Indirect Taxation Regimes in MENA

Presentation at the 7th Annual meeting of the MENA Tax Forum

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Agenda

- ✓ **Importance of indirect taxes**
- ✓ **Indirect Taxes in the MENA region: past, present & future**
- ✓ **Excise taxes: 3 examples**
- ✓ **Use of modern technologies in taxation**
- ✓ **Key messages**

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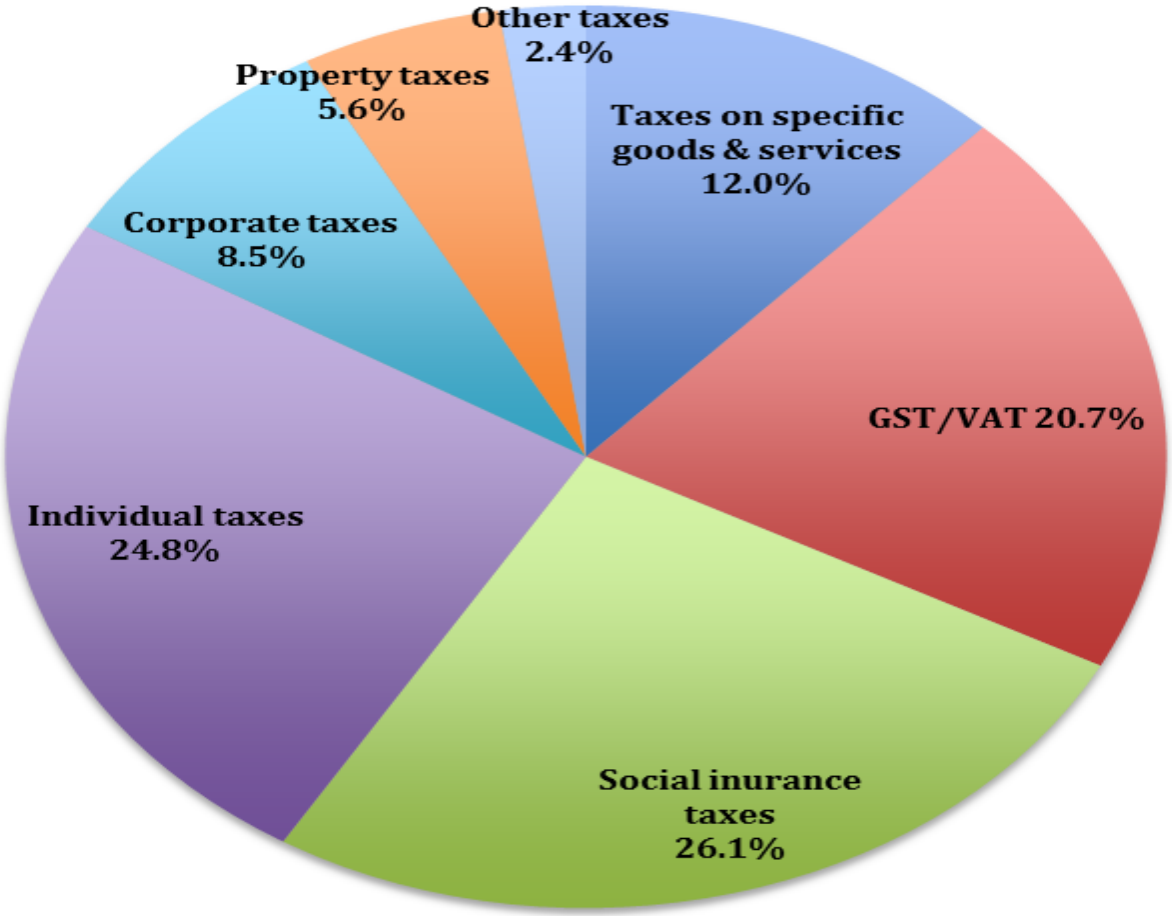
Average Sources of Tax Revenue in OECD countries, 2013: indirect taxes dominate



Source: OECDStatExtrats

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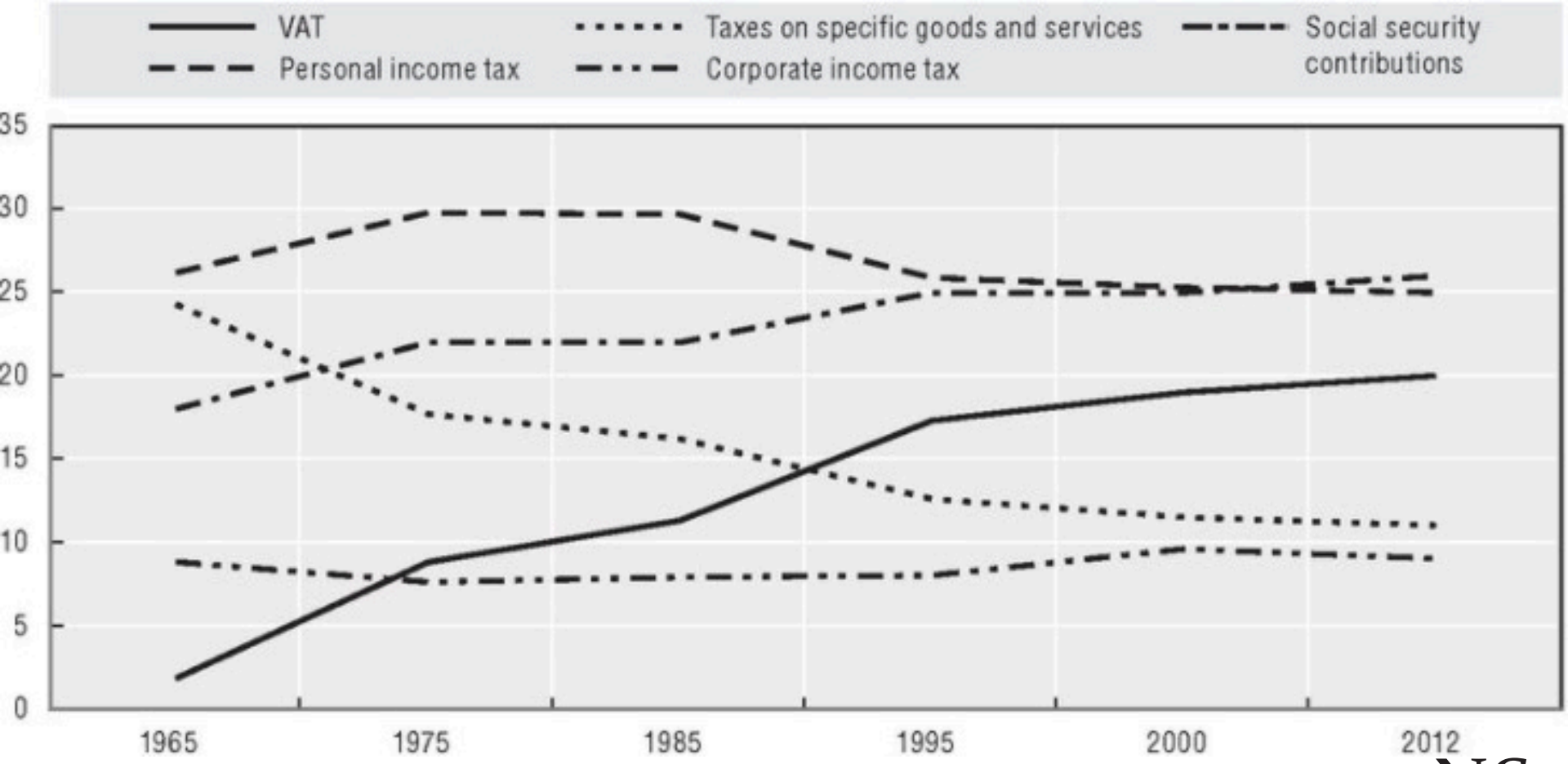
Evolution of the tax mix in OECD countries: growing importance of VAT

Tax Revenue shares (%)



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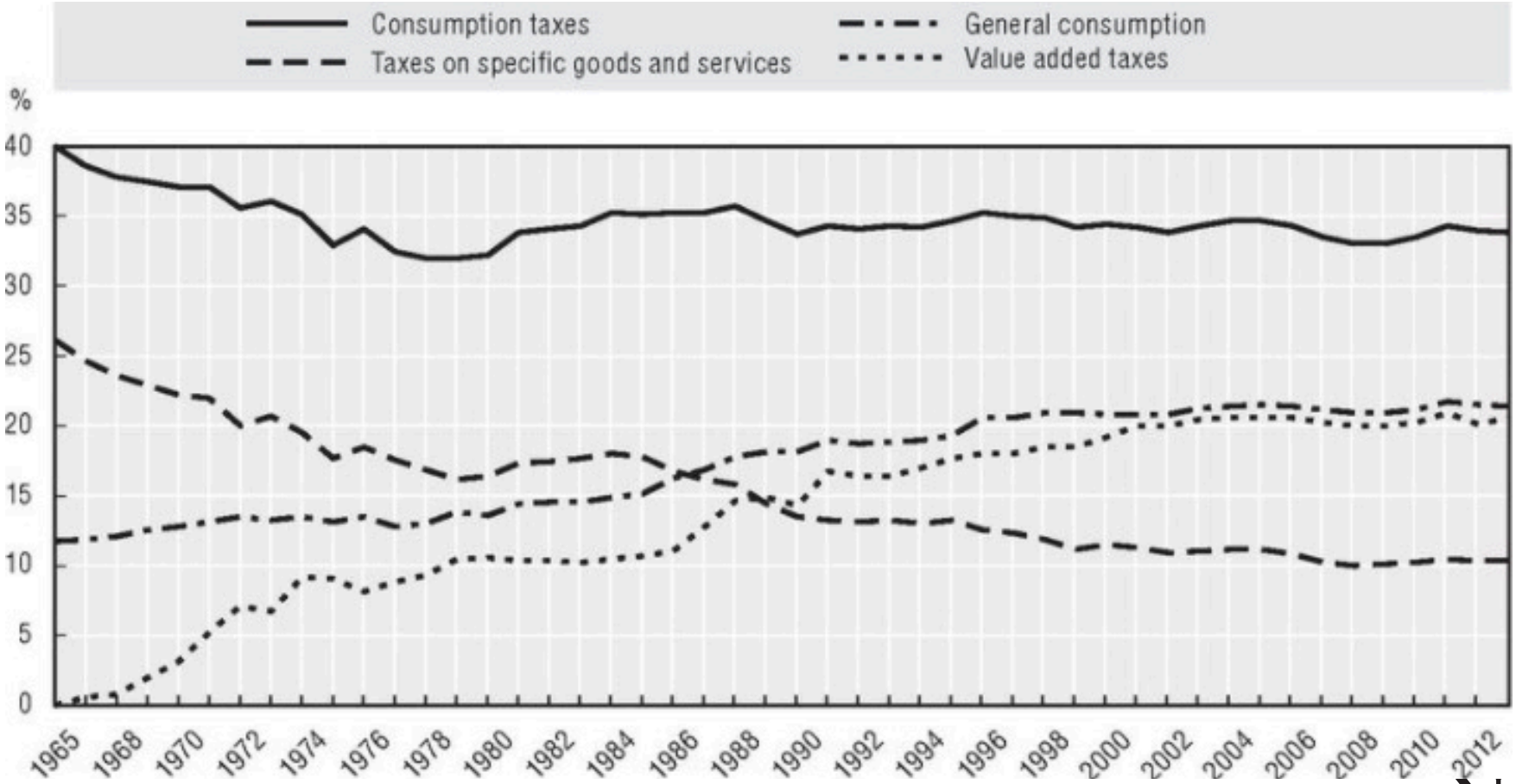
GST & VAT are principal form of OECD consumption taxes

Only Mexico & Turkey still collect a relatively large part of revenues from taxes on specific goods & services (34.9% and 22.4% respectively)



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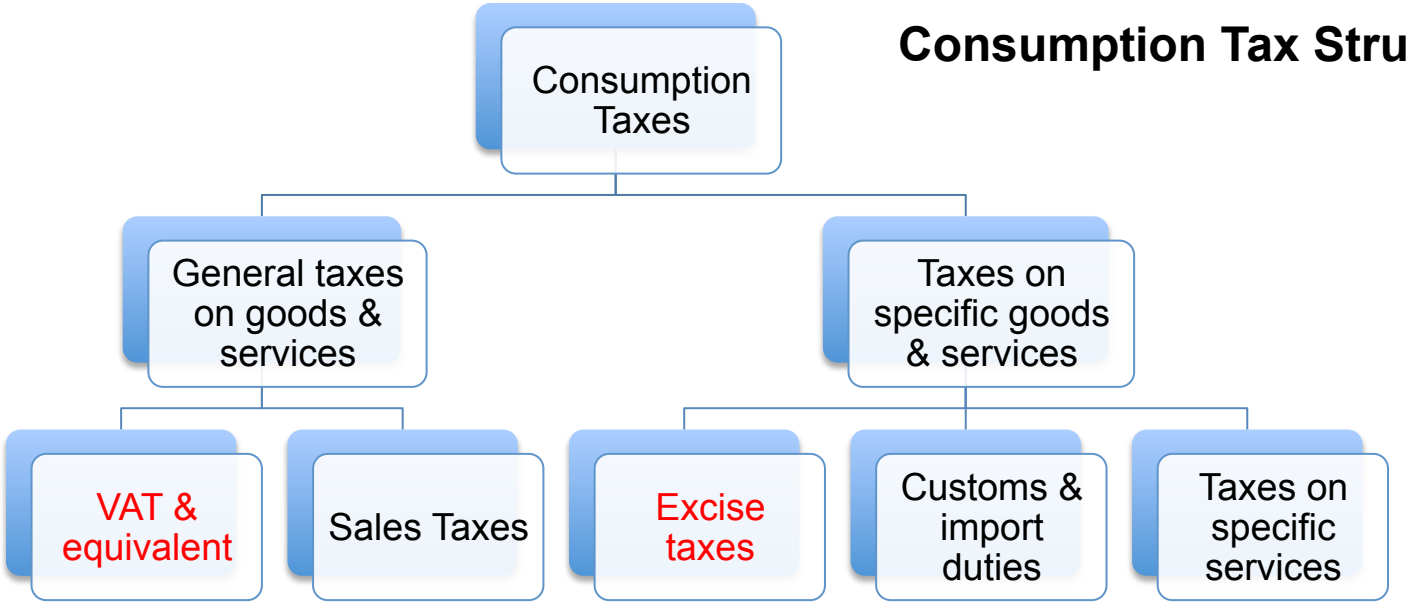
Indirect taxation: important & reliable source of government revenue

- Globally, rates are rising, tax bases continue to expand, VAT/GST systems spread worldwide and customs audit activity has seen a significant increase;
- Revenue from excises in OECD has been relatively stable, about ~8% of total tax revenue. Large country variance: 2.8% of total tax revenue in NZ, 17.8% in Turkey
- VAT/GST rates in OECD countries remain stable, even falling slightly in EU
- Taxes on specific goods & services can address economic or social objectives (e.g. health, environmental) and externalities (e.g. pollution, climate change)

Consumption Tax Structures



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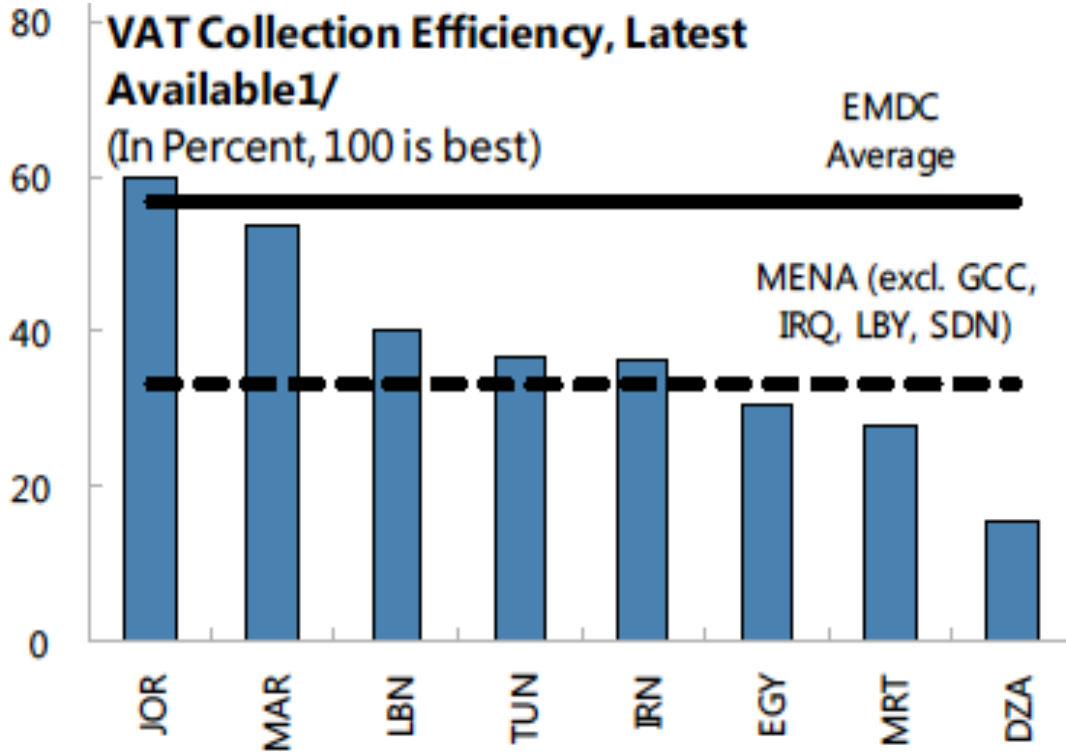
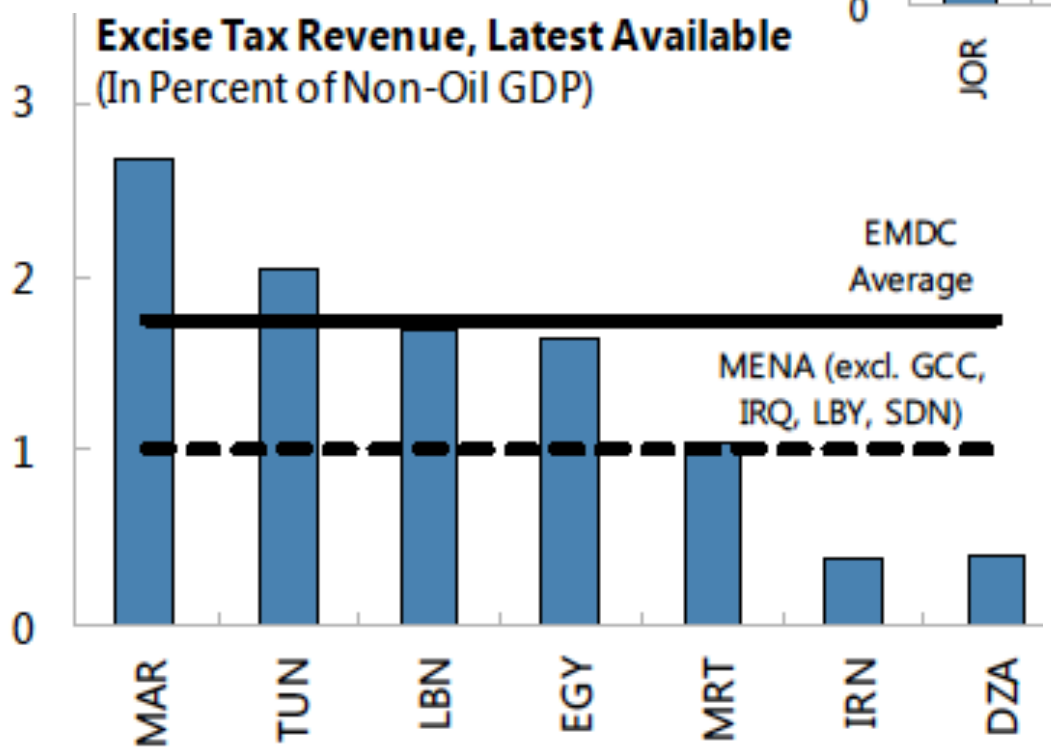
Tax exemptions, special rates and thresholds, etc. worsen limited progressivity of VAT & hamper efficiency, administration





Poorly designed excises provide limited revenues and do not currently target equity

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Excise taxes in MENA: modest contribution with significant potential

- Main excise taxes applied: tobacco, alcoholic & non-alcoholic drinks, petroleum products, cars, mobile telephony
- Excise revenues in % of GDP declined significantly in MENA since 2000, except Egypt & Lebanon
- In some countries, like the Maghreb, excises are still levied on a large no. of goods (in some cases >50)
- Excises remain untapped, potentially significant, revenue sources

Excise Tax Revenues: 2000-01 vs. 2011-12

	2000-01	2011-12
	(Percent of GDP) 1/	
Resource countries 2/		
Algeria	2.15	0.39
Iran	1.77	0.32
Non-resource countries 3/		
Maghreb		
Mauritania	2.62	0.88
Morocco	3.79	2.77
Tunisia	3.16	2.30
Mashreq		
Egypt	1.36	1.67
Jordan	0.83	0.42
Lebanon	3.51	2.96
Syria	0.26	0.20

1/ The two-year average is weighted by GDP.
2/ In the resource group, Libya & GCC do not apply excises; no data for Yemen
3/ The 2011-12 figure for Syria is for 2009-10. Jordan's figures include a real estate registration fee which could not be carved out.

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GCC: Breakdown of Tax Revenue

- Governments highly reliant on revenues from hydrocarbon exports and from investment income on government assets
- Various income and transaction taxes that exist in GCC on non-oil activities are characterized by very low rates & narrow bases => raise little revenue
- Share of tax revenue/ GDP averaged ~1.6% (3% of non-oil GDP) in 2012-14
- Significant variation among countries: Oman has the highest non-oil tax-to-GDP ratio at 2.7% and Kuwait the lowest at about 0.8% of GDP

GCC: Breakdown of Tax Revenue ***(in % of GDP,)***

	Total	Income	Goods & Services	Corporate	Trade	Property	Other
Bahrain	0.6	...	...	...	0.6	0.3	-0.3
Kuwait	0.8	...	...	...	0.6	0.03	0.2
Oman	2.8	...	...	1.4	0.7	...	0.6
Qatar	1.7	...	...	1.3	0.4	...	0.0
Saudi Arabia	1.4	...	...	0.0	0.9	...	0.5
UAE	2.5	...	...	1.0	0.7	...	0.7

Note: Latest data is for 2014 where available; Qatar total revenue is for 2013; Kuwait trade tax data is for 2012; Bahrain and Kuwait property tax data are for 2004 and 2012, respectively; Other taxes calculated as residual

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Use VAT/excise taxes to replace trade taxes, fees & charges → reduce cost of doing business

	Ease of Doing Business Rank	Paying Taxes-Rank	Payments (number per year)	Time (hours per year)	Total tax rate (% of profit)	Profit tax (% of profit)	Labor tax and contributions (% of profit)	Other taxes (% of profit)	Post-filing index (0-100)
Algeria	156	155	27.0	265.0	65.6	8.3	30.6	35.5	49.3
Bahrain	63	4	13.0	27.0	13.5	0.0	13.5	0.0	
Djibouti	171	106	36.0	82.0	37.6	17.7	17.7	2.2	52.2
Egypt	122	162	29.0	392.0	43.5	14.7	24.4	4.6	29.1
Iran	120	100	20.0	344.0	44.1	17.8	25.9	0.4	78.8
Iraq	165	52	14.0	312.0	27.8	14.3	13.5	0.0	84.9
Jordan	118	79	25.0	145.0	27.6	10.6	14.9	2.0	49.3
Kuwait	102	6	12.0	98.0	13.0	0.0	13.0	0.0	
Lebanon	126	67	20.0	181.0	30.3	6.1	23.8	0.4	63.3
Libya	188	121	19.0	889.0	32.6	22.1	10.3	0.3	90.8
Malta	76	33	8.0	139.0	43.8	32.4	10.9	0.5	86.0
Morocco	68	41	6.0	211.0	49.3	25.3	22.6	1.4	97.7
Oman	66	12	15.0	68.0	23.9	10.8	13.1	0.1	85.3
Qatar	83	1	4.0	41.0	11.3	0.0	11.3	0.0	
Saudi Arabia	94	69	3.0	67.0	15.7	2.2	13.5	0.0	10.9
Syria	173	81	20.0	336.0	42.7	23.0	19.3	0.4	90.4
Tunisia	77	106	8.0	144.0	60.2	13.1	25.3	21.9	49.8
UAE	26	1	4.0	12.0	15.9	0.0	14.1	1.8	
West Bank & Gaza	140	101	28.0	162.0	15.3	15.0	0.0	0.3	38.0
Yemen	179	92	44.0	248.0	33.1	20.0	11.3	1.8	95.4

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GCC VAT: the story so far

- GCC VAT framework is **expected to be finalized & formally announced by end-2016**. The provisions of the *GCC Framework Agreement* will be transposed into **domestic tax law** in the GCC prior to the effective date
- GCC **agreed to implement VAT regimes in 2018**. Most are working to implement by 1 Jan 2018 to avoid distortions arising from intra-GCC trade. All GCC States will need to have implemented VAT by end of 2018
- **Main design issues**: (a) Single or Multiple Rates; (b) Zero-rated and Exemptions; (c) Coverage: registration threshold; (d) international issues: VAT usually destination based. Zero-rating of exports; (e) treatment of financial services and digital products
- Confirmed that **certain essential food items and industries such as healthcare, social services and education will be exempt** from VAT

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GCC estimated VAT revenue: modest beginning

		Using average C-efficiency ratio (0.58) of selected sample of countries with experience relevant to the GCC			Assuming the base = 90 percent of private consumption		
	Year	Share of final consumption in GDP	Revenue at a VAT rate of 3%	Revenue at a VAT rate of 5%	Share of private consumption in GDP	Revenue at a VAT rate of 3%	Revenue at a VAT rate of 5%
Bahrain	2014	56.6	*0.9*	*1.6*	41.0	1.1	1.8
Kuwait	2014	50.2	0.8	1.4	31.2	0.8	1.4
Oman	2014	51.6	0.9	1.4	24.8	0.7	1.1
Qatar	2014	29.6	*0.5*	0.8	15.1	*0.4*	*0.7*
Saudi Arabia	2014	58.9	1.0	1.6	32.5	0.9	1.5
UAE	2014	55.3	0.9	*1.5*	47.7	*1.3*	*2.1*

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*Source: "**Tax Policy Reforms in the GCC Countries: Now and How?**", IMF, Nov 2015*

Recommendations for GCC countries

- Use tax reform (VAT, Excises) to replace large number of fees, charges, duties that increase the cost of doing business
- Excise taxes are a **versatile tool** that GCC governments can use **to replace trade taxes & achieve economic & social objectives**
- **Replace customs tax with a specific excise tax structure**; ad valorem taxes should be avoided
- **New tax structures should be harmonized, coordinated and synchronized across the GCC**
- **New tax structures require building tax capacity**, and new revenue administrations separate from customs
- **Implementation of taxes needs to be accompanied by revenue protection and anti-smuggling measures**, including tax marking stamps, unique identifiers, and law enforcement (sharp tax increases => jump in illicit trade and smuggling)
- **Establish GCC-wide track and trace systems** through implementing open standards which will enable information sharing across the GCC

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Governments need to undertake policy impact assessments when imposing new indirect taxes

Evaluation Arguments when Assessing Indirect Taxes

Effectiveness of a tax and unintended consequences

- Does an indirect tax achieve specified aims?
- Are there unintended consequences of introducing / changing a tax?

How much tax revenue? How is it used?

- Does an indirect tax generate substantial tax revenues?
- How is the tax revenue used – perhaps for particular projects?

What is the impact on businesses / competitiveness?

- Might there be a loss of jobs and/or investment?
- Will an indirect tax negatively affect competitiveness and trade?

Consequences for equity / the distribution of income

- Is the tax fair? Who are the winners and losers?
- Does a tax have a regressive effect on lower income groups?

Excise Taxes: specific or *ad valorem?*

	Ad valorem tax	Specific tax
Tax base	Based on value	Based on quantity (e.g. 1000 cigarettes)
Administration	Higher administration costs as prices and total market value need be monitored	Easier to administer as only volume needs to be known – lower administration costs
Invoice undervaluation concerns	Sensitive to undervaluation if, as taxation is based on invoice price - tax avoidance is possible	Tax is not based on price, so this is not an issue
Tax rate increase	Excise tax goes up automatically with price increase	Rates need to be regularly adjusted for inflation – link to inflation index
Tax revenues	Excise revenue is more volatile and less predictable as excise level depends on consumption dynamics and manufacturer price	Excise tax revenues are likely to be higher, stable and more predictable
Public health	Provides a higher incentive to lower prices as taxes reduce accordingly	Encourages relatively higher prices

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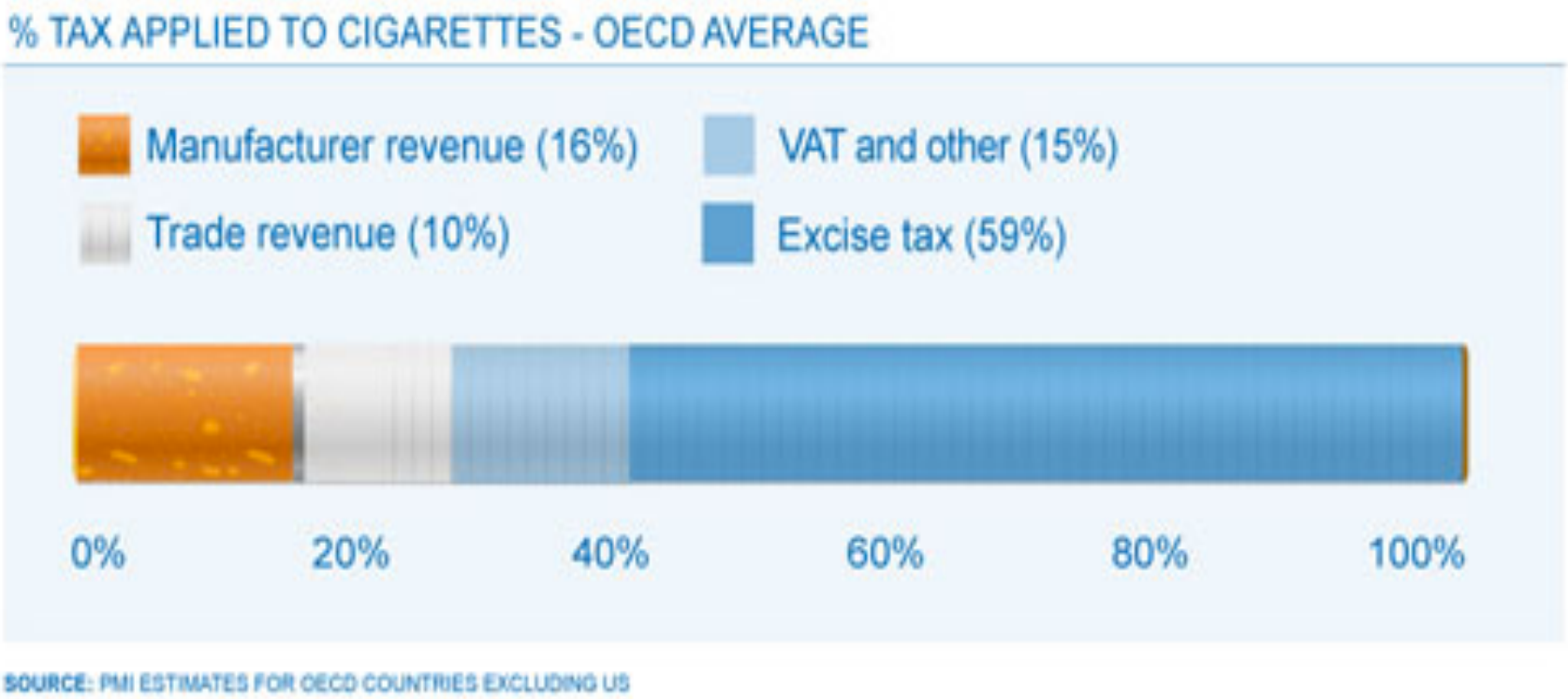
Case 1: Tobacco Taxes mainly excises



Total tax includes cigarette specific excises, ad valorem excises (% of total cost), VAT, import duties and other taxes.

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Excise taxes are the most important type of tobacco tax

- Simpler tobacco tax structures are more effective; complex systems create loopholes. Tax rates should be set considering affordability, avoidance of large tax & price differences with neighbors, ease of administration
- Greater reliance on ***specific excise*** taxes enhances the impact of tobacco taxes (e.g. health goals). Ad valorem tobacco excises are less effective than specific excises in achieving health objectives because they are more difficult to administer, increase opportunities for tax avoidance and evasion, and create greater price gaps between brands (leading to substitution)
- Ad valorem taxes are difficult to implement and weaken tax policy impact: an analysis of data from 21 EU nations b/n 1998-2007 showed that countries relying more heavily on ad valorem taxes experienced greater instability in government tax revenues from cigarette excise taxes
- Administration challenge with ad valorem taxes: relates to the base on which the tax is applied. Governments may use producer prices, CIF prices, distributor prices or retail prices as the base for levying ad valorem taxes

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Case 2: Tax on sugary/ fizzy drinks

- As many as 33 US states have ‘soda’ taxes in place
- France introduced a modest tax on all fizzy drinks (inc. low calorie) in 2012
- Hungary & Finland: tax high calorie food products & sugary soft drinks
- Mexico introduced a sugary drinks tax of around 10% in Jan 2014
- Denmark had tax on soft drinks in place for 80 years before repealing it in 2014
- **Latest: UK** in its 2016 budget introduced a new levy on sugary drinks, to be implemented by Apr 2018; tax is expected to raise £520mn in its first year
- Drinks with the highest sugar content will attract the highest tax rate. a lower level for drinks with between five and eight grams of sugar per 100ml, and a higher level for drinks with more than eight grams per 100ml.
- Oxford Economics: UK tax would reduce sales of soft drinks sold by just 1.6% + lead to 4k+ job losses and £132m fall in the industry’s economic contribution

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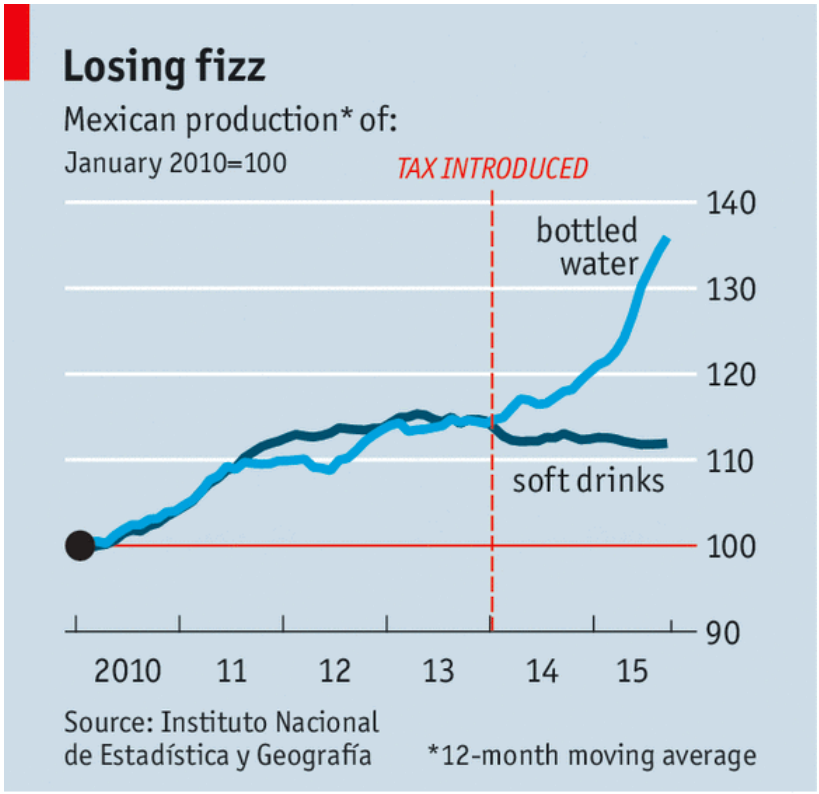
Impact of tax on fizzy drinks in Mexico

- Mexico: 4th-biggest guzzlers of sugary drinks in the world (Euromonitor)
- 2012: >70% of Mexican adults and 34% of 5-11-year-olds were overweight; 12% of Mexicans have diabetes
- So did taxes have an impact on consumption?
  - ✓ Retailers raised prices for soft drinks by 30% more than real value of tax
  - ✓ Higher prices do seem to have crimped demand for fizzy drinks
  - ✓ Some data suggest that Mexicans switched to healthier alternatives
  - ✓ But tax only saved Mexicans five calories a day on average: insignificant
  - ✓ Highly regressive: low-income households lose bigger share of income than rich



Economist.com

Manufacturing survey shows that sales of bottled water jumped by 5.2% in 2014

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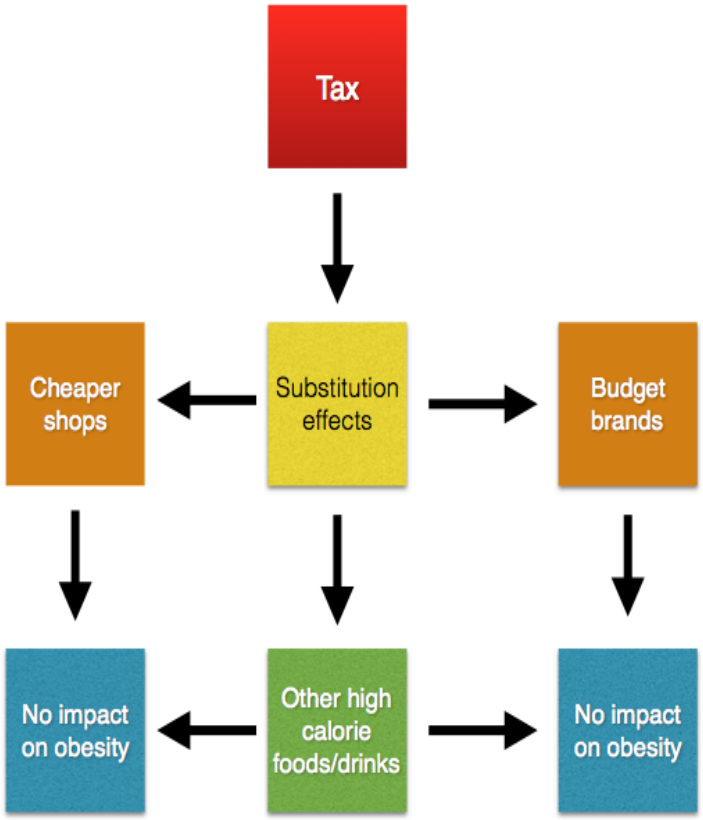
Lessons learned from sugar tax levy

- Tax base is ill-defined unlike tobacco
- Bad design can undermine much of the benefit: relatively high taxes are needed to change consumer behaviour
- Hard to impose a tax on sugary drinks when customers can easily shop elsewhere (e.g. neighbouring states)
- Taxes have not been in place long enough to assess their impact, if any, on public health
- Tends to be regressive
- Caveats: Demand for sugary drinks, snacks and fatty foods is inelastic. People tend to be quite unresponsive to price hikes and do not significantly change their shopping habits. Consumers can switch to cheaper brands; producers could change their ingredients to avoid the tax



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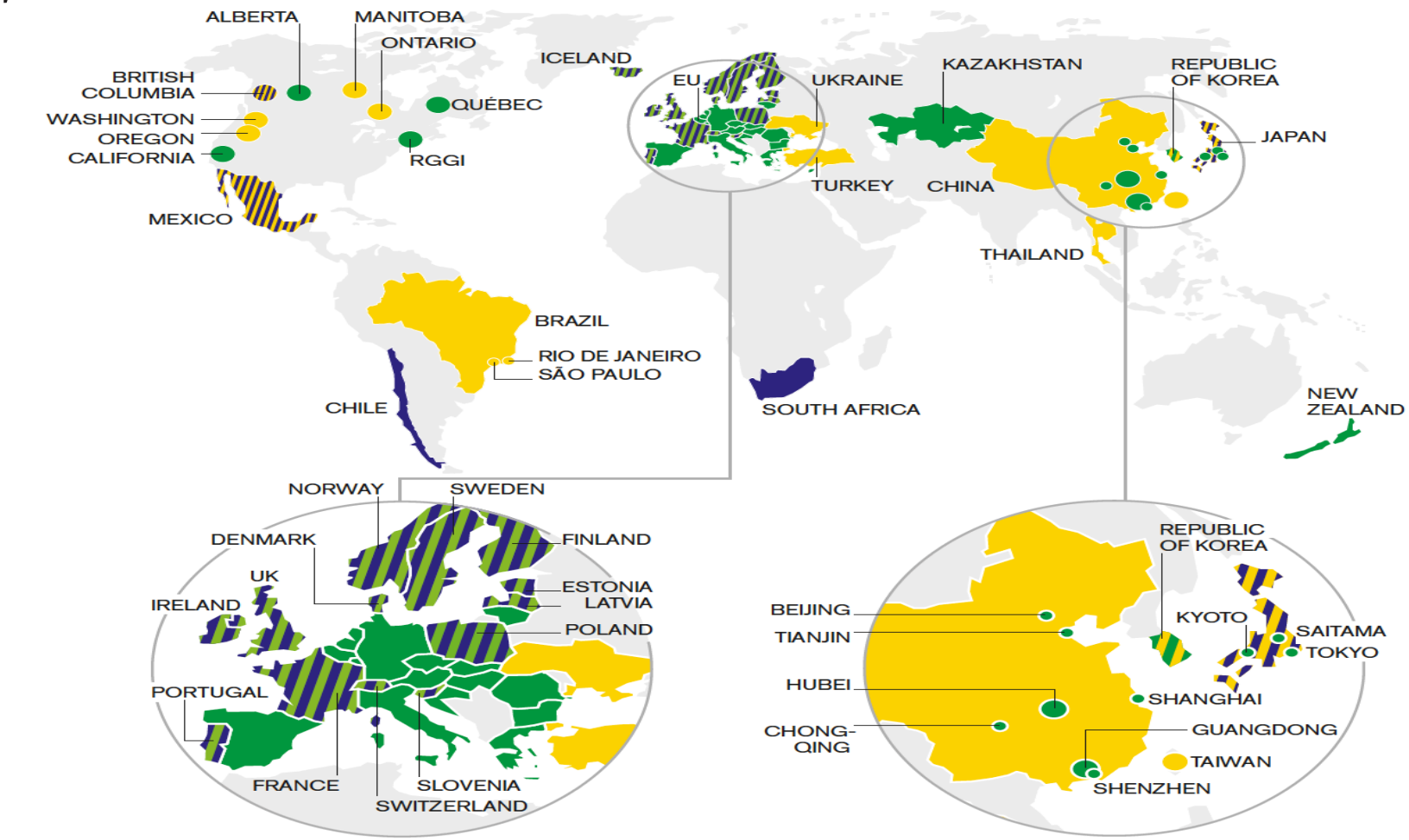
Case 3: Carbon Tax - Overview of existing, emerging, & potential carbon pricing instruments (Emissions Trading Schemes & Carbon Taxes). MENA not on the map!



- ETS implemented or scheduled for implementation
- Carbon tax implemented or scheduled for implementation
- ETS or carbon tax under consideration
- ETS and carbon tax implemented or scheduled
- ETS implemented or scheduled, tax under consideration
- Carbon tax implemented or scheduled, ETS under consideration

The circles represent subnational jurisdictions. The circles are not representative of the size of the carbon pricing instrument, but show the subnational regions (large circles) and cities (small circles).

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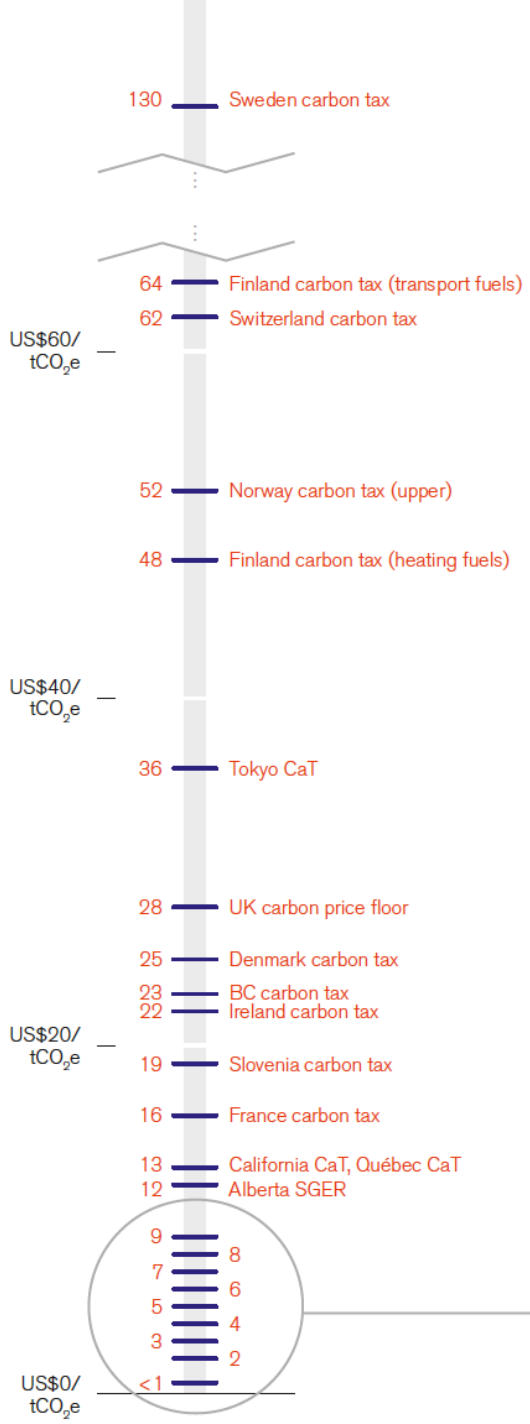
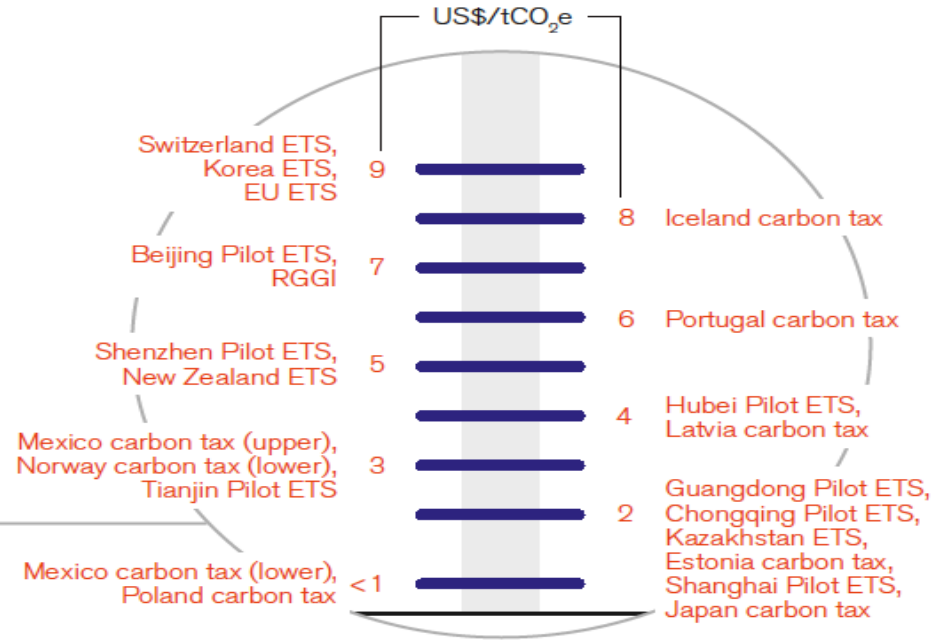
Prices in existing carbon pricing instruments

- Combined value of regional, national & subnational carbon pricing instruments is est. at just under $50bn globally, of which ~70% (~ $34bn) is attributed to ETSs & ~30% to carbon taxes (2015).
- Existing carbon prices vary significantly: from less than US$1 per tCO2e to US$130 per tCO2e
- Majority of emissions (85%) are priced at less than $10 per tCO2e: much lower than price that economic models have estimated is needed to meet the 2°C climate stabilization goal





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Carbon taxes: high revenue raising potential in the GCC

Carbon tax on Gasoline ($ per litre)					
	Carbon	Local air pollution	Congestion	Accidents	**Total**
Bahrain	0.08	0.01	0.15	0.07	**0.31**
Kuwait	0.08	0.05	0.42	0.11	**0.67**
Oman	0.08	0.02	0.05	0.38	**0.53**
Qatar	0.08	0.04	#N/A	#N/A	#N/A
Saudi Arabia	0.08	0.03	0.14	0.28	**0.52**
UAE	0.08	0.02	#N/A	#N/A	#N/A

Domestic oil consumption in KSA was 142mn tonnes in 2014; introduction of a 52 cents per litre tax, could raise a potential $53.3bn in revenue, compared to a declared 2015 budget deficit of $98bn

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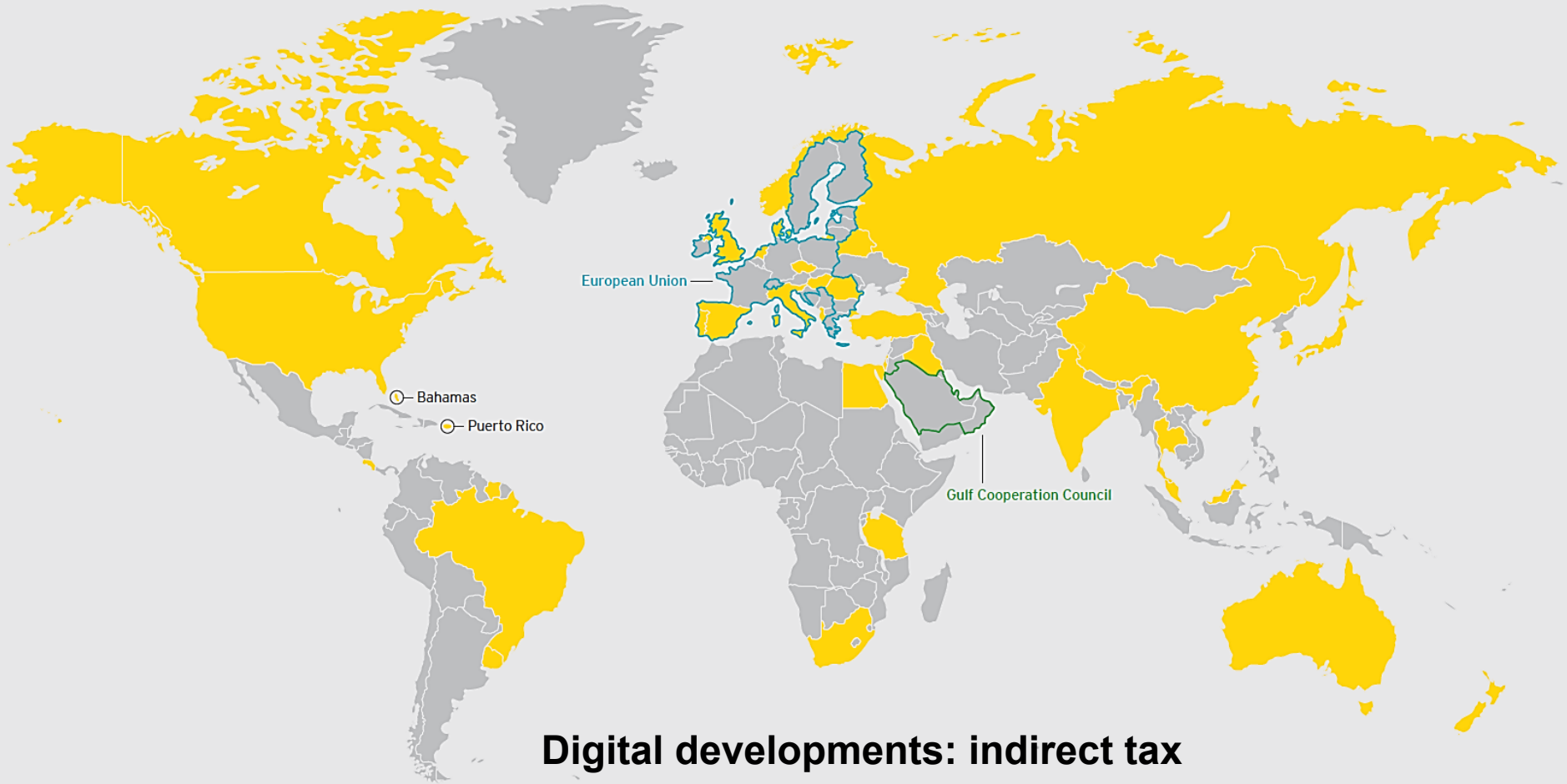

Digital developments: indirect tax

June 2014	South Africa
January 2015	Albania, Bahamas, European Union
April 2015	Czech Republic, Malaysia
July 2015	Puerto Rico, South Korea, Tanzania
August 2015	Iraq
October 2015	Japan
January 2016	Brazil, Denmark, Italy, Norway, Romania, Uruguay
February 2016	UK
March 2016	Israel, The Netherlands
April 2016	India, European Union
July 2016	Belarus
October 2016	Australia, New Zealand
January 2017	Spain, Russia, Romania
July 2017	Australia
January 2018	Gulf Cooperation Council[1]

2014

2015 – expected changes:
Canada, China, Egypt, Hungary, Israel, Italy, Portugal, Suriname, Thailand, Turkey

2016 – expected changes:
Costa Rica, US

2017

Source: EY, Apr 2016

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Albania
1 January 2015: digital services supplied by nonresident supplier businesses to consumers (B2C) subject to VAT.

Australia
1 October 2016: certain business to business (B2B) supplies will be taken out of the GST net as they will no longer be treated as "connected" with Australia.

1 July 2017: GST extended to B2C supplies of digital products, services and other intangibles.

1 July 2017: proposed abolition of low-value threshold on importation of goods.

Bahamas
1 January 2015: VAT introduced at a rate of 7.5%.

Belarus
1 July 2016: mandatory electronic invoicing introduced

Brazil
1 January 2016: sales of software in the state of San Paulo will be subject to State VAT (ICMS) on total sales price, rather than the equivalent of twice the value of the carrier medium.

Canada
2015: consulting on potential GST obligations for nonresident e-commerce businesses.

China
2015: VAT pilot expected to be extended to real estate and property, financial and insurance services, and lifestyle services.

Costa Rica
2016: plan to implement VAT to replace GST at a rate of 13% in 2016, rising to 15% in 2017.

Czech Republic
1 April 2015: domestic reverse charge extended to include mobile phones and laptops.

Denmark
1 January 2016: new reporting requirements introduced for distance selling and sale of electronic services.

Egypt
2015: plan to implement VAT to replace GST announced but implementation date not confirmed.

European Union
1 January 2015: new rules on B2C place of supply for digital services introduced and Mini One-Stop Shop (MOSS) introduced for simplified VAT compliance.

7 April 2016: European Commission adopts Action Plan on VAT including measures to adapt the VAT system to the digital economy.

Gulf Cooperation Council[1]
1 January 2018: VAT to be implemented at a rate of 5%.

Hungary
2015: flat-rate internet tax proposed.

India
April 2016: new indirect tax regime proposed.

Iraq
1 August 2015: sales tax applied to domestic providers of mobile phone and internet plans.

Israel
2015: proposal to charge VAT on online advertising and other digital services.

13 March 2016: legislation proposed to collect VAT on digital services acquired from overseas suppliers.

Italy
2015: considering introducing "virtual permanent establishment" rules and withholding tax for digital services.

1 January 2016: reduced 4% VAT rate applied to e-publishing.

Japan
1 October 2015: reverse charge introduced for B2B supplies of digital services.

Malaysia
1 April 2015: GST at rate of 6% implemented to replace existing sales and services tax.

The Netherlands
29 March 2016: tax authorities introduce Internet Service Center for the EU MOSS regime for digital services.

New Zealand
1 October 2016: GST to be imposed on cross-border supplies of digital services.

Norway
25 January 2016: European Free Trade Association Surveillance Authority rules zero rate for electronic news is in line with state aid rules.

Portugal
2015: excise tax on the sale of digital storage devices proposed.

Puerto Rico
1 July 2015: combined central government and municipal sales and use tax increased from 10.5% to 11.5%.

Russia
1 January 2017: new indirect tax rules for electronic services introduced.

Romania
1 January 2016: the standard VAT rate will be reduced from 24% to 20%.

1 January 2017: the standard VAT rate will be reduce from 20% to 19%.

South Africa
1 June 2014: nonresident suppliers of electronic services required to register for VAT.

South Korea
1 July 2015: sales of mobile applications by nonresident suppliers subject to VAT.

Spain
1 January 2017: taxpayers filing monthly VAT returns must do so electronically.

Suriname
2015: VAT expected to be introduced. Implementation date postponed.

Tanzania
1 July 2015: nonresident suppliers of B2C telecoms and e-services required to register for VAT.

Thailand
2015: considering applying VAT to downloads of mobile applications.

Turkey
2015: proposing the introduction of the concept of an "electronic taxpayer" to apply income tax to nonresident suppliers of digital services.

UK
1 February 2016: new VAT reverse charge for wholesale supplies of electronic communications services.

US
2016: many US states and cities are considering, or adopting, measures to tax the digital economy. Examples include: Ohio discussion of "internet nexus" for sales and use tax and Chicago's introduction of an entertainment tax on digital activity.

Uruguay
1 January 2016: the number of parcels taxpayers may import tax-free is reduced.

The use of modern technology & taxes

- Digital revolution is accelerating introduction of new tax frameworks and cooperation:
  - ✓ Digitization allows consumers to order goods from almost anywhere in the world, directly to their homes or replace orders of physical goods with downloads, causing governments to lose out on tax revenue; technologies like 3D printing may reduce flow of taxable tangible goods & services
  - ✓ Around the world, tax and customs authorities are taking steps to protect these revenue sources
  - ✓ Some countries require foreign service providers to register in the country & pay VAT/GST (e.g. Switzerland, Norway, EU…)
  - ✓ Need to shift to a global framework for applying VAT/GST to cross-border flows of services & intangibles: OECD 2015 Guildelines

✓ MENA region tax authorities have to wake up to digital revolution

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Policy Priorities for Governments

- Indirect taxation can be the principal & reliable source of government revenue in MENA
- Use VAT & Excises to replace large number of fees, charges and stamp duties that raise cost of doing business
- Trade taxes should be phased out and replaced by excise taxes in MENA and can make a significant contribution to revenue
- Undertake a policy impact assessment when introducing new taxes
- Excise taxes are a domestic tax; to avoid distortions, these should apply equally to imports & domestic production, including those originating in FZs.
- Adapt modern technology for tax administration & collection: introduce e-filings, e-VAT/GST, digital markers, track & trace systems etc.
- MENA countries need to wake up to taxing digital economy

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Thank you

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