

Excise taxation is a viable option for GCC: Gulf News op-ed, 29 May 2016

The op-ed titled "[Excise taxation is a viable option for GCC](#)", and reproduced below was, appeared in Gulf News on 29th May 2016.

For almost three decades, the economies of the GCC have experienced economic prosperity that has been largely dependent on oil and gas revenues. This contributed between 70-95 per cent of total government revenues during the period 2011-14.

But following the dramatic drop in oil prices since June 2014, this reliance on oil revenues has meant a corresponding sharp rise in budget deficits – to 16.3 per cent of GDP for Saudi in 2015 – across the GCC.

This means that the existing plans for economic diversification need to go faster to ensure that GCC nations can sustain strong growth in the future.

Growth is essential to help boost productivity and living standards, create jobs and reduce the fiscal and external risks associated with the previous dependence on oil revenues for economic growth and prosperity.

Currently, trade taxes (custom duties) are the most significant non-oil revenue contributor and plans are now well developed for the introduction of VAT in 2018 that will help produce a stable and more broad-based source of revenue.

In addition to this, discussions are ongoing in regard to the imposition of selective taxation in the form of excise taxes on commodities such as cigarettes/tobacco, alcoholic and non-

alcoholic drinks, petroleum products, cars and mobile telephones.

Tobacco taxes

GCC countries are home to four million smokers who consume up to 50 billion cigarettes annually and with an impact to governments of more than \$500 million (Dh1.83 billion) in health care costs to treat smoking-related diseases. Now, with revenues lowered because of current oil prices, regional governments are more aware than ever of the significant health and economic burden that smokers inflict on their treasuries.

In a bid to cut smoking incidence and increase revenue, GCC Ministers of Finance met in November 2015 agreed that a uniform 100 per cent tax would be imposed on tobacco products. Two countries – Bahrain and Saudi Arabia – have also introduced additional “fees” on tobacco in the past few weeks.

Bahrain introduced a special goods fee/tax on cigarettes (imposed when entering the domestic market and collected by Customs), equivalent to a 100 per cent of CIF (Cost, Insurance & Freight) value of goods (with no minimum specific component). This has resulted in an increase in cigarette prices by some 40 per cent, with the cost being directly passed on to the consumer.

In Saudi Arabia meanwhile, the minimum specific import duty has doubled and import duties will now be assessed at either 100 per cent of the CIF value of the goods or at a minimum specific of 200 riyals/1000 (\$54/1000), whichever is higher.

Excise taxes versus ad valorem

It is clear that for a finance ministry, a specific excise duty (applied to each cigarette pack) is preferable to an ad valorem tax because they are easier to administer, have a well-defined tax base that is quantifiable through past usage trends and generate higher and more predictable tax revenue.

They also make sense from a health perspective: every cigarette is equally harmful, independent of its price. On the other hand an ad valorem tax can be abused because the exact tax base, its valuation, can be manipulated. Importantly this means that governments should undertake good market analysis before undertaking tax reform in order to optimise tax design and the impact on health and revenue.

Another point to consider is that governments should avoid steep successive increases in tax rates as this can be counter productive – leading to a loss of revenue and an increase in illicit trade as consumers seek cheaper, albeit illegal, sources of products. More dangerous is that the proceeds from illicit trade can finance organised crime syndicates as well as terrorist groups like Daesh.

Principles & recommendations

The GCC's proposed 100 per cent tax increase on tobacco should take the form of a domestic specific excise tax that comes with a gradual implementation that will allow authorities to assess success in implementation of the policy change. Given the recent tax changes in Saudi and Bahrain and best international practice, I believe there are five main recommendations that can be made:

(i) Replace customs tax with a specific excise duty and tax structure; ad valorem taxes should be avoided.

(ii) Ensure that new tax structures are harmonised, coordinated and synchronised across the GCC in line with the requirements of maintaining the GCC customs union and common market to avoid creating tax-induced market distortions and arbitrage. They should be based on market data, information and analysis.

(iii) New tax structures require building tax capacity, and new revenue administrations separate from customs and under the authority of ministries of finance.

(iv) Implementation of taxes needs to be accompanied by revenue protection and anti-smuggling measures, including tax stamps, unique identifiers and law enforcement as sharp tax increases will lead to a jump in illicit trade and smuggling with proceeds financing criminal activities and terrorism, given the proximity of the GCC to countries suffering from turmoil, violence, as well as a lack of security coupled with a high illicit penetration rate.

(v) Establish GCC-wide track and trace systems (for tobacco products and ingredients, equipment and finished illicit tobacco products) through the implementation of open standards which will enable information sharing across the GCC.