

Issue #7

**VAT and the Egyptian Economy - What are the
Future Prospects?**

November 2016

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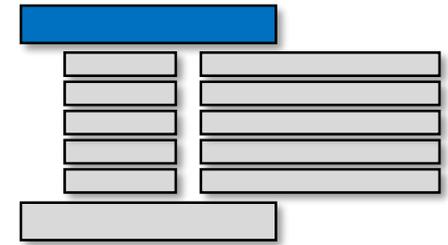
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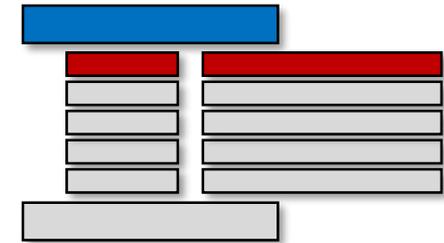
Introduction



Taxation is considered as the main source of governments' income and is a world-wide used economic mechanism to redistribute wealth in the society. Recently, the Egyptian parliament has approved a law for a Value-added Tax (VAT) standard rate of 13-14% in the next fiscal year as part of a reform program that is financed by the country's IMF-obtained loan. As a result, several questions were triggered regarding the impact of taxation on the economy in general and how the VAT implementation can affect the Egyptian market in specific. This report aims to address these questions through shedding light on different tax systems and trends.



Why Do Governments Impose Taxes?



To Generate Revenue



To Control Economic Activities



To Redistribute Income



To Manage Inflation Rates

Sweden Case: One of the highest taxation rates in the world

VAT rate
25%

VAT

Withholding Tax

Real Estate Tax

Corporate Income Tax

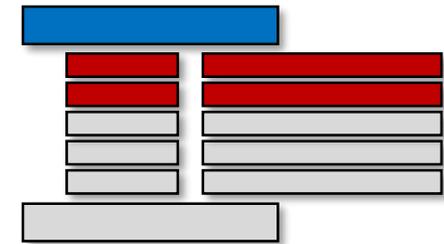
Social Taxes

Stamp Duties

Tax revenue forms the foundations for their social welfare system



What Are the Different Types of Taxes?



Classified based on two Perspectives

How the Tax is Levied

Direct Taxes

Levied directly upon individuals or firms.
Examples: corporate and income taxes.

Indirect Taxes

Levied on goods and services and thus only “indirectly” imposed on individuals.
Examples: excise and sales taxes.

Proportional to Individuals Income

Progressive Taxes

Higher income individuals pay a higher fraction of their income.

Regressive Taxes

Higher tax rate on low income band than on higher income categories

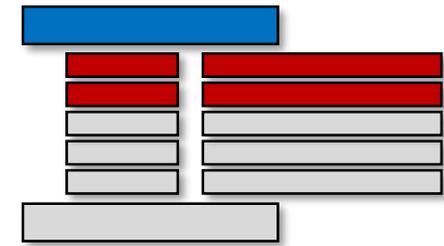
Proportional Taxes

All taxpayers pay the same amount of tax regardless of their income.



Q2 What Are the Different Types of Taxes?

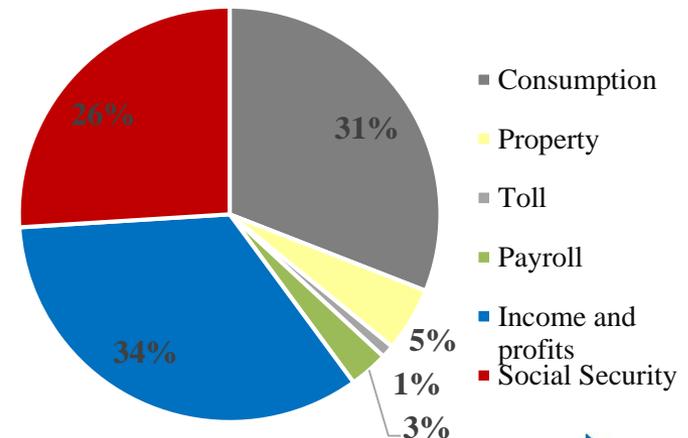
Common Types



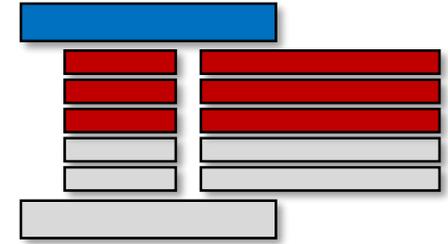
Income Tax	On net gains, net profits and other forms of income from individuals and corporations.
Capital Gains Tax	On the sale of capital assets.
Excise Tax	On the quantity of goods or products bought as opposed to total worth.
Corporate Tax	On certain types of legal business entities. Applicable at state level or other levels of administration.
Property Tax	On money or property that changes ownership; as a transfer fee for changing property titles.
Toll Tax	For using a road that has been constructed privately or publicly.

There are several types of taxes that are imposed in most countries, the following diagram shows the average tax revenues as a percentage of total taxation by category of tax in OECD countries

Average Tax Revenues as a Percentage of Total Taxation by Category of Tax 2014 (OECD Countries)



What Are the Global Trends in Taxation?



There has been a fall in all compliance sub indicators globally including the number of tax payments, total tax rate and compliance times. The increase in labor and consumption taxes are noted to have contributed to the significant fall in compliance times. The average global Total Tax Rate (TTR) has amounted to 40.9%. In the Middle East the average TTR is 24% which is the lowest of any region.

EU and EFTA

Total tax rate is above global average

Central Asia

Reducing time to comply is the main focus

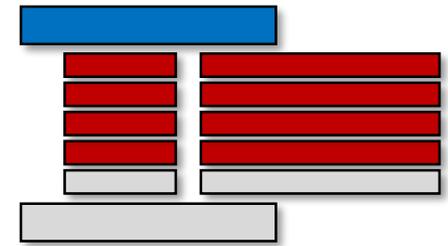
North America

Diverse tax system where all sub indicators are below the world average

Middle east

Lowest tax rates and time to comply

What is the Nature of the Value-Added Tax ?



General Tax

Applied to all commercial activities involving the production and distribution of goods and the provision of services.

Yet, if the annual turnover of this person is less than a certain limit (the threshold), which differs according to the country, the person does not have to charge VAT on their sales.

Consumption Tax

As it is paid by the final consumer as a percentage of price, which means that the actual tax burden is visible at each stage in the production and distribution chain.

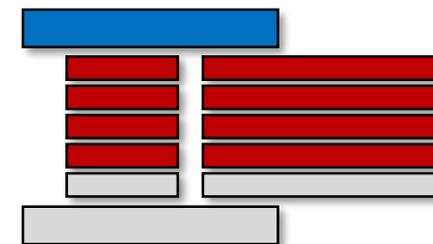
Indirect Tax

As it is imposed on goods and services a consumer purchases.



What is the Nature of the Value-Added Tax ?

Recent Trends in the VAT System



Largest Source of Taxes on General Consumption

Accounting on average for 6.6% of GDP and 19.5% of total tax revenues, and employed in 33 out of 34 OECD countries. Taxes on sales and consumption come second as proportion of OECD tax revenues after profit and income taxes.

Important Development in Taxation

Limited to less than 10 countries in the late 1960s, today VAT is a key source of government revenue in more than 160 countries worldwide. VAT raises approximately 20% of the tax revenue in OECD countries and worldwide.

Prevents Trade Distortions and Promotes Neutrality

VAT regimes are designed on final household consumption, however, the amount of revenue ultimately due is collected through a staged collection process with a portion of tax remitted at each stage of production and distribution.

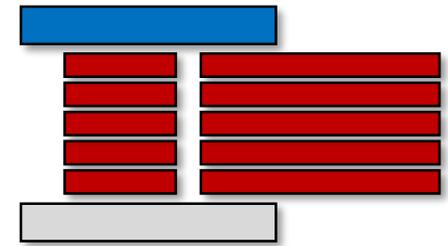
Standard Rates of VAT Significantly Increased since 2009

Due to financial consolidation pressures caused by the financial crisis, 21 OECD countries raised their standard VAT rate at least once, mainly in EU countries.



Q 5

How Will the Introduction of VAT Impact the Egyptian Economy?



The Egyptian parliament approved a law for a VAT standard rate of 13% rising to 14% in the next fiscal year as part of a plan to reform the economy and cut budget deficits.

Advantages

Correct Market Distortions

- Replace the current sales tax
- Broaden the tax base in a country where the government struggles to collect income tax due to a large informal economy and tax avoidance.

VAT Seeks to Be More Equitable for The Poor

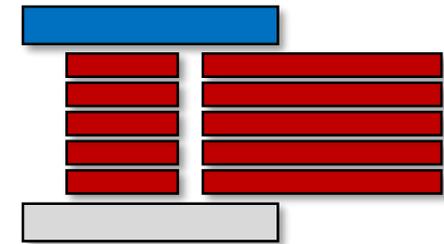
- Exempts basic goods and services.
- The list of exempted goods and services increase from 52 to 56 to protect the poorest of households.

Reduce Tax Evasion

- Applied to each member of the production chain of goods and services at the final retail stage instead of the current sales tax that is imposed as a one off levy placed on the final sale to consumers.



How Will the Introduction of VAT Impact the Egyptian Economy?



However, the success of the VAT system to enhance the economic situation depends on several factors including:

Risks

Inflationary Pressure

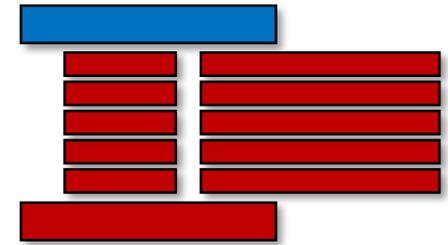
- Applying the tax will hike prices especially during the currency turbulence.
- This will burden low and average income citizens who represent more than 85% of the total population

Effectively Circulating the Billing System between Producer and Consumer

- Risk of overtaxing producers and traders in the formal economy especially that most raw materials are imported.
- An effective billing system will lead to ineffective VAT application. This could cause further downturns in production and trading services overall reducing growth rates to less than 3%.



Conclusion



The VAT regulations in Egypt will provide an alternative source of government revenue which promotes a more neutral and equitable taxation scheme. However, the success of the scheme depends on the strategic timing and consideration for the current vulnerable economy which is witnessing weak currency and high unemployment.

Therefore, it is necessary to consider:

- Impact of such measures on investment and consumption activities especially that the long term economic benefits of the proposed scheme rely strongly upon the way in which the extra government revenues will be spent.
- The dissatisfaction of the Egyptian population if an improvement or restructuring of social welfare is not witnessed in return for the increases in taxation, especially that the political economic situation is already vulnerable.



Thanks ... End

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