ANDERSEN

REGISTER A BANK IN EGYPT

Legal and Tax Strategies

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PART 1

Legal Strategies

Part 1: The Legal and Regulatory Framework

Introduction

The Egyptian banking sector is one of the cornerstones of the Republic's economy, regulated by a robust legal framework to ensure financial stability, integrity, and compliance with international standards.

Establishing a bank in Egypt is a multi-step process requiring a clear understanding of the regulatory environment, key stakeholders, and compliance obligations. This guide offers a step-by-step overview to help potential investors and stakeholders navigate the complexities of bank registration.

1. The Legal Framework for Banking in Egypt

1.1 Key Regulatory Authorities

The **Central Bank of Egypt (CBE)** is the primary authority overseeing the banking sector. Its responsibilities include granting licenses, supervising compliance, and ensuring systemic financial stability. The CBE is directly involved in every stage of the bank registration process.

Other relevant entities include:

- **The Financial Regulatory Authority (FRA):** While primarily focused on non-banking financial services, its scope may intersect with banks involved in securities or investment services.

- **The General Authority for Investment and Free Zones (GAFI):** Handles the incorporation process for all companies in Egypt, including banks.

- **The Egyptian Tax Authority:** Responsible for overseeing tax compliance, which is vital for operational readiness after registration.

1.2 Relevant Legislation

Establishing a bank in Egypt is governed by a combination of laws designed to regulate financial institutions and encourage investment:

1. **Central Bank and Banking Law No. 194 of 2020:**
   - Sets the framework for licensing, operational guidelines, and governance requirements for banks.
   - Outlines capital adequacy standards and risk management protocols.

2. **Anti-Money Laundering Law No. 80 of 2002:**
   - Mandates banks to implement comprehensive anti-money laundering (AML) and counter-terrorism financing (CTF) measures.

3. **Investment Law No. 72 of 2017:**
   - Provides foreign investors with protections and incentives, ensuring a transparent and efficient investment process.

2. Pre-Registration Planning

2.1 Initial Market Research

Before initiating the registration process, investors must conduct thorough market research to determine the viability of their proposed bank. Critical factors to consider include:

- **Demand for Banking Services:** Identifying gaps in the market, such as underbanked regions or specialized banking services (e.g., Islamic banking, digital banking).

- **Competition Analysis:** Understanding the positioning and performance of existing banks in Egypt.

- **Regulatory Barriers:** Familiarizing with specific requirements for foreign and domestic banks.

2.2 Developing the Business Model

A robust business model is essential for securing approval from regulatory authorities. This model should address:

- **Banking Services Portfolio:** The range of services to be offered, such as retail banking, corporate lending, or asset management.
- **Operational Framework:** Planned organizational structure, including branches, digital platforms, and ATMs.
- **Target Market:** Demographics and industries the bank will cater to, supported by research data.
- **Sustainability and Risk Mitigation:** Financial plans that account for economic fluctuations, currency risks, and compliance costs.

2.3 Meeting Capital Requirements

Capital adequacy is a cornerstone of the CBE's licensing criteria. The minimum paid-in capital requirements are:

- **EGP 5 billion** for locally established banks.
- **USD 150 million** for foreign banks.

Investors must provide documentation proving the legitimacy of their funding sources, including audited financial statements or equivalent verification.

3. Preparing for the Registration Process

3.1 Preliminary Approvals

Investors must submit an initial application to the CBE, which evaluates the following:

- The business plan and proposed banking model.
- Proof of capital adequacy.
- Profiles of the founding members, directors, and executive management, ensuring they meet the CBE's "fit and proper" criteria.

3.2 Establishing Governance Structures

The CBE requires banks to adhere to strict governance standards. This includes:

- Appointing a Board of Directors with relevant expertise and diverse experience.
- Establishing risk management and compliance committees to oversee operational integrity.
- Drafting clear internal policies for corporate governance, ethics, and accountability.

Part 2: The Registration Process

Once the pre-registration steps are complete, the process of formally registering a bank in Egypt begins. This phase involves compliance with Central Bank of Egypt (CBE) regulations, submission of required documents, and securing the necessary approvals. Below, we break down the key stages of the registration process.

4. The Registration Process

4.1 Submitting the Application to the Central Bank of Egypt (CBE)

The first official step is submitting an application to the CBE. The application must include the following:

1. **Business Plan:** A comprehensive document detailing the proposed bank's services, target market, and operational framework.
2. **Capital Verification:** Evidence of meeting the minimum paid-in capital requirements (EGP 5 billion for local banks, USD 150 million for foreign banks).
3. **Articles of Association:** The legal document outlining the bank's structure, governance, and purpose.
4. **Profiles of Founders and Executives:** Background checks to ensure compliance with the CBE's fit-and-proper standards for individuals involved in managing the bank.
5. **Organizational Chart:** A detailed structure of the bank, including key management and departments.

Once submitted, the CBE reviews the application for com, pleteness and alignment with regulatory standards. This initial review typically takes **60-90 days** depending on the complexity of the application and the responsiveness of the applicants.

4.2 Securing Initial Approval

Upon successful review of the application, the CBE grants **initial approval**, which permits the founders to proceed with incorporating the bank. Initial approval is conditional on completing additional compliance requirements and does not yet allow the bank to commence operations.

Key compliance requirements following initial approval include:

- Establishing the required capital in a CBE-approved escrow account.
- Finalizing governance frameworks and internal policies.
- Securing a physical office location and demonstrating operational readiness.

4.3 Incorporation with the General Authority for Investment and Free Zones (GAFI)

With initial approval in hand, the next step is to incorporate the bank as a legal entity through GAFI. This process includes:

1. **Submission of Documents:**
    - Articles of Association.
    - Founders' identity documents (individuals and corporate entities).
    - Proof of capital deposit a local bank account.
2. **Notarization and Legalization:**
    - All submitted documents must be notarized and, if applicable, legalized by the Egyptian consulate in the applicant's country of origin.
3. **Certificate of Incorporation:**
    - Once approved, GAFI issues a certificate of incorporation, officially recognizing the bank as a legal entity in Egypt.

This phase typically takes an additional **30-45 days**, depending on the completeness of the submitted documents and any required amendments.

5. Final Licensing Approvals

5.1 Operational Readiness Inspection

Before granting the final license, the CBE conducts an inspection to ensure the bank’s readiness to operate. This inspection evaluates:

- **Physical Premises:** Adequacy of office spaces, security systems, and IT infrastructure.
- **Staffing:** Appointment of qualified personnel for critical roles, including compliance officers and risk managers.
- **Governance Frameworks:** Implementation of the approved governance structures and operational policies.

5.2 Granting the Final License

After verifying operational readiness, the CBE issues the **final banking license**. This license permits the bank to officially launch its operations, including accepting deposits, offering loans, and providing financial services.

The entire registration process—from application submission to final licensing—typically spans **6-9 months**, depending on the complexity of the application and regulatory reviews.

PART 2

Tax Strategies

Part 2: The Banking Sector in Egyptian Tax Law

Introduction

The banking sector is the heart of any economy and makes a significant contribution than any public finances by shaping monetary policy, controlling interest rates, and managing inflation, banks create a stable economic environment. Additionally, by providing financing facilities to companies focused on export markets, the banking sector empowers industries to access global markets, expand the presence of Egyptian products internationally, strengthen the economy, and contribute to reducing the trade deficit.

The banking sector also has a significant impact on the industrial sector by providing financing to industrial companies through loans and lines of credit. This financial support enables factories and companies to fund equipment purchases, expand production, and develop infrastructure.

Nature of Activity

Banks in Egypt provide a wide range of services, including: banking services and retail banking in both local and foreign currencies, within and outside the Arab Republic of Egypt.

Licensing Requirements for Banking Operations in Egypt

The Central Bank of Egypt's Board of Directors grants preliminary approval for any entity seeking a banking license, provided the following conditions are met:

1. Legal Structure

- The entity must be either a joint-stock Egyptian company or a branch of a foreign bank.

2. Capital Requirements

- The fully issued and paid capital must not be less than:
    - **EGP 5 billion** for an Egyptian bank.
    - **USD 150 million** (or equivalent in freely convertible currency) for foreign bank branches in Egypt.

3. Ownership Transparency

- Ownership structure must be transparent, allowing for identification of the ultimate beneficiary and verification of the legitimacy of the funds' source.

4. Economic Alignment

- The license must align with Egypt's general economic interest.

5. Competition Compliance

- Licensing must not breach competition laws or promote monopolistic practices.

6. Unique Trade Name

- The bank's trade name must not resemble or cause confusion with that of another bank or business entity.

7. Feasibility Study

- The feasibility study must include:
    - The bank's purpose.
    - Nature of activities and services it intends to provide.
    - A market analysis demonstrating its ability to mobilize and utilize savings.

8. Integrity and Solvency

- Key individuals involved in the bank must possess integrity, a good reputation, and financial solvency.

9. Governance and Risk Management

- Internal control plans, risk management, governance, and operational systems must be efficient and clearly defined.

Additional Requirements for Foreign Bank Branches or Subsidiaries

For a branch of a foreign bank or a subsidiary of a foreign bank:

- The foreign bank's headquarters must have a specific nationality and be subject to oversight from the corresponding regulatory authority in its home country.

- The foreign authority must approve the branch's operation in Egypt and agree to joint supervisory standards with the Central Bank of Egypt.

The Board of Directors may waive the minimum capital requirement (item 2 above) for specialized or digital banks.

Application Process

1. **Preliminary Approval Request**: Applicants must submit a request for preliminary approval to the Central Bank, accompanied by required documentation (as specified by a Board resolution) and pay a processing fee of **EGP 1 million**.

2. **Decision Timeline**: The Board of Directors will review the request and issue a decision within **90 days** from the date the completed application is submitted.

3. **Establishment Period**: Necessary steps to establish the bank must be taken within **one year** of the notification of preliminary approval. If not completed within this period, the approval will be considered null and void. The Board may extend this period once for an additional term.

4. **Denial Notification**: If the request is denied, the applicant will be notified within **30 days** of the decision's issuance.

5. **Governor Approval for Board Appointments**: The Governor's approval must be obtained before appointing the first Chairman and Board members.

Licensing Requirements for Foreign Bank Branches in Egypt

Applicants seeking preliminary approval for establishing a foreign bank branch in Egypt must follow these steps:

1. **Application Submission**: Submit a request to the Central Bank, accompanied by required documents (as specified by a Board resolution) and pay a processing fee of **USD 50,000**.

2. **Board Review and Decision**: The application for preliminary approval will be reviewed by the Board in accordance with a cooperation policy between the Central Bank and the foreign regulatory authority overseeing the foreign bank's headquarters. A decision will be issued within **90 days** from the date the completed application is submitted, with a possible **one-time extension**.

3. **Establishment Timeline**: Steps to establish the branch must be completed within **six months** from the date the preliminary approval is granted. If not completed within this period, the approval will be considered void.

4. **Final Submission to the Governor**: Once preliminary approval is granted, the licensing request must be submitted to the Governor, along with specified documents, including:
    - An **unconditional guarantee** from the foreign bank's headquarters covering all deposits, creditors' rights, and any other obligations of the branch.

Corporate Income Tax Rate

The banking sector in Egypt is subject to an income tax rate of 22.5% on net profits. This rate is considered attractive for investment, being 0.9% lower than the global average of 23.4%, providing Egypt with a competitive advantage over its peers.

Banking Sector Revenues:

Banking sector revenues include:

1. **Interest on Loans and Similar Incomes**: This category includes:
    - Interest from loans and credit facilities provided to customers in both local and foreign currencies.
    - Returns from investments in debt instruments in both local and foreign currencies.
    - Deposits and current accounts in both local and foreign currencies.

   These revenues represent the primary activity of banks and are subject to taxation.

2. **Fee and Commission Income**: These are taxable revenues.

3. **Dividends Income**: Dividends income is generally exempt from taxation but may be subject to certain conditions.

4. **Net Trading Income**: This includes profits from foreign exchange forward contracts (buying and selling commitments in foreign and local currencies) and currency swap contracts.

5. **Investments Incomes**: Income from financial investments is generally exempt from taxation, subject to certain conditions, such as listing on the Egyptian Stock Exchange.

Reserved Interest (Deferred Income)

Definition of Reserved Interest: Reserved interest refers to interest or returns that are earned on loans or investments but have not yet been paid or collected. This interest is recorded as income in the bank's records, and although it may be collected in the future, there is a possibility that it will not be collected if, for example, loans are not repaid.

Reserved interest is used for accounting purposes, recorded as part of the bank's potential revenues, but is not considered actual cash income until it is collected.

Reasons for Reserved Interest in Banks:

Reserved interest is recorded in banks for several reasons, including:

- **Loan Repayment Delays**: When customers delay in paying loan installments, interest is recorded as earned but unpaid, and thus accrued until actual repayment occurs.

- **Credit Risk**: In cases where there may be doubt about the customer's ability to repay, accrued interest is recorded as a precautionary measure until repayment is confirmed.

- **Legal and Regulatory Requirements**: Some laws and accounting regulations mandate the accrual of uncollected interest as a precautionary measure to ensure transparency in financial reporting.

- **Loan Restructuring**: When loans are restructured to extend repayment periods or reduce interest rates, some interest may be deferred, resulting in accrued interest.

- **Financial Reserves and Security**: Banks retain accrued income to provide financial protection in case some clients default, enabling the bank to manage potential credit risks and ensure business continuity.

- **Market Changes**:
    - **Interest Rate Fluctuations**: Changes in interest rates may reduce returns on loans and investments.
    - **Market Volatility**: Financial market fluctuations may cause losses, thereby reducing the bank's profits.

Tax Treatment Under Income Tax Law: Reserved interest is added to the taxable base, while written-off accrued interest is deductible.

Cost of Deposits and Similar Expenses

The cost of deposits and similar expenses includes:

- Costs of deposits and accounts held by banks.

- Costs of customer deposits and current accounts.

- Costs of other loans.

These are considered the main operational costs for banks and are recognized as deductible expenses.

Foreign Payments and Their Taxation Scope

Banks incur expenses abroad, such as royalties (software licenses) and services, including legal consultations, development services, regulatory and fraud detection services, and maintenance fees. These are subject to a 20% withholding tax, which the bank must remit to the Tax Authority. However, under tax treaties, a reduced rate or exemption may apply. Not all foreign payments are subject to withholding tax, as the local Income Tax Law provides certain exemptions.

It is worth noting that Egypt has an excellent international tax reputation, having signed nearly 60 bilateral or multilateral agreements to prevent double taxation.

Tax Advantages

- **Provisions**: Provisions are treated differently in the banking sector compared to other sectors. Legislators generally prohibit the deduction of provision amounts from the taxable base, except for banks and insurance companies, which are allowed to deduct:
    - **80% of loan loss provisions** that banks are required to create under Central Bank financial reporting and valuation standards.

- **When Deducting Provisions, The Following Should be Considered:**

    - The amount used from loan loss provisions to cover bad debts incurred during the year must be determined. If this usage exceeds the 80% deductible cost, the excess must be deducted from previously tax-exempt provisions. Generally, excess amounts should be deducted first from provisions that were not previously taxed.
    - Any recovery of previously written-off loans should be added to the taxable base if these loans were previously recognized as bad debts. For loans handled in accordance with legal provisions, 80% of the recovered amount should be added to the taxable base.

- **Interest Expense**: Interest expenses on loans are considered deductible regardless of their amount, after deducting non-taxable or tax-exempt interest income. Taxable income includes all amounts the taxpayer receives as returns from investments in loans, advances, debts, bonds, treasury bills, deposits, and cash securities.

- **Payments to Head Office:** A branch of foreign banks may deduct head-office charges of up to 10% of its taxable income. Moreover, the branch or subsidiary should withhold taxes before the payment of interest, royalties, and service fees to non-resident foreign banks or corporations.

Dividend Distributions

- **A flat rate of 5% WHT**: Applies if securities are listed on the Egyptian Stock Exchange, whether to resident or non-resident shareholders.

  Please note that the company's shares should be registered and also traded on the EGX in order to be considered as listed shares.

- A flat rate of 10% WHT is to be imposed on dividend distributions from an Egyptian unlisted company, whether to resident or non-resident shareholders.

- **Exemption for Parent or Holding Companies**: Dividends received by a parent or holding company from resident subsidiaries are generally exempt, with an additional 10% of these distributions added to the parent or holding company's taxable base as non-deductible costs, provided that:
  - (A) The parent or holding company's ownership share is at least 25% of the subsidiary's capital or voting rights.
  - (B) The parent or holding company holds this share for at least two years or agrees to retain this share for two years from the date of acquisition of shares or voting rights.

- **Capital Gains (Separate-tax pool):** Capital gains subject to taxation are determined based on the net gains of the securities portfolio at the end of the fiscal year, calculated as the difference between the sale or exchange (or any other form of disposal) of securities and their acquisition cost, after deducting brokerage fees.

CGT Treatment Applicable to Resident Companies

Capital gains realized by resident shareholders from the disposals of listed shares on the EGX should be subject to CGT at the rate of 10%.

Whilst, capital gains realized from the sale of unlisted shares/securities should be subject to 22.5% CGT.

Foreign shares/securities (invested abroad): Capital gains realized from shares invested abroad would be subject to a capital gains tax at the rate of 22.5%, with a credit to be given for the foreign tax paid.

Capital Gains Tax Treatment Applicable to Non-Resident Companies

- Capital gains realized by non-resident shareholders from the disposals of listed shares on the EGX should not be subject to CGT, including the T-bonds.
- **Capital gains realized from the sale of unlisted shares/securities should be subject to 22.5% CGT with the exception of the T-bills that are not taxable.**
- **Capital gains realized from shares invested abroad should not be taxed in Egypt**

Foreign Tax Credit

For capital gains realized from securities listed on foreign stock exchanges, foreign taxes paid abroad may be credited against income tax. This credit extends beyond capital gains to include income from:

- Dividends
- Operations
- Branches
- Royalties
- Rents
- Interest from loans granted abroad

Carrying Forward of Capital Losses: Capital losses from the disposal of listed securities may be carried forward for up to three years.

Debt Instruments (Treasury Bonds)

Many companies invest in debt instruments; however, banks' investments in these instruments are significantly larger than those of other sectors. Consequently, exempting the returns on these investments aids in improving liquidity. The legislator stipulated the following:

- Exemption of returns on non-governmental bonds listed on the Egyptian stock exchanges.
- Exemption of returns on bonds offered for subscription abroad (in global markets).

Currency Differences for the Parent Company in Egypt

Currency Differences: The headquarters in Egypt may have foreign branches in various countries. The financial results and financial position of these foreign branches are translated into the presentation currency (assuming none operate in a hyperinflationary economy) when their functional currency differs from the bank's presentation currency, as follows:

- Assets and liabilities in each presented balance sheet of the foreign branch are translated using the closing rate at the balance sheet date.

- Revenues and expenses in each presented income statement are translated using average exchange rates, except if the average rate does not reasonably approximate the cumulative effect of the rates prevailing at the transaction dates. In this case, revenues and expenses are translated using the exchange rates at the transaction dates.
- The resulting currency differences are recognized as a separate line item titled "foreign currency translation differences" within equity. Currency differences resulting from the valuation of net investments in foreign branches and loans, as well as financial instruments in foreign currency allocated to hedge these investments, are also transferred to equity under the same item. These differences are recognized in the income statement under "other operating income (expenses)" when the foreign branch is disposed of.

Foreign Company Branches

Income Tax Rate: Foreign company branches are subject to a 22.5% tax rate on net profits.

This rate is the same as that imposed on Egypt headquartered banks, no higher rate is imposed on branches of foreign banks in Egypt, unlike other countries such as the UAE, which imposes a 20% tax rate on branches of foreign banks, higher than the 9% rate for UAE headquartered banks.

Capital: The Central Bank of Egypt requires banks to:

- Maintain a minimum issued and paid-up capital of USD 150 million.

- Maintain a ratio between capital elements and risk-weighted assets and contingent liabilities equal to or greater than 10%.

Branches of the bank operating outside Egypt are subject to the supervisory rules governing banking in the countries where they operate.
Capital adequacy and utilization are reviewed daily by the bank's management in accordance with the requirements of the regulatory authority, the Central Bank of Egypt, using models based on Basel Committee guidelines. Required data is submitted and filed with the Central Bank of Egypt quarterly.
There are no tax restrictions on increasing capital.

Profit Distributions

The bank's profit distributions are recognized as a deduction from the equity of the headquarters in the period in which they are approved by the general administration. These distributions include the employees' share of the profits.
Profits of foreign company branches in Egypt are considered distributed by default within sixty days from the end of the financial year.

Interest Revenue

Interest revenue earned by foreign company branches is fully subject to the general tax base at a 22.5% rate.

Currency Differences

Generally, the financial statements of foreign company branches are prepared in a foreign currency, unlike other banks, and actual currency differences are accounted for tax purposes.

Accounting Impact of Currency Differences

Transactions in other currencies during the financial year are recorded based on exchange rates at the transaction date. Monetary asset and liability balances in other currencies are re-evaluated at the financial year-end based on the rates prevailing at that date, and the resulting profit or loss from settling these transactions and the differences from re-evaluation are recognized under the following items:

- Net income from financial instruments at fair value through profit or loss for assets/liabilities classified at their inception as fair value through profit or loss by type, and as other operating income (expenses) for other items.

- Within items of other comprehensive income in equity for equity financial instruments at fair value through other comprehensive income.

- Changes in the fair value of monetary financial instruments in foreign currencies classified as investments at fair value through other comprehensive income are analyzed into differences resulting from changes in the instrument's amortized cost, changes from prevailing exchange rates, and changes in the instrument’s fair value. Differences related to changes in amortized cost are recognized in the income statement under loan returns and similar revenues, differences related to exchange rate changes in other operating income (expenses), and differences related to fair value changes within items of comprehensive income in equity under fair value reserve / financial investments at fair value through other comprehensive income.

- Re-evaluation differences resulting from non-monetary items include gains and losses from fair value changes, such as equity instruments at fair value through profit or loss. The re-evaluation differences resulting from equity instruments classified as financial investments at fair value through other comprehensive income are recognized within other comprehensive income items.

Value Added Tax (VAT)

To enhance financial stability and promote saving and investment, the legislator has exempted the banking sector from VAT to avoid imposing unnecessary additional costs on the end consumer, which would increase their financial burden. However, VAT may be imposed on certain banking services offered by banks, with the applicability determined by specific terms and conditions.

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