www.pwc.com/middle-east

Middle East Developments
Egypt

Tax Policy Direction and Likely Developments

April 2011

Contents

Introduction

The recent Egyptian youth revolution and the recent change in political leadership has revealed a deep appetite for constitutional, legal and political reform with the hope it will deliver on the promise of better outcomes across Egyptian society. At the same time, political change and the evolutionary nature of early stage reform have led to a great deal of uncertainty about the future direction of government and economic policy, which in turn impacts on the national economic outlook.

The implications of reform and uncertainty on the investment climate, specifically for current and potential foreign investors, are significant. This briefing paper considers the direction of tax policy in Egypt, given the evolving reforms and their potential impact on investors.

The fiscal climate

Following President Hosni Mubarak's departure in February 2011, early indicators suggest a range of policy reforms and other developments are now underway which should have a positive impact on the economy on the long term:

- Tax policy and administration are likely to continue to move in business's favour as a key plank of the Egyptian Government's policies to encourage local and foreign direct investment.
- The current interim government is driving policies to attract investors – providing incentives such as land grants and reform of business licenses. The Finance Minister's public comments make it clear he favours competitive tax rates to encourage economic growth including the continuation of the current 20% flat rate corporate income tax or even gradual reductions in the corporate tax rate for SMEs.
- Signs of a much-hoped-for clampdown on corruption are sending a positive signal to potential investors.
- Despite these encouraging signs, it is also clear that public finances are under pressure. Foreign currency reserves are down to $30 billion at the end of March 2011, but still at a comfortable level of nearly six months of imports. The regime is in urgent need for cash budgetary support and has asked the United States of America to forgive $3.6bn in debts. Public demand for political reform, improved infrastructure and a higher standard of living is also putting considerable additional pressure on the public purse.

What is the likely future direction of the Egyptian economy?

According to the World Bank, Egypt has undertaken many positive economic reform initiatives in the past years and achieved good growth, but the pace of reform was not sufficient to accommodate the growing needs for jobs, nor did it address major imbalances in wealth distribution

Egypt's recent political developments have opened a new chapter for the economy, filled with opportunity and the promise of a better future. We believe it is likely that these developments will drive and deliver much-needed reform to support the growth and development of the Egyptian economy. It has been widely recognised that the Egyptian economy has been in decline for many years, despite many positive fundamentals: central geographic location, competitive labour cost and supply of educated, bi-lingual (English and Arabic speaking) young workers. Economic reforms, the opening up of the Egyptian economy and Egypt's new commitment and energy for change have the potential to drive rapid economic growth and development.

Widespread corruption under the former Mubarak regime also severely affected the economy's ability to create employment and fund much needed public infrastructure. Tackling this effectively will be key to the country's prosperity.

With respect to taxation, the previous pace of reform was slow and administration of existing tax laws was poor and inconsistent, causing a lack of certainty with respect to the calculation and payment of taxation for the business community and foreign investors.

In the medium term, reform of the political and economic institutions would help Egypt raise the standards of living of its people and generate employment opportunities. The reform agenda includes greater transparency and governance reforms; deeper domestic and foreign competition; creating a thriving private sector that includes small businesses; offering equal access to economic opportunities; labor market reforms; trade reform; and fiscal consolidation and reforms to reduce waste in general subsidies and create a well targeted safety net.

The political landscape has changed markedly and a broad ownership of the national economic reform agenda will therefore be key to ensuring success going forward.

While there are clearly many challenges going forward, there is also a great deal of optimism that political reform and a new government will deliver economic and tax reform, in turn delivering economic growth, development and opportunity.

Reform priorities of the Ministry of Finance

Based on discussions with relevant sources, we understand the Ministry of Finance is likely to have the following short term priorities:

- Restructuring the wages system as a tool for realising social equity by increasing the minimum wage in addition to aligning wages with productivity levels; and
- Rationalising and increasing the efficiency of the food and energy subsidy bill.

Economic challenges

According to the government's recent forecast, GDP growth is expected to fall to 3% in FY10/11 from an earlier (pre-revolution) expectation of 5.8%. Gradual recovery to about 4 percent growth is foreseen in 2011/12.

Economists also predict that in 2011, growth in energy consumption will cause Egypt to switch from a net oil exporting country to a net importer. In the long run, this can only lead to higher energy prices, meaning that the Egyptian people will have to pay significantly more for petroleum products such as gasoline, diesel and kerosene as well as for the other subsidised goods and services.

On the other hand, Egypt has recently increased its domestic natural gas industry. It's is worth noting that Egypt's natural gas reserves are the third largest in Africa (after Algeria and Nigeria) and the 11th largest in the world. Further expansion is under discussion and this is likely to provide a significant source of additional revenue for the government.

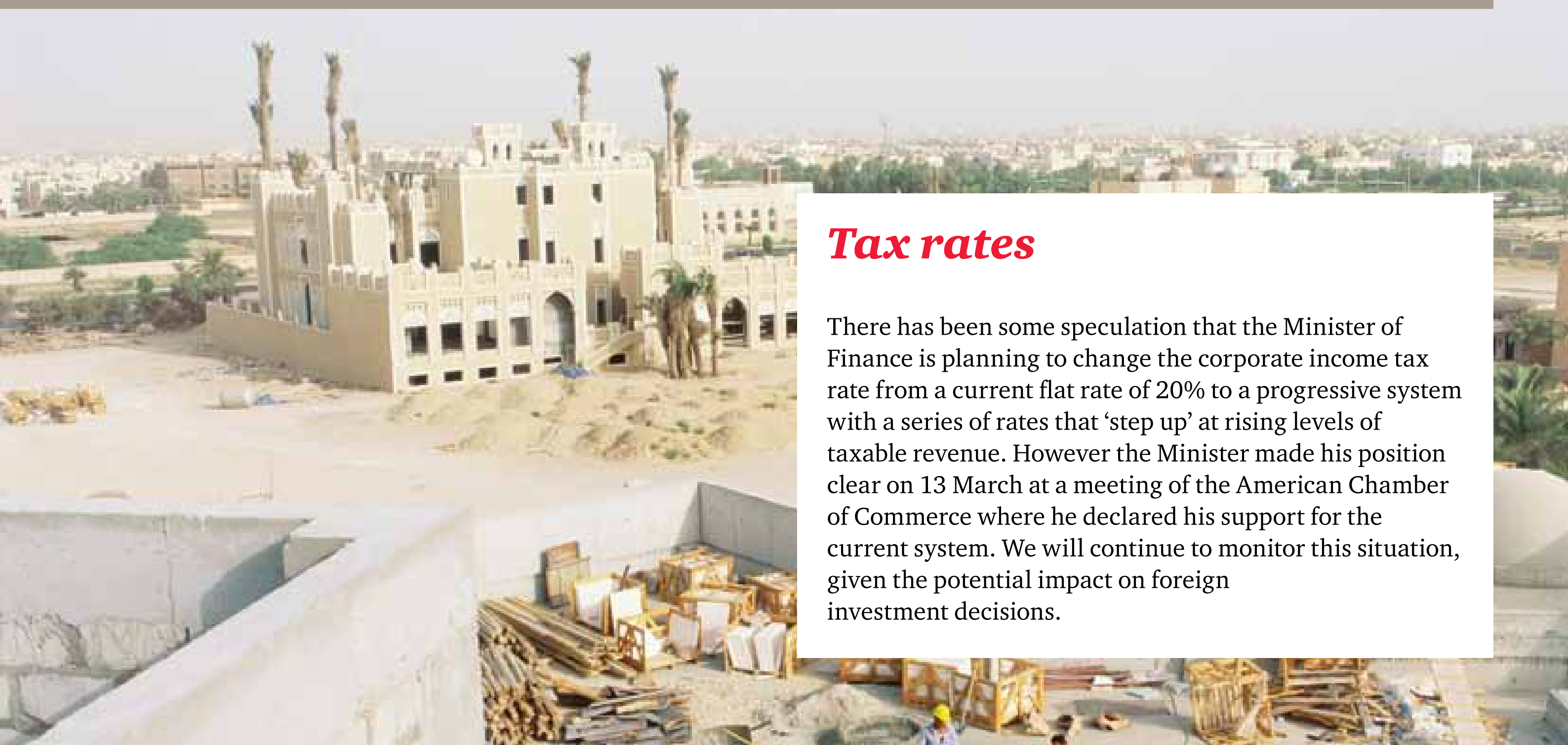
Other challenges facing the new government include the nation's poor infrastructure and, given Egypt's large and growing population in need of employment – the lack of social security, health and education provided to the majority of the population.

All of these challenges must be addressed by promoting economic growth and increasing government revenues.

Clearly the new government must carefully consider how to generate the revenue necessary to fund a whole range of new social and infrastructure policies, in turn putting tax collection and administration high on the national agenda.

However, given constitutional and political reform will see the focus on rewriting the Egyptian constitution and finalising governance and legislative arrangements, any such developments are likely to take place slowly, remaining uncertain for some time to come. The interim government is also somewhat restricted in its ability to make any major changes until these broader reforms are finalised.

The new Prime Minister, Dr. Essam Sharaf, has stated that he expects it will take between six and twelve months for the current economic situation to begin to improve and our conversations with business leaders suggest they foresee a similar timeframe. Recognising the need to make some immediate changes, Dr Sharaf and his new Minister of Finance, Dr. Samir Radwan, are meeting regularly to evaluate different options for generating revenue and any associated need for tax reform.



Tax rates

There has been some speculation that the Minister of Finance is planning to change the corporate income tax rate from a current flat rate of 20% to a progressive system with a series of rates that 'step up' at rising levels of taxable revenue. However the Minister made his position clear on 13 March at a meeting of the American Chamber of Commerce where he declared his support for the current system. We will continue to monitor this situation, given the potential impact on foreign investment decisions.

Tax administration in the short term

Corporate taxation in Egypt changed fundamentally in 2005 with the introduction of new Tax Law 91. This introduced a self-assessment regime, a 20% tax rate (reduced from the former 42% top rate) and introduced checks and balances designed to prevent an unduly aggressive approach from the Tax Authority. The government has also worked on introducing a full-fledged VAT system. However, such plans have been delayed given the more challenging economic and political priorities.

At the time of the 2011 Revolution, the first returns filed under this regime were subject to widespread audit, given the five year statutory limit on tax claims. Following the Revolution, the Egyptian Tax Authority announced a circular letter (No.3 /2011) regarding tax audits for the year 2005.The circular advises that the Tax Authority will no longer select sample returns to be audited for FY 2005 and that they are satisfied with the inspected samples for corporate tax. There are signs that some tax officials are resisting this concession, but this circular remains the official position and it is expected that the Tax Appeals Committee and, ultimately the courts, will uphold its authority.

Commencing with review of FY2006 returns, the Tax Authority will select the samples to be audited using its normal procedures and methodology.

With respect to the submission of current tax returns, the Egyptian Tax Authority have announced that they will not charge Egyptian entities penalties due on late submission of monthly sales tax returns due to be filed in January and February 2011, given the difficulties caused by recent events. For corporate income tax returns, filing to obtain an extension until the end of June 2011 is already possible under the existing mechanism.

Additionally, Law 8 for the year 2011 was issued on February 2011 to allow taxpayers to pay any income taxes due in three (monthly) instalments rather than a one-off payment, for 2010 corporate tax due to be paid in April 2011. As a result, the final payment of corporate income taxes may be delayed until June without any penalties or interest.

Transfer pricing

Transfer pricing legislation was introduced to the Egyptian statute books in 2005. As has been the case in many other jurisdictions, a transfer pricing regime has been identified as a potential source of a substantial amount of tax revenue.

Subsequently, and following extensive cooperation with the OECD, the Egyptian Tax Authority has developed the most sophisticated transfer pricing infrastructure in the region. Over the past year, the Egyptian Tax Authority has continued to invest substantially in its transfer pricing infrastructure. With a dedicated transfer pricing team, the first part of transfer pricing guidelines launched in November 2010, and substantial investment in training tax inspectors, the Egyptian Tax Authority is well placed to administer the transfer pricing law.

Post-Revolution, there has been no public discussion of any specific reforms or changes impacting the transfer pricing laws, administration or agenda within the Egyptian Tax Authority. However with greater transparency and less potential corruption as a result of the prospective political changes, we expect transfer pricing is increasingly likely to be utilised as a key tax revenue collection tool, in part because the infrastructure to administer transfer pricing law is available, ready and robust. We expect transfer pricing to continue to be a primary focus of the Egyptian Tax Authority and that they will be vigorous in their efforts to increase tax collections, particularly from foreign multinationals. We also understand that taking into consideration these rules apply to both cross-border and domestic transactions (with related parties), the Egyptian Tax Authority understands that risks exist from transactions with related parties in Free Zones Therefore, the Egyptian Tax Authority is expected to focus on domestic related party transactions which include Free Zone companies as a top priority going forward.

Double Tax Treaty Policy

A large number of Egypt's Double Tax Agreements (DTA) were negotiated many years ago, and as a result of tax reform in 2005, many of these International Agreements do not reflect current Egyptian tax policy nor the latest provisions of both the OECD and UN Model Conventions. As a result, the Ministry of Finance intends to focus on revising its existing DTAs which contain provisions that are not consistent with tax policy or the new tax law.

The new Finance Minister

Dr Radwan was appointed by the Military Supreme Council and the Prime Minister as the new Minister of Finance in February 2011. Dr Radwan is one of the Arab World's most respected development economists and employment specialists and is widely considered to be 'pro-reform'.

He is currently a member and advisor on the Board of Trustees of the Investment and Free Zones Authority of Egypt (GAFI). From 2003 – 2006, he was Managing Director of the Economic Research Forum for the Arab Countries, Iran and Turkey, a regional think-tank based in Cairo. Prior to that he had spent close to 30 years in the International Labour Organization where he held key positions including Adviser to the ILO's Director-General on Development Policies and Counselor on Arab Countries. He is the author of a number of seminal books and publications on labor markets, industrialisation, development and agrarian systems and poverty.

Dr. Radwan holds a PhD in Economics from the School of Oriental and African Studies, University of London, a Masters in Economics of Underdeveloped Countries from the University of London and a BA in Economics from Cairo University.

The Minister's public statements indicate increased public and welfare spending will need to be financed by economic growth rather than by "new taxes". He has stated an intention to introduce a minimum wage, however his comments suggest this may be limited to low-paid public sector workers, suggesting a particular focus on 'fairer' spending of Egyptian taxpayers' money. He has also made reassuring comments that "the private sector will remain the main pillar of the economy."

The role of the Supreme Council of the Armed Forces in tax decisions

The Egyptian Supreme Council of the Armed Forces started governing the country following the departure of former President Hosni Mubarak in early February 2011. The Council has the power to appoint the Prime Minister, oversee decisions taken by Government Ministries and approve or disapprove and issue laws at this critical period.

Tax decisions are therefore issued by the Council. However in practice, their role appears to be ratification of decisions that are actually made by the Ministry of Finance. As a result, the new Minister of Finance has the capacity to make decisions which impact tax laws but material changes to tax laws are not anticipated until the formation of a new government in Egypt later in the year.

PwC Egypt

About PwC

PwC (www.pwc.com) provides industry-focused assurance, tax and advisory services to build public trust and enhance value for its clients and their stakeholders. More than 163,000 people in 151 territories across our network share their thinking, experience and solutions to develop fresh perspectives and practical advice.

We assist businesses, individuals and organisations with tax strategy, planning, and compliance, whilst also delivering a wide range of tax advisory services via 23,000 tax professionals globally. PwC is the global market leader for tax services. Established in the region for over 30 years, PwC Middle East covers 13 territories and has around 2,500 people.

Complementing our depth of industry expertise and breadth of skills is our sound knowledge of local business environments across the Middle East.

PwC is the fastest growing firm in the Middle East region with the largest tax and advisory practice.

This combination of global reach and local experience means that we can support you both locally and globally, wherever you require tax advice. We take a holistic view, combining industry insight with the technical skills of financial and tax professionals, economists, lawyers and our other in-house resources as necessary, to develop comprehensive integrated solutions.

Abdallah ElAdly – Tax Leader, Egypt

Abdallah has over 25 years of experience and knowledge of the Egyptian tax laws and system, investment laws and sales tax laws.

Abdallah advises on strategic planning, deals with cross border transactions and the implementation of all tax related initiatives to minimise tax burdens for multinational companies operating in Egypt. He also deals with tax due diligence missions for national and international mergers, acquisitions and other business deals. Abdallah has a diploma in political and economic systems.

He is a Fellow of the Egyptian Fiscal Association, the Egyptian Society of Public Finance and Taxation, and the Egyptian Society of Accountants of Auditors and a member of the International Fiscal Association.

Abdallah has served as a board member with the Egyptian Society of Public Finance and Taxation since 2003. He also sits as accountant expert on the Egyptian Tax Appeal Committee, serving since its formation by the Egyptian Ministry of Finance in 2006.

Abdallah El Adly

Tax Partner, Egypt Tax Leader

Egypt

Tel: +20 (0)2 759 7700 Ext: 7887

Email: abdallah.eladly@eg.pwc.com

Dean Rolfe

Tax Partner, Middle East Tax and Legal Services Leader

UAE

Tel: +971 4 304 3351
Email: dean.rolfe@ae.pwc.com

PwC in the Middle East

Bahrain

PricewaterhouseCoopers
9th Floor, BMB Centre
Diplomatic Area
Manama
Kingdom of Bahrain
PO Box 21144
Tel: +973 (0) 1754 0554
Contact: Ebrahim Karolia [ext.250]

Iraq

PricewaterhouseCoopers
Gulan Street
English Village, Building no. 252
Erbil, Kurdistan
Republic of Iraq
Tel: +971 (4) 304 3471
Contact: Emad Majid

Kuwait

PricewaterhouseCoopers Al-Shatti & Co.
Arraya Tower II, 23-24 Floors
Al-Shuhada Street, Safat 13018
Sharq, P.O. Box 1753
State of Kuwait.
Tel: +965 2227 5777
Contact: Fouad Douglas

Egypt

PricewaterhouseCoopers
Plot 211,Second Sector,
City Center
New Cairo 11835
PO Box 170 New Cairo
Cairo, Egypt
Tel: +2 (02) 2759 7700
Contact: Abdallah El Adly [ext.7888]

Jordan

PricewaterhouseCoopers Jordan
3rd Circle,
Jabal Amman
14 Hazza' Al Majali Street ,
P.O Box 5175
Amman 11183, Jordan
Tel: +962 (0)6 500 1300
Contact: Stephan Stephan

Lebanon

PricewaterhouseCoopers
SNA Building, 6th Floor
Tabaris, Beirut
Lebanon
P.O. Box 11-3155
Tel: +961 (0)1 200 577
Contact: Wadih AbouNasr [ext.1610]

Libya

Al Motahedoon LLC –
PricewaterhouseCoopers
Aldol Street, Ben Ashour Area
Tripoli, Libya
P.O. Box 6026
Tel: +218 (0)21 3609830/32
Contact: Husam Elnaili (Extn.110)

Oman

PricewaterhouseCoopers
Hatat House, Suites 204-210
Wadi Adai, Muscat
Sultanate of Oman
P.O. Box 3075
Ruwi, Postal Code 112
Tel: +968 (0)2455 9122
Contact: Russell Aycock

Palestine

PricewaterhouseCoopers
Sa'adi, Orfaly, Daher
Jerusalem
5 Shufat Street
Jerusalem, Palestin
P.O. Box 18366
Tel: +972* (0)2 532 6660 (Jerusalem)
Tel: +972* (0)2 240 0230 (Ramallah)
Tel: +972* (0)8 285 5733 (Gaza)
Contact: Wael Saadi
(*from Arab countries use 970 instead of 972)

Qatar

Tornado Tower,
West Bay
P.O. Box 6689
State of Qatar
Tel: +974 (0) 4419 2801
Contact: Declan Mordaunt

Saudi Arabia

PricewaterhouseCoopers

Riyadh Office

King Faisal Foundation Building, South Tower, 12th Floor
P.O. Box 8282
Riyadh 11482
Tel: +966 (0)1 465 4240
Contact: Soudki Zawaydeh (extn: 1020)

Al Khobar Office

AlHugayet Tower, 15th floor
PO Box 467,
Airport 31932
Dhahran
Tel: +966 3 849-6311 (ext. 3093)
Contact: Ebrahim Karolia

Jeddah Office

Al Suhaili Business Center, 5th Floor
P.O. Box 16415
Jeddah 21464
Tel: +966 (0)2 667 9077
Contact: Mohammed Yaghmour

Syria (Lebanon coordinating)

PricewaterhouseCoopers
SNA Building, 5th Floor
Tabaris, Beirut
Lebanon
P.O. Box 11-3155
Tel: +961 (0)1 200 577
Contact: Wadih AbouNasr [ext.1610]

United Arab Emirates

PricewaterhouseCoopers

Dubai Office

Emaar Square, Building 4, Level 8
Dubai,
United Arab Emirates
Tel: +971 (0)4 304 3351
Contact: Dean Rolfe

Abu Dhabi Office

East Tower 9th Floor
AUH Trade Centre
PO Box 45623
Abu Dhabi, United Arab Emirates
Tel: +971 (0)2 694 6918
Contact Lars Lawall

Specialist tax and legal contacts

Tax Leader, International Tax Services
Dean Rolfe
Tax Partner
Tel: +971 (0)4 304 3351
E-mail: dean.rolfe@ae.pwc.com

M&A Tax Leader
Dr. Lars Lawall
Tax Partner
Tel: +971 (0)2 694 6918
Email: lars.c.lawall@ae.pwc.com

Financial Services Tax Leader
Ebrahim Karolia
Tax Partner
Tel: +973 (0) 17540554 ext. 250
Email: ebrahim.karolia@bh.pwc.com

Individual taxes services (IAS) Leader
Dennis Allen
Tax Partner
Tel: +974 (0) 4419 2830
E-mail: dennis.allen@qa.pwc.com

Compliance Services Coordination
Damian De Backer
Tax Senior Manager
Tel: +20 (0)2 2759 7705
Email: damian.de.backer@eg.pwc.com

Legal Services Leader
Waseem Khokhar
Managing Partner – Legal
Tel: +971 (0)4 304 3181
Email:waseem.khokhar@ pwclegal.co.ae

www.pwc.com/middle-east

Design Services 26257 (05/11).