registry Rules, which should be in place by the end of January.

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Saudi Arabia

Recent Developments in Saudi Arabian REITs

Guiding Principle

Investment in real estate frequently offers a number of positive aspects with regard to security, profitability and sometimes tax. On the downside, real estate investments require a high amount of capital for starters, thus limiting its benefits in many cases to exclusive circles. From the sixties onwards democratization of this kind of investment in the form of Real Estate Investment Trusts or REITs was fostered in many parts of the globe and has frequently proven to be a history of success. In the Middle East, this kind of investment opportunity has only become a topic after the turn of the Millennium. It still develops actively and shows a particular dynamic these days in Saudi Arabia.

A. History, Definition and Features of REITs

In 1960, US-President Eisenhower signed Public Law 86-779 into force, amending Subchapter M of chapter 1 of the Internal Revenue Code (US-IRC) of 1954 and adding Sections 856-858 to it. What sounds like a mere and simple administrative action, left and leaves its traces in worldwide capital markets until today. By establishing a legal regime for Real Estate Investment Trusts (REITs) Eisenhower managed to democratize real estate investment in the USA. All of a sudden, it became possible for middle class citizens to invest their fortune into real estate and participate in the same

benefits that used to be a privilege of those being able to afford the sums needed for these kinds of investments on their own or financed by loans.

Generally speaking, US REITs are modelled close to mutual funds. Sec. 856 of the US internal revenue code outlines the general features of a REIT. It has to be a cooperation, trust or association, whose beneficial ownership is evidenced by transferable shares and distributed amongst 100 persons or more. It has to gain 95% of its income derived from dividends, interest, and property income sources and at least 75% of its gross income from rents or mortgage interest. 75% of the value of its assets has to be made up out of certain real estate assets. It has to pay dividends of at least 90% of the REIT's taxable income. In turn, corporate tax for the REIT is reduced or eliminated.

This approach proved very successfully word wide and in the US has become a major pillar of securities investment.

B. The Current Saudi Structure of Real Estate Funds and Financial Markets

I. General Legal Structure of the Kingdom of Saudi Arabia

In order to understand the Saudi Legislation on REITs and in particular the terminology, it has to be taken into account, that Saudi Arabia is one of the few countries in the world to apply Islamic law directly. Even though the country has a Basic Law (SA-BL) organizing the public Power, this law sees itself subject to Islamic law. In consequence, it is not called a constitution. It also enlists any norm giving power below executive and

judicial powers (cf. Art 44, 67, 70, 71 SA-BL) and does not call Laws by the Arabic word for law qānūn but nizām (lit. order) to underpin, that these norms only order the Islamic system without setting rules on their own. In English, they are still translated by the word Law. Below Laws, rules can be set by regulations (lawā'ih) and below them by Instructions (ta'limāt).

II. Regulatory Structures of the Financial Market

The Saudi Capital Market Law (Nizām as-sūq al-mālīya) (SA-CML) forms the legal basis for any capital market structures in Saudi Arabia. This law sets up the main institutions of the Saudi capital market as well as the essential policy rules to be followed and the sanctions in case of their contraventions.

1. The Main Institutions in the Saudi Financial Market

The main institutions are The Capital Market Authority (hay'a as-sūq al-mālīya) (SA-CMA), The Stock Exchange (as-sūq al-mālīya as-sā'ūdīya) including The Securities Deposit Centre (markaz idā' al-awraq al-mālīya) as a department of The Stock Exchange (Art. 26 a SA-CML) and the Committee for the Resolution of Securities Disputes (lajnat al-faṣl fī munāza'āt al-awraq al-mālīya) (Art. 25 SA-CML).

a) The Capital Market Authority (hay'a as-sūq al-mālīya) (SA-CMA)

The SA-CMA is set up as the main regulatory body of the Saudi Financial Market. It has been vested the power to set general rules under the SA-CML as well as to take a number of individual

administrative decisions vis-à-vis individual market participants and to interpret the statutory provisions of the SA-CML (Art. 6 SA-CML). In summary, this presents the SA-CMA as the central and most dominant institution in the Saudi Capital Market with a clearly prevailing power and partially able to define its own scope of competences.

The SA-CMA itself has a legal personality and financial and administrative autonomy. It reports directly to the Council of Ministers (Art. 4 a. SA-CML). The core body in the SA-CMA is the Board (majlis hay'a al-sūq al-mālīya), which assumes the majority of the responsibilities of the institution (c.f. Art. 7 SA-CML).

b) The Stock Exchange (as-sūq al-mālīya as-sā'ūdīya)

The stock exchange itself is organized as a joint stock company (c.f. Art. 20 SA-CML) with a number of legal specialties as set out in the SA-CML amongst them the composition of its board (Art. 22 b. SA-CML), which is competent to propose the necessary regulations, rules and instructions for the operation of the stock exchange for approval to the SA-CMA (Art. 23 SA-CML).

The Stock Exchange operates under the name tadawul¹ (meaning “circulation” or “negotiation”) and operates its single transactions through brokers on behalf of their clients (c.f. Art. 21 SA-CML).

Furthermore the board is also the

¹ <https://www.tadawul.com.sa/wps/portal/tadawul/about/company/about-tadawul>

competent authority to establish the Securities Depository Centre (markaz ḥidā' al-awraq al-mālīya) as a department of the Stock Exchange authorized as the sole entity in the Kingdom to practice the operations of deposit, transfer, settlement, clearing and registering ownership of Saudi Securities traded on the Exchange (Art. 26 a. SA-CML).

c) Committee for the Resolution of Securities Disputes (lajnat al-faṣl fi munāza'āt al-awraq al-mālīya)

The Committee for the Resolution of Securities Disputes is established by the SA-CMA and assumes the task to have jurisdiction over public and private actions with regard to the provisions of the SA-CML, its implementing regulations and the regulations, rules and instructions issued by the SA-CMA and the Stock exchange (Art. 25 SA-CML).

2. Essential Policy Rules of the Saudi Capital Market

Aside the core institutions of the Saudi Capital Market, the SA-CML also sets out the framework and the basic rules of the market. This includes amongst other things the rules for brokers (al-wusātā') (Art. 31 -38 SA-CML) on disclosure (al-ifṣāḥ) (Art. 40 – 48 SA-CML), manipulation and insider trading (al-iḥṭiyāl wa-at-tadāwul binā'an 'alā ma'lūmāt dākhlīya) (Art. 49-50 SA-CML) as well as proxy solicitations, restricted purchase and restricted offer of shares (ṭalabāt at-tawkīl wa-sh-shirā' al-muqayyad wa-l-'arḍ al-muqayyad li-l-ashum) (Art. 51-54 SA-CML). Finally yet importantly Art. 55 – 64 SA-CML sets out the Sanctions and Penalties for violations (al-'uqūbāt wa-l-aḥkām al-jizā'iya) of the capital market rules.

III. Real Estate Investment Funds

After taking an introductory glance at the main features of the Saudi Capital market according to the SA-CML, the focus of the following shall be the structuring of investment fund in accordance with Saudi legislation and with a particular regard to real estate funds.

1. Investment Funds in General

When analysing the SA-CMA with regard to investment funds, immediately Art. 39 SA-CML comes to one's focus of attention. This Article gives a general definition of investment funds (ṣanādīq al-istithmār, sg. ṣundūq al-istithmār) (Art. 39 a. SA-CML) as "a collective investment scheme aimed at providing investors therein with an opportunity to participate collectively in the profits of the scheme which is managed by a portfolio manager for specified fees".

Hence investment funds in Saudi Arabia are regulated by the SA-CMA and in particular by its Investment Fund Regulation (lā'iḥat ṣanādīq al-istithmār) (SA-CMA-IFR) enacted 2006 and comprising 104 Articles. The main features of investment funds according to the SA-CMA-IFR are the differentiation between Fund Management and Custody on the one hand as well as between public and private funds on the other hand.

Managers and Custodians have to be installed for public and private funds alike (Art. 7, 22 SA-CMA-IFR). The Fund Manager has the main responsibilities of actually managing the fund and operating it (including administering it) and offering its units (Art. 9 c. SA-CMA-IFR). He is

generally responsible for ensuring compliance with the applicable legal framework and for keeping registers and issuing statements. Therefore, he may delegate powers to sub managers and appoint advisors and the custodian. The custodian is responsible to keep the fund's assets, which still belong collectively to the unitholders of the fund - in a separate account and to administer this account.

With regard to the differentiation between public and private funds the Glossary of Defined Terms Used in the Regulations and Rules of the Capital Market Authority (CMA-GDT) defines public funds as those, whose units may be offered by the Fund Manager in accordance with Part Four (Art. 30 – 72) SA-CMA-IFR. This includes amongst other things an approval of the CMA to the fund upon application of the future fund Manager, a contractual fund structure established by the signature of the first potential unit holder and the fund manager, the establishment of a public Fund board as well as a number of provisions and limitations applying to all investment funds and only to those with a particular investment profile. In this context Art. 44 a. SA-CMA-IFR needs to be highlighted. This provision excludes public real estate investment funds from the SA-CMA-IFR and subjects them to a further regulation, the Real Estate Investment Funds Regulation (SA-CMA-RFR). On the contrary private real estate investment funds remain subject to the provisions of the SA-CMA-IFR (Art. 44 b. SA-CMA-IFR). In accordance with the given by CMA-GDT private funds are those, not fulfilling the requirements of public funds. The SA-CMA-IFR further defines

and outlines the regulatory framework of private funds by limiting the potential investors to so called sophisticated investors (Art. 74 a., b. SA-CMA-IFR) and by requiring a minimum investment and trading amount in the secondary market of SAR 1,000,000/- (approximately US\$ 26,600/-) (Art. 74 a., 92 3) SA-CMA-IFR).

2. Legal Framework for Real Estate Investment Funds in Particular

Though a different regulation, the Real Estate Investment Funds Regulation (SA-CMA-RFR) takes over the main structural shapes of investment funds in general for Real estate investment funds as well. As already stated, under the SA-CMA-RFR only public funds can be established.

With regard to the institutional construction of the fund, again, the positions of the fund manager and the custodian can be found, but for real estate investment funds, the fund manager can also assume the position of the custodian under certain circumstances (Art. 11 SA-CMA-RFR). An institution explicitly outlined in real estate funds is its board of directors. This means, that the fund is under collective supervision from within. Whereas in regular investment funds the CMA is entitled to change the Fund Manager, here it can only change members of the board of directors, i.e. the fund can change its management and accordingly its policies, but not the manager itself. The fund's daily business is managed by a portfolio manager, who in the case of real estate funds has to be an employee of the fund manager in charge of managing the fund and has to be a registered person with the CMA as per

the Authorized Persons Regulation (SA-CMA-APR)² (c.f. Art. 2 SA-CMA-RFR).

Art. 6 SA-CMA-RFR sets out the types and objectives of real estate investment funds. In Art. 6 (a) SA-CMA-RFR a number of standard types and objectives are set out. All of them are closed ended funds that foresee to sell the concerned real estate in the end and to terminate the fund afterwards. The differences between the three types of funds can be seen in the stage of development of the property to be undertaken by the fund: Either initial (Art. 6 (a) 1) SA-CMA-RFR) or construction development (Art. 6 (a) 2) SA-CMA-RFR) or one of the aforementioned combined with the intention of selling the property after a certain period of time (Art. 6 (a) 3) SA-CMA-RFR).

C. The New Development of Saudi REITs

As outlined above REITs have been a successful product on capital markets worldwide. Firstly for enabling small and medium sized incomes to participate in the advantages of real estate investment and secondly because in most jurisdictions REITs enjoy a number of taxation benefits. In contrary to these international developments the REIT market in the Middle East experienced a more reluctant development with regard to this kind of investment possibility.

² This is a core difference to the general definition of the defined terms used in the regulations and rules of the CMA, as the Portfolio Manager of a real estate investment fund thus has to be a natural person.

This might be due to a number of reasons. Firstly, Tax advantages in most GCC Countries would be close to none, as generally taxes are not imposed in this world region, but also since the market was always saturated with investors willing to contribute to projects outside REIT structures. Finally, legislation was not enacted in a way to allow REIT structures to be established.

I. History of REIT Regulations in Saudi Arabia

From 2009 on, first attempts to initiate REITs in the Kingdom of Saudi Arabia were made by Encore Management, a Swiss-based asset management company.³ After Dubai already adopted enabling legislation in DIFC in 2006 and Kuwait launched the first Islamic REIT in the GCC 2007 followed by Bahrain opening its legislative framework for REITs in 2009.⁴ Despite the aforementioned announcements, concrete plans for a legislative framework to enable REITs in Saudi Arabia were not recognizable until early 2016, when the CMA announced to have approved rules governing the listing of

³ C.f. Oxford Business Group: New trusts and funding vehicles aid property investment in Saudi Arabia, <https://www.oxfordbusinessgroup.com/analysis/finding-finance-new-trusts-and-funding-vehicles-offer-solutions-property-investment-needs> (last visited January 2, 2017).

⁴ C.f. Alawi, Abdullah; al Kadi, Sultan: Real Estate Investment Trusts (REITs), KSA Real Estate, Thematic Report, http://www.aljaziracapital.com.sa/report_file/ess/SPE-165.pdf (last visited January 2, 2017), p. 4.

real estate investment trusts.⁵

From July 31, 2016 until August 23, 2016⁶ the CMA displayed the drafts online with an invitation to concerned and interested parties to provide their comments and observations in accordance with Art. 5 b. SA-CML.⁷

After considering comments and observations, the Real Estate Investment Traded Funds Instructions (SA-CMA-REITI) were issued by the CMA Board on October 24, 2016.

⁵ C.f. Reuters: Financials, Jan 13, 2016 (<http://www.reuters.com/article/saudi-reit-regulations-idUSL8N14X1BX20160113>) (last visited January 2, 2017).

⁶ C.f. Al Arabia: Hay'at al-sūq al-sa'ūdīya tuqīrr qawā'id šanādīq al-'aqār al-mutadāwala, <https://www.alarabiya.net/ar/aswaq/financial-markets/2016/10/30/%D9%87%D9%8A%D8%A6%D8%A9-%D8%B3%D9%88%D9%82-%D8%A7%D9%84%D8%B3%D8%B9%D9%88%D8%AF%D9%8A%D8%A9-%D8%AA%D8%B9%D8%AA%D9%85%D8%AF-%D8%AA%D8%B9%D9%84%D9%8A%D9%85%D8%A7%D8%AA-%D8%B5%D9%86%D8%A7%D8%AF%D9%8A%D9%82-%D8%A7%D9%84%D8%B9%D9%82%D8%A7%D8%B1-%D8%A7%D9%84%D9%85%D8%AA%D8%AF%D8%A7%D9%88%D9%84%D8%A9.html> (last visited January 2, 2017).

⁷ http://www.cma.org.sa/En/News/Pages/CMA_N_2096.aspx (last visited January 2, 2017).

II. Content of the Real Estate Investment Traded Funds Instructions (SA-CMA-REITI)

The CMA regulated REITs in the form of instructions. This kind of legislation is subject to Regulation, which do have a higher level in the Saudi hierarchy of norms. Though contradicting some of the passages of the SA-CMA-RFR in its wording, in the end the SA-CMA-REITI is conform to the SA-CMA-RFR, as Art. 6 b. SA-CMA-RFR allows for real estate funds to differ with regard to their types and purposes from the ones outlined above. Accordingly, REITs are structured differently in a number of respects than ordinary real estate investment funds.

A Saudi REIT is a real estate investment fund, that is publicly offered and the units of which are traded on the exchange, whose primary investment objective is to invest in constructionally developed real estates qualified to generate periodic and rental income, and distribute a prescriptive percentage of the fund's net profit in cash to the unitholders at least annually (Part 2 C. SA-CMA-REITI). Furthermore, it can only take the shape of a closed ended Fund (Part 4 A. 1) SA-CMA-REITI), i.e. initial subscription to the fund is not possible after a closing date, from when on it will be traded only in the secondary market.

1. Institutional Framework

As outlined, worldwide REITs have a very distinct, yet common structure, bearing a lot of similarities to publicly listed stock companies. From an institutional point of view, this means a significant increase of participation

rights of the single unit holders. This is displayed in Part 6 and 7 SA-CMA-REITI. Both Provisions were not included in the initial draft and have been added after the consultation of the public in August 2016. Part 6 SA-CMA-REITI calls for the consent of the unitholders, when fundamental changes to the fund are to be made and Part 6 SA-CMA-REITI organises the meetings of the unitholders.

In contrary to the provisions established by the SA-CMA-RFR, the custodian has to be strictly separated from the fund manager, as is the case in normal investment funds regulated by the SA-CMA-IFR. Furthermore, the institution of a portfolio manager cannot be found in the SA-CMA-REITI, rather one or more property management companies have to be appointed by the fund manager for property management, property maintenance, leasing services and rent collection (Part 3 G SA-CMA-REITI).

2. Policy of a Saudi REIT towards its Assets

In comparison to the outlined real estate funds under the SA-CMA-RFR it is not the pronounced aim of a Saudi REIT to develop and sell its property at some stage. The fund is rather focussed on the generation of continuous income. In consequence 75% of the of the fund's total assets value according to the last audited financial statements must be invested in constructionally developed real estates qualified to generate periodic and rental income (Part 4 B. 1) SA-CMA-REITI). Consequently, the fund manager is restricted in investing in vacant lands. The fund manager is allowed to invest up to a maximum of

25% of the fund's total assets value according to the last audited financial statements in real estate development whether on real estates owned by the fund manager or not, and to renovate or redevelop these properties (Part 4 B. 4) SA-CMA-REITI). Saudi REITs also focus on investing in real estate domestically. In turn, the fund manager shall not invest more than 25% of the fund's total assets value according to the last audited financial statements in properties outside the Kingdom (Part 3 O. SA-CMA-REITI).

3. Policy of a Saudi REIT towards its Unit Holders

As REITs aim to spread the risks of real estate investment between a large number of unitholders and to let them participate in the benefits of this kind of investment, the SA-CMA-REITI takes measures to ensure a large number of unitholders. The core term for Saudi REITs in this context is the 'unitholder from the public'. As defined in Part 2 C. SA-CMA-REITI, unitholders from the public means unitholders who own units in the REIT other than any unitholder owning 5% or more of the REIT's units, the fund manager and its affiliate or the fund's board of directors. For a REIT's units' registration and admission to listing, it must have at least 50 unitholders from the public and at least 30% of the total REIT units are owned by unitholders from the public (Part 4 B. 2) a), b) SA-CMA-REITI). These requirements are a continuous obligation throughout the operation of the REIT and have to be upheld actively by the fund manager (Part 4 B 2) c), d) SA-CMA-REITI).

This broad distribution is also underpinned by the price of each unit set at SAR 10/- (US\$ 2.66) and the amount to be raised of at least SAR 100,000,000/- (US\$ 26,650,000) (Part 4 A.2), 3) SA-CMA-REITI)

On the other hand, the SA-CMA-REITI assures that at least 90% of the fund's net profits must be distributed annually to the unitholders (Part 4 B. 3) SA-CMA-REITI). Finally, borrowing of the fund is limited to 50% of the total assets value of the fund (Part 4 B. 5) SA-CMA-REITI).

D. Assessment and Conclusion

Saudi Arabia is frequently compared to a huge crude oil tanker vessel, not only due to its main and predominant export product, but also because it is by far the largest economy and population in the GCC and thus politically far more difficult to manoeuvre than other countries in this region. However, certain factors like a constant population growth and low oil prices (amongst other things) have presented themselves as shallow waters in which the country has to manoeuvre. Thus, the country is presenting its plans to the future in form of the royal vision 2030, which is a huge transformation plan with a large impact in the legal, social and economic framework of the country. One of the main goals of this vision is to diversify the national economy. This applies not only to the ways of generating income and funding to move away from an economy strictly relying on oil revenues, but also to the way of spending money and taking into account that the Saudi population has become more and more differentiated with regard to income and asset wealth. It is this context, in which

the establishment of REITs in Saudi Arabia has to be seen. On the one hand, the country has a considerable housing problem that needs to be tackled⁸; on the other hand, funds for real estate operation cannot come from solely from oil revenues distributed by the state. In this context, it seems only consequent that private initiative is fostered also on financial markets and in accordance with differently distributed wealth in the Kingdom, it seems moreover consequent to try and find an approach to open the benefits of real estate investment to all layers of society and safeguard this in the respective legislation.

As the Vision 2030 on a large scale for the Kingdom, the introduction of REITs to the Saudi Capital Market is a huge endeavour for this Market and the CMA. The number of amendments to the original draft shows, that a lot of dialogue was necessary between concerned sides to enable this new kind of financial product to the Saudi market.

From an institutional point of view, no investment fund product offers participation rights and possibilities of control that close to the single unit holder. In usual investment funds, the fund manager may appoint advisors (Art. 18 SA-CMA-IFR), in other real estate funds, a board partly comprised of independent directors is obligatory (Art. 7 SA-CMA-RFR), but only in REIT's a

⁸ Barnard, Lucy: Affordable home shortage in Saudi Arabia 'likely to worsen' in The National, May 31, 2016 <http://www.thenational.ae/business/property/affordable-home-shortage-in-saudi-arabia-likely-to-worsen> (last visited January 2, 2017).

direct participation of the unit holders becomes possible.

From a policy point of view, a continuous and far-reaching distribution of profits is legally enacted and provides quicker and safer revenue to investors than in other kinds of real estate investment funds in the Kingdom.

The main feature of REITs in other parts of the world, the tax benefits, still do not apply to Saudi REITs. However, with the deep changes ahead in some of the GCC economies and the Saudi economy in particular even this perspective does not seem out of thinkable options for the future.

Overall, the Kingdom seems to manoeuvre on the course, president Roosevelt once set so successfully in the US: to open up and diversify its real estate markets in order to let everyone in the Kingdom participate from its benefits.

Since November 2016, the first REIT started trading at tadāwul and has a price at around SAR 11.10 per January 2, 2017.

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Egypt

Egypt Liberalize its Currency's Exchange Rate

Guiding Principle

In a press release dated November 3rd, 2016, the Central Bank of Egypt (CBE) announced its decision to move, with immediate effect, to a liberalized exchange rate regime in order to quell any distortions in the domestic Forex market.

As per the decision, banks and other market participants are at liberty to quote and trade at any exchange rate. Bid and ask exchange rates will be determined by demand and supply. The banks were obliged to deal with the rates set by the CBE prior to this decision. The CBE will use the prevailing market rate for any transactions it undertakes as per the new decision.

This move represents a part of the reform plan that the country undertakes as it secured the approval of the International Monetary Fund's (IMF) for the three-years, \$12bn loan agreement. It came also to terminate the parallel "black" market in the country and restore trading Forex within legal channels.

The CBE expects that its decision will allow market demand and supply dynamics to work effectively creating an environment of reliable and sustainable provision of foreign currency.

A. Foreign Currencies Shortage in Egypt

The Egyptian economy has been suffering from the turmoil followed the ousting of the Egyptian President Hosni Mubarak in 2011. The turmoil affected dramatically the number of tourists arriving to Egypt. In parallel, the foreign investment dropped sharply to unprecedented levels. Such reductions caused a major shortage at the foreign currencies in the country.

On the other hand, the Central Bank of Egypt (CBE) continued its policy of controlling the exchange rate of the Egyptian Pound. Rationing its cash in a rate that does not commensurate with the volume of demand for the foreign currency.

The policy of the CBE caused a lower competitiveness, reduction of foreign reserves, and foreign exchange crisis, which in turn has affected investments. The ration of the Egyptian Pound in unrealistic rate resulted also in the emergence of a black market selling foreign currencies with much higher rates than the banks to fulfil the needs of small and big businesses in the country.

B. Devaluating the Egyptian Pound

The high budget deficit and public debts resulting from weak revenues, large subsidy bills forced the Government to start negotiation with the International Monetary Fund (IMF) for a loan.

On November 11, 2016 Egypt successfully secured the IMF approval for a three-year, \$12bn loan agreement. The first instalment of \$2.75m was received following the IMF executive board's approval. The loan payment will

be over a 10-year period with an interest rate of 1-1.5%.

The loan was granted to Egypt after it undertaken to implement a reform plan for securing the approval of the IMF over the loan agreement.

Egypt had already started implementing the plan by to liberalize the exchange rate for the Egyptian Pound few days before the IMF announced its approval to grant the loan.

The CBE floated the currency, moving it from EGP 8.83 to the US dollar to about EGP 13 on November 3rd, 2016. The decision is expected to improve Egypt's competitiveness, increase attractiveness to foreign direct investments, as well as helping exports and tourism, it is expected also give the CBE the chance to rebuild Egypt's international reserves.

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Iran

Tax and Customs Duties on Export from Iran

Guiding Principle

In order to support local producers and manufactures, Iran's tax regime has placed incentive tariffs or even full exemption on export of non-oil products out of Iranian territory. This being an important issue for foreign traders, who purchase goods and products from Iranian suppliers and plan to export these purchased goods out of Iran.

The tax and duties imposed on exportation of goods and services are subject to the below mentioned laws and regulations:

a) Taxation

According to Article 141 of Direct Taxation Act (abbrev. "IR-DTA"), 100% of the income derived from exportation of non-oil services and goods and products of agricultural sector and 20% of incomes derived raw materials shall subject to tax with the rate of zero.

Therefore, in case a foreign trader purchases any type of goods, which is neither oil-services or goods nor raw materials, from an Iranian supplier and the final destination of the purchased goods or services is outside of Iran, the exportation is exempted totally from taxation.

b) Value Added Tax (VAT)

As mentioned above, according to the Iran Direct Act, in general exportation of non-oil goods and services are not

subject to tax. Moreover, based on the Iranian VAT Act, no VAT shall be imposed on exportation of goods and services abroad. Article 13 IR-VAT provides that:

"Exportation of goods and services abroad, via formal departure gates shall not be liable to the tax subject of this Act and taxes paid on such terms shall be refunded upon providing bill of export issued by the customs (as regards goods) and proving documents and certificates."

c) Customs Duties

Customs duties are actually one of the types of indirect tax, which is imposed based on Customs Tariff Table on importation only. Therefore, exportation is not subject to customs duties.

d) Commercial Benefit Tax

Commercial benefit tax is also imposed on importation and is not imposed on exportation.

e) Customs Charges

Customs charges are imposed on both export and import. The most important customs charges include the charges for unloading, loading, test and warehousing charges, freight carriage in customs and extra services.

f) Export Duties

Export duties is imposed on some specific goods, the list of which is declares from time to time by Ministry of Industry, Mine and Commerce. The export duties on any type of goods or services should be studied case by case.

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