Changes in tax structure and probable impact in GCC

Jeanine Daou, PwC Middle East Partner and Indirect Taxes and Fiscal Policy Leader

In a region where most government revenues are derived from oil & gas, the current drop in oil prices and associated budgetary pressures has led to increased speculation regarding taxation reforms.

The current revenue structure in the GCC countries is mainly dominated by revenues from the energy sector and income-seeking investors, and its tax base consists mainly of import duties, together with various fees and charges. But it is anticipated that such a revenue structure would be impacted by the recent decrease in commodity prices and oil prices in particular, along with the growing trend towards regional or bilateral Free Trade Agreement ("FTAs") that would potentially lead to a reduction in customs duties collection.

Tax reforms should be accompanied by tax administration system set up incorporating best practice methodologies and systems and procedures for an efficient and effective tax revenue management.

The Paying Taxes 2015 Report prepared by the World Bank and PwC indicates that stable tax systems and strong tax administration are important for businesses, helping them to operate in an environment where the tax treatment of transactions is predictable and where governments operate transparently.

The clarity and simplicity of the legislation and taxpayers obligations are key to enhance voluntary compliance. It also results in lower administrative cost on tax authorities as well as lower compliance burden on taxpayers allowing them to operate in a competitive environment.

One of the main objective of tax reforms is to finance public expenditures. The expected inflows from the new revenue streams will enhance Federal Government budget, granting it additional leverage to invest in growth enhancing sectors, hence stimulating the economy. The IMF has recently estimated that adopting a corporate tax at a rate of 10% applicable on a broad base would raise Government revenue by 4.1% of non-hydrocarbon GDP, whereas the implementation of a VAT system at a 5% rate would increase Government revenue by 2.7% of non-hydrocarbon GDP.

Introducing new taxes could also have an important socio-economic impact notably on investments, which needs to be assessed. This will also largely depends on the design features of the new system and the systems and processes that will be put in place for its administration. The Government must consider the effects on business decisions that a change in fiscal policy would have and develop a system that would allow to mitigate any adverse effects.

The expected approval of the GCC States of the GCC VAT common framework represents a significant step and implementation by all GCC States is expected to be effective by 2018 or 2019 at the latest. The introduction of such a broad based tax system, constitutes an important policy tool to help governments achieve medium to long-term social and economic policy goals, by notably reducing reliance on hydrocarbon revenues and ensuring a more sustainable revenue stream.

From a business perspective, VAT is considered neutral, as taxpayers collect VAT on their operations on behalf of the government and recover VAT incurred on their inputs. However, the impact on businesses and, more generally on the economy, will highly depend on the design features of the envisaged tax system, notably the tax base, the number of exemptions and the compliance requirements. A simple, efficient and neutral corporate tax system would help minimize the impact on businesses, particularly in terms of compliance costs. As an example, on an average, it takes less time for businesses to comply in countries with online filing and payment, single rate and reduced number of exceptions.

Although in theory VAT should not create an additional tax cost, businesses should look into their commercial strategies in light of a possible shift in demand and consumer spending, as an approach to properly anticipate the changes and ensure a smooth transition. While the introduction of VAT may not have a major impact on a firm's profits, it can mean significant new tax compliance obligations, which will require companies to increase their capabilities and enhance their IT infrastructure as well as educating and empowering stakeholders at all levels.

All in all, globally, the management of taxes has never been of more significance in corporate, government and public interest circles, than it is now in the GCC and the Middle East. Through appropriate frameworks, systems and resources by the government as well as companies the ease of paying taxes can be helped considerably.

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