The Egyptian Tax System and Investment Tax Incentives

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1. Introduction

A country's tax system has a significant impact on business activities conducted in the country and may play a role in encouraging or discouraging such business activities. Many countries use tax laws as a mechanism for the encouragement of investments. In developing countries, tax incentives such as tax holidays, reduced tax rates, etc. are used to encourage both domestic and foreign investments. These tax incentives in the form of a special tax treatment or otherwise may be included in the domestic tax law or in a purpose designed law (e.g. investment laws).

Since 1971, Egypt has been providing investors, via its investment laws, with many tax incentives regardless of the legal form of their business activities (i.e. corporate or unincorporated).

In this article, the structure of Egyptian tax system is discussed, i.e. direct versus indirect taxes, and investments tax incentives, particularly corporate tax incentives.

2. The Structure of the Egyptian Tax System.

2.1. Overview.

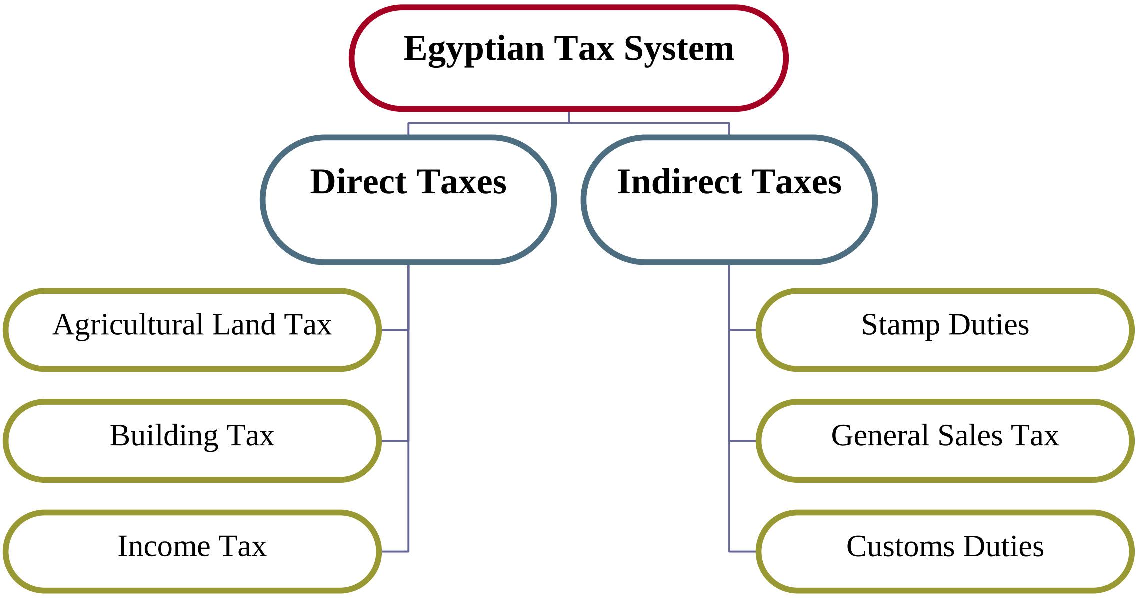
A country's tax system, which is an outcome of tax policy, plays a significant role in the overall fiscal policy. The tax system refers to various taxes that are imposed in the country in a specific time period. It is not a static but flexible and is always changed to fit with requirements of the surrounding socio-economic conditions. There are number of factors that influence the design of the tax system, such as the historical background (e.g. cultural, religious, etc.), political system (e.g. central or federal systems), and the economic system.

Egypt introduced its first tax law in 1939 which imposed taxes on business and labour gains (i.e. Law No. 14 of 1939) and on agricultural land (i.e. Law No. 113 of 1939). Other tax laws were issued in the subsequent years including:

- an urban building tax in 1954 (Law No. 56 of 1954);
- a customs regime in 1963 (Customs Law No. 66 of 1963);
- stamp duties in 1980 (Stamp Duties Law No. 111 of 1980);
- consumption taxes in 1981 (Consumption Tax Law No. 133 of 1981) which in was replaced by the General Sales Tax Law No. 11 of 1991; and
- a new income tax law in 1981 (Income Tax Law No. 157 of 1981) were introduced. This Income Tax Law was amended in 1993 by Law No. 187 of 1993 (Unified Income Tax).

The current structure of the Egyptian tax system includes both direct taxes and indirect taxes. See Figure 1 for an illustration.

Figure 1



2.2. Enforcement of Tax Laws.

The Ministry of Finance is in charge of the enforcement the various tax laws via its independent tax departments. In addition, these tax departments are involved in amending, designing and drafting tax laws, which are then submitted to the legislature for ratification. These departments are as follows:

- General Tax Department (GTD) which is in charge of the income tax law, stamp duties law and development fees law;
- Customs Department which is charge of customs duties;

- General Sales Tax Department which is in charge of the general sales tax law; and
- Real Estate Tax Department which is in charge of the agricultural land tax law and building tax law.

3. Direct Taxes

Income tax plays an important role in the Egyptian economy and in particular, its fiscal policy. Income tax proceeds represent a considerable percentage of the total tax revenues (33.40% in the fiscal year 1998/1999 and 36.23% in the fiscal year 1999/2000[1]).

The current income tax law is Law No. 157 of 1981 amended by Law No. 187 of 1993 (hereinafter referred to as Income Tax Law) and is divided into 3 parts as follows:

- Unified Income Tax (Individual Income Tax);
- Corporation Income Tax; and
- The General Rules.

3.1. Individual Income Tax

[1] Central Bank of Egypt statistics.

The Unified Income Tax that is applicable to individuals is also known as the Individual Income Tax (IIT) and encompasses five types of revenues, as follows:

- Mobile capital revenue;
- Salaries and wages;
- Business revenue (i.e. profits arising from commercial and industrial business activities);
- Non-commercial professional revenue; and
- Real wealth revenue.

The reason the IIT is known as the unified tax is because an individual must report his annual income from various sources in a single income tax return. This may be a little misleading because, income arising from mobile capital revenue, and, salaries and wages are excluded from the annual tax return but instead subject to a special tax treatment.

3.1.1. Mobile capital revenue tax

Mobile capital revenue (MCR) refers to income arising from investments in:

- Treasury bills, government bonds and debts that yield interest income;

- Interest bearing loans or returns on loans of all kind which are contracted by the government, individuals, and other legal business forms;
- Stock that yield dividends;
- Bank deposits that yield interest; and
- Other revenues such as attendance allowance paid to stockholders, salaries and wages paid in cash and fringe benefits, attendance allowance and other payments to the members of the board of directors.

Exemptions

In general, MCR is subject to MCR tax but in order to achieve tax equality and to encourage savings and investment, a number of items that fall within the definition of MCR are exempted from tax. These include:

- interests paid by banks to depositors;
- interest paid by banks or corporations to bondholders up to the discount rate which is determined by the central bank of Egypt. Payments above the determined discount rate will be subject to the MCR tax;
- interest paid by the government or local authorities to foreign governments; and
- dividends paid by domestic corporations.

Tax rate

As MCR is not part of the income that must be reported in the annual tax return, it is subject to a flat tax rate of 32%. The MCR tax is imposed on gross amounts and no deductions are permitted.

Tax collection

The MCR tax withheld at source, which means that the payer of MCR must withhold the amount of tax payable on the amount due to the recipient of the income, and remit the MCR tax withheld to the appropriate tax office within the first 15 days of the following month of paying the amount to the recipient.

3.1.2. Salaries and wages

Under Art. 49 of the Income Tax Law, salary and wage tax is imposed on the following items of income:

- Salaries and similar payments, remunerations, wages, bonuses and annuities (except insurance payments) paid by government agencies, public enterprises and funds subject to Law No. 54 of 1975 (i.e. Private Insurance Funds' Law); and

- Salaries and similar payments, remunerations, wages, bonuses and annuities (except pension payments) paid by companies, establishments, societies, private organizations, educational institutions and individuals to any person residing in Egypt or any person residing abroad for services rendered in Egypt.

Taxable income

Taxable income encompasses all revenue obtained by a taxpayer (employee) including salaries, wages, various allowances and fringe benefits. In calculating the taxable income, the revenue of each part of the year is taken as proportion of annual revenue according to the ratio of period to the year (e.g. the monthly salary is calculated as 1/12 of the annual salary). Since the tax rate must be calculated on an annual basis, the monthly salary is first multiplied by twelve, in order to obtain the annual taxable income after which, the appropriate tax rate is applied. The amount of tax payable is then divided by twelve to determine the monthly tax due (see the illustrative example).

Deductions

There are specific deductions from the taxable income relating to salaries, etc. These deductions are as follows:

– An amount of EGP3,000 per annum in respect of bonuses;
– An annual “Nature of Work Allowance” of up to EGP480;
– An annual “Representative Allowance” of up to EGP2,500;
– Social insurance and health insurance premiums; and
– 10% of the net taxable income in respect of job related expenses plus EGP 2,000.0 as an employee special relief.

It should be noted that the total deduction for bonuses, “Nature of Work Allowance” and “Representative Allowance” cannot exceed EGP4,000 per annum.

Also, the wages of causal workers are generally exempted from tax. Casual workers are those who do not have a permanent employment and no other source of income.

Tax relief

The law also provides for a special deduction in respect of “family burden” that is only applicable to employees, as follows:

– An annual amount of EGP2,000 for unmarried taxpayers without dependents; or
– An annual amount of EGP2,500 for married taxpayers without dependents; or
– An annual amount of EGP3,000 for married taxpayers with dependents.

Tax rates

As income from salary and wage is not part of the income that must be reported in the annual tax return, it is subject to salary and wage tax rates, as follows:

Annual taxable income (EGP)	Rate
Up to 50,000	20%
More than 50,000	32%

The salary and wage tax rates are applied at source and deducted by the employer, who will then remit the tax due to the tax authorities.

In order to understand the method of computing salaries tax monthly, let us suppose that there is one employee, who monthly pay as follows; basis salary is EGP 1,000.0, Bonus is EGP 300.0 , Nature of work Allowance is EGP 100.0 the his social insurance premium is EGP 200.0., and his social status is single.

To compute monthly tax liability, we have to convert monthly income to annual income and compute tax liability on annual basis then divide the annual tax liability by 12,

Annual income =(1,000 x12)+(300X12)+(100X12)= EGP 16,800

Minus	Social insurance per. (200x12)	(2,400)
	Exempted Bonus	(3,000)
	Exempted Nature of work allowance	(480)

Taxable income		EGP 10,920
Minus 10% Job related expenses.		(1,092)
Employee special Relief		(2,000)

Net Taxable Income		EGP 7,828
Minus Family allowance		(2,000)

Tax Base		EGP 5,828

Tax Rate	20%Annual
Tax Liability	EGP1,165.6

Monthly Tax Liability = 1,165.6/ 12 =EGP 97.13

3.1.3. Business revenue (i.e. profits arising from commercial and industrial business activities

Business revenue which is income arising from commercial and industrial business activities, unlike MCR and salary and wages, is included in the annual unified tax return. Pursuant to Arts. 15 to 24 of the Income Tax Law, income arising from the following business activities must be included in annual tax return:

- Professions: persons conducting commercial and/or trading activities, which are based on both labour and capital. This is considered a self-employed business;
- Mining and oil establishments: their net profit is subject to the unified tax as business revenue;
- Craft–related professions: all professions which rely upon personal skills and experience to transform raw material into finished products (e.g. tailors, carpenters, etc.);

- Sole deals[2]: gains arising from sole deals are fully taxable;
- Brokerage, agency & intermediates;
- Commission and brokerage fees that are not related to professions;
- Leasing of trading and industrial stores and machines;
- Capital gains: all profits arising from the disposal of capital assets are subject to the unified tax as commercial and industrial revenues;
- Real estate transactions;
- Rental of furnished flats;
- Cultivation and land reclamation ventures; and
- Poultry, cattle breeding and fishing projects.

Taxable income

The taxable profit is the business turnover from the 12-month period preceding the tax year, and having deducted all related costs. In determining the net profit, an accrual basis is used, according to which credit sales during the period are considered revenue, even if they have

[2] The taxable sole deal is a business transactions (selling or purchasing), which is related to a movable property not assigned for private usage and it has to meet two conditions; first, it must be commercial or industrial transaction, and its selling / purchasing price more than EGP 20,000 or its gross profit more than EGP 4,000

not been collected. Similarly in order to apply the accounting principle of matching revenues with expenses, expenses are included the accounting period whether or not they have been settled.

Deductions

With respect to income from business revenue, the following are some of the items that are deductible in arriving at the taxable profit:

- Rent of business premises. If the premise is owned by the taxpayer, an amount equal to the rent payable by similar business may be deducted;
- Depreciation of fixed assets that has been computed in accordance with the business accounting system;
- Accelerated depreciation of 25% with respect to the cost of new machinery;
- Taxes, other than the unified tax, paid by the business;
- Donations made to the government up to the actual amount donated and to registered charities up to 7% of the net taxable income;
- Allowances (e.g. allowances for bad debts) up to 5% of the net profit; and

- Incentive and bonuses, social insurance contributions, salaries and wages, tips, commissions, interest expenses, compensations and fines, insurance expense, advertising, etc.

The deductible expenses mentioned above are not comprehensive. Expenses other than those mentioned above may be tax deductible if a provision is available in the tax legislation.

Exemptions

Profits arising from the following business activities are exempted from tax (Art. 36, Income Tax Law):

- Bee breeding projects;
- Reclamation and cultivation of land, for a period of 10 years commencing in the first fiscal year in which the land is considered productive;
- Special insurance funds that have been established in accordance to the law on special insurance funds (i.e. Law No. 54 of 1975);
- Poultry breeding projects, and fisheries involving the use of fishing boats and trawlers, for a period of 10

years beginning on the date when such activities are first commenced; and

– New projects that are wholly or partly financed by the Social Fund for Development, for a period 5 consecutive years after the project is initiated.

3.1.4. Non-commercial professional revenue

Non–commercial professional revenue is the second type of revenue that is included in annual unified tax return. Pursuant to Art. 66 of the Income Tax Law, tax shall be imposed on the net income realized from the free professions and other non-commercial professions practiced independently by taxpayers and the basic component of the net income is realized from exercising the profession or activity in Egypt.

The tax shall also be applied to the net income realized from practicing the profession abroad, if the business is headquartered in Egypt

Taxable income

The taxable revenue is the annual turnover, on a cash basis, from the preceding year, and after having deducted all related costs.

Deductions

Under Art. 67 of the Income Tax Law, the net income is to be determined after deducting all expenses necessary for practicing the profession, such as registration fees, subscription in syndicates and professional societies, as well as direct taxes, and other costs related to profession. The expenses in question must be from the same tax period and be supported by documentation.

After calculating net income, there are additional deductions that are stipulated by Art. 68 of the Income Tax Law as follows:

- 15% of the net income for professional use;
- Payments to associations or syndicates to finance pension related schemes, providing that the deductions do not exceed 10% of the net income;
- Life and health insurance premiums benefiting the taxpayer, spouse and dependents up to 15% of net income or EGP1,000 per annum whichever is less; and

- Actual donations made to the government and/or related agencies, and donations to registered charities up to 7% of the net income.

Exemptions

Under the law (Art. 71, Income Tax Law), the following are exempted from tax:

- Agricultural establishments with specific exceptions;
- Non-profit organizations, within the limits of their social, scientific or sporting activities;
- Free professionals, who are registered as members in professional syndicates in the field of their specialization, for a period of 3 years commencing on the date they begin to exercise their free profession. Such persons must settle their tax on the first month following the end of this three year period;
- Writers and translators of books and articles relating to religious, scientific, cultural and literary topics. The profits from these activities are exempt but this does not include profits realized from the sale of books or translations produced in audio or visual form; and

- Profits of members of the teaching staff in universities, institutes and other academic institutions, earned from their books and literary works published according to the rules of the university.

3.1.5. Real wealth revenue

Real wealth revenue that must be included in annual unified tax return comprises of revenue arising from:

- agricultural lands;
- fruits gardens; and
- buildings.

Taxable income

In computing the taxable income for real wealth revenue purposes, there are two prescribed methods. The first is based on the actual accounting books, and the second is an estimated method. The estimated method, if used, is tied to the property tax (see 4.) and computed as follows:

- Revenue derived from agricultural land[3]: Rental value = (Land tax x 100)/tax rate. Once the rental value is obtained, the taxable revenue = Rental value x 80%;
- Revenue derived from productive fruit gardens
  - when the land is leased: Taxable revenue = Rental value x 80%;
  - when the land is owned: Taxable revenue = Rental value x 2 x 80%; and
- Revenue derived from buildings[4]: Rental value = (Building tax x 100)/tax rate. Once the rental value is obtained, the taxable revenue = Rental value x 80%.

Exemptions

The real wealth revenue tax is not applies to revenue from productive fruit gardens where the cultivable area does not exceed 3 *faddan(acre)*, and for ornamental medicinal and aromatic plants where the cultivable area does not exceed 1 *faddan(acre)*.

3.1.6. General rules for the Unified Income Tax

[3] Para 1 of Artc. 82 of income tax law stipulates that the revenues of agricultural land are to be evaluated based on their rental value, which is in turn based upon the land tax according to Law No.113 of 1939. Currently the land tax rate is 14% of rental value.

[4] Article No. 83 of income tax law stipulates that revenues of buildings shall be determined based on their values as it is used in assessing building tax according to Law No. 56 of 1954.

Tax relief for family burden

The tax relief for family burden is not applied where the law specifies a fixed tax rate (e.g. in the case of MCR). According to Art[5]. 88 of the Income Tax Law, the annual tax relief is as follows:

- An annual amount of EGP2,000 for unmarried taxpayers without dependents; or
- An annual amount of EGP2,500 for married taxpayers without dependents; or
- An annual amount of EGP3,000 for married taxpayers with dependents.

Tax rates

The unified tax rates are progressive and are applicable to income arising from business revenues (see 3.1.3. above), non-commercial professional revenue (see 3.1.4. above), and real wealth revenue (see 3.1.5. above). The rates are as follows:

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[5] When a taxpayer has salary income and other incomes that driven from business, non commercial profession and real wealth (Unified Income Tax), he claims deduction for Family burden Relief only under salaries tax. If the salaries income below family burden relief he can claim the difference from other income(Unified Income Tax).

Annual taxable income (EGP)	Rate
0 – 2,500	20%
2,501 to 7,000	27%
7,001 to 16,000	35%
More than 16,000	40%

Tax filing

Any taxpayer, who derives income from commercial activities, non-commercial professional activities, and real wealth activities, is obliged to file a tax return. The tax return will have to be filed by the taxpayer in his/her capacity as a sole proprietor, active partner or silent partner.

The Egyptian tax system is a self-assessment system, whereby the taxpayer is required to compute his/her tax liability and remit the tax payable to the tax authorities. The tax authorities may dispute the tax return and make amendments but the burden of proof is on the tax authority to show that the tax return was erroneous or fraudulent.

The tax return must be filed by 31 March (e.g. the tax return for the income year 1 January 2003 to 31 December

2003 must be filed by 31 March 2004). Failure to meet this deadline could result in penalties up to 20% of the final tax due.

3.2. Corporate Profits Tax

The second volume of the income tax law deals with the tax treatment of corporations, due to the different characteristics of the corporate business form to other forms of unincorporated businesses.

Art. 111A of the Income Tax Law defines the various forms of business that are liable to corporate profits tax. These businesses are:

- Joint-stock companies, limited liability companies and limited partnerships;
- Public sector banks and public sector corporations;
- Foreign banks, offshore banks, foreign corporations and their subsidiaries; and
- Public economic authorities and other juridical persons that are involved in profitable activities with the exception of national services agency belonging to the Egyptian Ministry of Defense.

Taxable income

The accounting profit, after adjustments for differences between accounting principles and tax provisions, is the basis for determining the taxable income. The taxable income is calculated on an annual basis.

The taxable income includes ordinary profits, which arise from ordinary business transactions, and in addition, it includes capital gains as the Egyptian tax system does not have a separate provision for the taxation of capital gains.

Deductions

Expenses incurred during the relevant accounting period may be deducted, and in general, an accrual basis is used to determine if the expenses have been incurred. Art. 114 of the Income Tax Law specifically mentions a number of deductible expenses including the following items:

- Rent paid for business premises. Where the premises are owned by the taxpayer, an amount equal to the rent that would be paid by a similar business for such premises may be deducted;

- Depreciation of fixed assets that has been computed in accordance with the business accounting system;
- An accelerated depreciation of 25% of the cost of new machinery;
- Taxes, except for the corporate profits tax, paid;
- Interest paid to bondholders or other creditors;
- Donations made to government up to the actual amount donated, and donations made to registered charities up to 7% of the net taxable income;
- Allowances (e.g. allowances for bad debts) up to 5% of net profit. Banks may claim an allowance for bad debts of up to 10% of their net profits, while insurance companies may claim a deduction for allowances that have been made in accordance to the requirements of the insurance law;
- Incentives and bonuses, social insurance contributions, salaries and wages, tips, commissions, compensations and fines, insurance expense, advertising, etc.;
- Attendance allowances paid to shareholders; and
- Allowances, salaries and other in-kind payments made to board members.

Exemptions and reliefs

There is a number of incentives, etc. available to corporations in Egypt, which will be discussed in detail later. Some of the exemptions and reliefs available include:

- A 5 year tax exemption for new established Industrial Corporations which employ at least 50 workers and have proper and accurate accounts;
- A 5 to 20 year tax holiday, depending on the location of the corporation’s headquarter, for corporations established according to the investment laws
- An allowance for corporate equity, whereby corporations listed on the Egyptian Stock Market are provided with a tax relief for paid-up capital

The exemptions and reliefs granted under the Egyptian tax system works to reduce the effective tax rate to about 25%.

Corporate tax rates

The general tax rate is 40% while a special tax rate of 32% is applied to industrial companies and on profits derived from exports transactions. Oil exploitation and production companies are subject to a tax rate of 40.55%.

There is a development duty rate of 2% which is imposed on annual taxable profits that exceed of EGP18,000.

The MCR Tax (see 3.1.1) is also imposed on corporate revenues that are derived from mobile capital, at a rate of 32%. Corporations, particularly banks, are able to exclude 90% of their revenue that is derived from mobile capital from their taxable income or exclude specific portion of such income in accordance with special formula provided by Interpretative Regulations No 1 of 1998 of Law No. 5 of 1998.

Tax filing

Companies are required to file their annual tax return together with all supporting schedules and original financial statements within thirty days of the approval of the company's financial statements by the general assembly of stockholders. It is a legal requirement that the general assembly be held within 3 months of the end of financial period.

Offshore banks and subsidiaries of foreign companies must file their annual tax return within 3 months of the end of their financial period.

Failure to comply with the tax filing requirements could result in a tax penalty up to 20% of the tax payable.

4. Property Taxes

There are two types of property taxes in Egypt, the first being agricultural land tax and the second, building tax

4.1. Agricultural land tax[6]

This tax is levied on all land used for agricultural purposes and land which can be used for agricultural purposes irrespective of the method of irrigation, etc.

The tax base is determined according to the rental value of the land that is estimated by the tax authority. The tax authority reviews the rental value every 10 years. The landlord is responsible for the tax liability and he/she is

[6] It is imposed pursuant to Law No 113 of 1939.

required to remit the estimated tax amount on an annual basis to the tax authority.

The tax rate is 14% of land rental value.

4.2. Building tax[7]

Building tax is imposed on permanent structures located in certain prescribed areas, and is not dependent on whether the building is occupied or whether any actual income is derived from the building. Buildings belonging to the government and public enterprises are exempted from this tax.

The tax base is determined according to the rental value of the building and as with agricultural land, the rental value is estimated by the tax authority. The tax authority reviews the rental value every 10 years. The landlord is responsible for the tax liability and he/she is required to remit the estimated tax amount on an annual basis to the tax authority.

[7] It is imposed by Law No 56 of 1954.

The building tax is a progressive tax that ranges from 10% to 40%.

5. Indirect Taxes

There are three types of indirect taxes levied in Egypt. These are the general sales tax, stamp duties and customs duties.

5.1. General Sales Tax (GST)

GST was first introduced, as a replacement to Consumption Tax, in 1991 by Law. No 11 of 1991. GST which formed 21.75% of total tax revenue in the fiscal year 1990/91 and 32.64% in the fiscal year 1999/2000[8], has played an outstanding role in increasing tax revenue and consequently the budget deficit has declined considerably.

Under the GST legislation, manufacturers, importers, and service providers with annual turnover of EGP54,000 or more, while wholesalers and retailers with an annual turnover of EGP150,000 or more, are required to collect GST from their

[8] Central Bank of Egypt statistics.

customers and remit such amounts to the Sales Tax Department.

According to the legislation, GST shall be levied on goods that are locally manufactured or imported unless such goods are specifically exempted. GST is also levied on a number of specified services. Goods and services exported are subject to a zero rate.

Exemptions

The following are exempted from the GST application:

- Products that fulfill a social purpose, e.g. food and medicine, are exempt;
- All taxable commodities, equipment and services that are necessary for defense, national security, and the manufacture of armaments, as well as related raw material, production prerequisites and components thereof are exempt;
- Goods purchased or imported by foreign embassies and consulates in Egypt;
- Gifts, donations and presents made to the state administration or municipalities, and expressly exempted by the Minister of Finance; and

- Scientific, educational and cultural products imported for use by scientific research institutions and expressly exempted by the Minister of Finance.

Tax rate

The standard GST rate levied on taxable goods is 10% while the GST rate for taxable services is 5%.

Tax filing

A GST registered taxpayer is obliged to file a monthly Sales Tax Return that must be based on the regular accounting books and records. Failure to do so could result in a weekly penalty of 0.05% of the tax due.

GST is based on a self-assessment system, and the Sales Tax Department has the right to amend or ignore the GST return, and estimate the taxpayer's tax liability based on available information. In such instances, the burden of proof rests on the Sales Tax Department. The Sales Tax Department has the right to conduct tax audits which are usually based on the invoice system.

5.2. Customs duty

Customs duty plays an important role in Egypt's international trade and fiscal policy. In recent year's, customs duty proceeds have declined as a result of trade liberation policy and signing of trade agreements with other countries. Customs duty was 21.07% of total tax revenue in the fiscal year 1990/91 and this declined to 18.03% by the fiscal year 2000/01.

The current customs law is Law No. 66 of 1963, as amended. In general, goods that are exported are not liable to customs duty but a number of specified goods are subject to an export tax (e.g. raw peltry, iron, copper, nickel, aluminum and zinc).

Imports are subject to customs duty which is imposed in accordance with customs tariff of the import. Currently, the highest rate in the customs tariff is 40%, although there a few exception where the rate exceeds 40%. This usually occurs with luxury goods such as cars, wine, etc.

The law also provides for exemptions from customs duty and such exemptions are usually geared towards meeting socioeconomic objectives and to attract investment.

5.3. Stamp duty

Stamp duty is levied pursuant to Law No. 11 of 1980, and in general is imposed on the following:

- Documents: a wide range of documents including certificates and declarations, judicial documents, commercial advertisements, licenses, utility bills, commercial invoices, etc.;
- Contracts: all types of contracts; and
- Transactions: wide range of transactions such as banking transaction (i.e. loans, deposits, accounts and documents), insurance premiums, transportation services, lotteries, company registrations, etc.

There are two types of stamp duty rates. The first is a fixed amount that is imposed on documents, contracts, etc. The amount of fixed stamp duty is specified in the legislation and varies according to the document in question. The second is proportionate rate and this, generally, applies to transactions. The proportionate rate is calculated as a percentage (which is prescribed in the legislation) of the amount being transacted.

6. Investment Tax Incentives

Egypt, like other developing countries, uses investment tax incentives a tool to encourage investment, particularly foreign direct investment (FDI). Investments into Egypt are currently regulated by Law No. 8 of 1997 (i.e. Law of Investment Guarantees and Incentives)[9].

Investment tax incentives in Egypt can be divided into 3 categories, (i) income tax incentives, (ii) customs incentives and (iii) other tax incentives (e.g. stamp duty exemptions). Among these incentives, the income tax incentive is the most important and in this section, we will discuss investment tax incentives that are related to income tax, in particular corporate profits tax.

6.1. Investment incentive policy for corporate businesses

[9] Prior to Law No. 8 of 1997, the effective law was Law No. 230 of 1989 which had replaced Law No. 43 of 1974 (i.e. Investment Law for Arab and Foreign Capital).

Tax incentives play a significant role in encouraging investments, and both developed and developing countries have policies that utilize tax incentives to attract and increase both domestic and foreign investments.

6.1.1. Definition of tax incentives

The 2001 OECD Tax Policy Study defined tax incentives as provisions in the tax code or other codes, that offer a preferential tax treatment to certain activities over others (e.g. manufacturing versus non-manufacturing industries), some organizational forms of business over others (e.g. incorporated versus unincorporated), etc.

Tax incentives imply a reduction in either the tax rate or the tax liability. Tax holidays, for example, are a reduction in the tax rate during a period in the business lifecycle, accelerated depreciation or an upfront write-off of investment expenditure is a reduction in the tax base, and an investment tax credit results in the reduction of taxes.

6.1.2. Types of tax incentives

Tax Holidays

A tax holiday is a simple and effective form of tax incentive. Under a tax holiday, a qualifying entity would not be required to pay corporate income tax for a specific period of time, with the goal of encouraging investment. In order to implement this policy successfully certain rules must be stipulated, for example, the definition of the qualifying entity, qualifying activities/sectors and the period of commencement of the tax holiday

A tax holiday may be targeted at firms in a specific region or industry sector. Targeted sectors of tax holidays may address a perceived knowledge gap in the host countries and draw in skills and knowledge transfer to domestic workers in key area, in the case of foreign direct investment.

Tax holidays are most attractive to firms in sectors where profits are generated in early years of operations (e.g. firms in trade, short term constructions, and services sectors, etc.).

Tax rate reductions

A tax rate reduction may be broad–based, applicable to all domestic and foreign source income from specific activities or sources, or, at income earned by non-resident investors alone, or, a combination of these. When the reduced rate applies only to profits from a targeted activity, then careful legislative drafting and administration are required to clarify eligibility and limit tax avoidance and revenue leakage.

The rate reduction may be introduced as either a temporary or permanent measure, or generally more to foreign investors the longer the period that they can benefit from it.

Special investment allowances

Under an investment allowance regime, taxpayers are provided with accelerated or more generous write-offs for qualifying capital costs. Generally, there are two types of investment allowances, as follows:

- Accelerated depreciation: taxpayers are allowed to write-off capital costs over a shorter period time than dictated by the useful economic life of such capital item, which generally corresponds to the accounting basis for depreciating capital costs; and
- Enhanced deduction: taxpayers are allowed to claim deductions for the cost of qualifying capital that exceeds the (market) price at which it is acquired. Depending on the rate at which these (i.e. enhanced costs) can be depreciated, the system carries a risk as it may generate a stream of tax deductions that exceed in present value the corresponding acquisition costs.

Investment tax credits

Tax credits provide a set-off against taxes otherwise payable, rather than a deduction against the tax base (thereby removing the dependency of the value of a tax credit claim on the income tax rate). Investment tax credits have two forms:

– A flat investment tax credit: it is earned as a fixed percentage of investment expenditure incurred in a year on qualifying capital; and
– An incremental investment tax credit: it is earned as a fixed percentage of qualifying investment expenditure in a year that is in excess of base which is, typically, a moving average base (e.g. the average investment expenditure by the taxpayer over the previous three years). Usually, incremental tax credits have the most stimulative impact when targeted at short-lived assets, rather than long–lived assets of the same productivity. This follows from the fact that the present value of the stream of tax payments on revenues from short-lived asset is smaller than in the case of a longer-lived asset.

Therefore an investment tax credit at a flat, fixed rate sets-off a larger percentage of the tax revenues imposed on the stream of earnings from a short-lived asset.

Financing incentives

Financing incentives, which operate to lower the required rate of return that a taxpayer must offer on its shares, may also be used to encourage investment. There are three broad classes of financing incentives provided via a tax system, each intended to lower a taxpayer’s cost of capital:

– Up-front tax incentives (i.e. a tax deduction or credit) that provide shareholders with an income tax relief on the cost of their equity investment in targeted activities;
– Down-stream tax incentives (i.e. a tax deduction or credit) that provide shareholders with income tax relief in respect of the return (dividends or capital gains) from their investment in targeted activities; and
– Flow-through tax incentives that allow businesses to transfer unused tax deductions or tax credits earned on qualifying expenditure to investors. This will be used to set-off taxes at the shareholder-level rather than business-level.

6.2. The Egyptian scenario

The Egyptian tax system provides two types of investment tax incentives to corporations, the first are general incentives contained in the Income Tax Law and applicable to all corporations who conduct a business in Egypt. The second is incentives that are specific to corporations that have been established under the investment law.

6.2.1. Incentives under the Income Tax Law

Art. 120 of the Income Tax Law sets out the general tax incentives and reliefs available to corporations conducting business in Egypt. These incentives are classified into two types, i.e. (i) tax holidays and (ii) tax incentives.

Tax holidays

The Income Tax Law distinguishes between a limited period tax holiday and an unlimited tax holiday period. Limited tax holidays are granted to specified types of corporations for a limited period of time and the details are as follows:

– An ‘Industrial Company’ employing 50 employees or more, is exempted for a 5-years beginning with the first financial following the commencement of production. Under the condition that the company maintain accurate accounts. When a company failed to meet this condition at any year during the 5 year period, it will be taxed in this year.

- A company involved in the reclamation and cultivation of land is exempted from corporate tax for 10 consecutive years, beginning in the year after it commences production; and
- A ‘Poultry Breeding’ company is exempted from corporate tax for 10 consecutive years, beginning in the year after which it commences production.

Under the Income Tax Act, an unlimited tax holiday is currently only granted to companies involved in the breeding of bees. Such companies are exempted for corporate profits tax indefinitely.

Tax incentives

The tax incentives contained in Art. 120 of the Income Tax Law are aimed at mitigating the corporate tax burden in order to encourage the use of a corporate legal entity to conduct business as opposed to an unincorporated legal form. The following are some of the incentives contained in the Income Tax Law:

- A joint-stock company listed in the Egyptian Stock Exchange is entitled to claim an annual paid-up capital deduction, known as ‘Allowance for Capital Equity’, deduction. This deduction is equal to the product of paid up capital and the interest rate payable on government treasury bills, for example if a net taxable income of a listed company is EGP 1,000,000.0, its paid up capital is EGP 6,000,000.0, and the interest rate on treasury bills is 10%. Then the company gets tax relief from its net taxable income equal 6,000,000.0 x 10%= 600,000. this amount deducts from taxable income and their tax liability =(1,000,000.0-600,000)x tax rate. This deduction is lowering the statutory tax rate, which implies that listed corporations are subject to lower marginal tax rate that unlisted corporations.
- 90% of the interest income derived from publicly–subscribed bond issues, and, from bank deposits are excluded from the taxable income of corporations;
- Profits arising from the merger of two or more companies are exempted from corporate profits tax;
- Profits arising from the incorporation of new subsidiaries are excluded from the taxable income of

parent company if the subsidiary is liable to corporate profits tax in Egypt; and

- Foreign sourced MCR of an insurance company is exempted from MCR tax (see 3.1.1.).

6.2.2. Incentives under the Investment Law

Egypt started implementing its investment tax incentives policy in 1971 (i.e. Law No. 65 of 1971). The 1971 law did not achieve its objectives and therefore, a new investment law (Law No. 43 of 1974) was introduced in 1974. Law No. 43 of 1974 which was known as the Law of Foreign and Arab Capital Investments and Free Zones, could be considered the cornerstone of Egypt's open door policy. Law No. 43 of 1974, provided foreign investors with numerous incentives and guarantees, and many corporations were established under its auspices. As a result of socio-economic changes that Egypt had faced during late 1980s, a new investment law (i.e. Law No. 230 of 1989) was introduced. However, Law No. 230 of 1989 could not meet the changing needs of Egypt and Law No. 8 of 1997 (known as the Law of Investment Guarantees and Incentives and hereinafter referred to as the Investment Law) was introduced. This law abolished all previous tax incentives, except for those covered under the

Income Tax Law. This meant that any corporation which wanted to avail itself to an incentive, other than that provided by the Income Tax Law, had to be established pursuant to the Investment Law. The General Authority for Investment is tasked with the enforcement of the Investment Law and investment incentives and guarantees are granted according to the type of the business activity and the location of the business.

Approved business activities

The Investment Law provides for incentives and guarantees for investments in specified business activities, regardless of the venture's legal form. These business activities are as follows:

- Reclamation and/or cultivation of wasted and desert lands, including reclamation of lands and installation of infrastructure facilities that render the same cultivable, and, cultivation of reclaimed land;
- Animal husbandry, poultry and fishery production;
- Manufacturing and mining, including:
    - Industrial activities that transform substances and raw materials and change the form of such materials by blending, mixing, treating or shaping, and

packing, as well as assembling parts and components, and mounting them for production of intermediary or end products;

  - Design of machinery and industrial equipment; and
  - Activities connected with exploration for mining ores and metals, and with the extraction cutting and preparation thereof;

- Operation of hotels, motels, hotel apartments, tourist villages and tourist transportation;
- Refrigerated transportation of goods, refrigerators for the purpose of storing crops, manufactured products and foodstuffs, container stations and grain silos;
- Air transport and directly related services;
- Overseas maritime transport;
- Petroleum and gas drilling, and, exploration support services, including oil–well maintenance and enhancing, maintenance of drilling equipment and oil pumps, service related to oil exploration, etc.;
- Housing complexes for the purposes of leasing to non-commercial users. This is subject to proviso that the number of housing units should not be less than 50;

- Infrastructure including potable water, wastewater drainage, electricity, road and communications systems;
- Hospital and medical and therapeutic centers that offer 10% of their capacities free of charge;
- Lease finance activities as stipulated in Art. 2 of Law No. 95 of 1995;
- Underwriting of subscription to securities;
- Venture capital investment in projects or firms;
- Production of computer programs and systems, design, production, operation of, and training on all kinds of computer programs, systems and applications; and
- Social fund for development-funded projects.

The abovementioned business activities would be able to enjoy tax holidays, the length of which will depend on the physical location, in Egypt of the activity.

Tax incentive period

There are 3 different periods with respect to the length of the tax incentives granted under the Investment Law, as follows:

- Corporations established under the Investment Law will be exempted from corporate profits tax for a period of 5 consecutive years. This period starts in the fiscal year following the year in which the corporation commences its activities or production;
- Corporations established under the Investment Law and located in new industrial zones, or new urban communities, or in specified remote areas, will be exempted from corporate profits tax for a period of 10 years; and
- Corporations that have established or moved their operations to an area outside the old valley, will be exempted from corporate profits tax for a period of 20 years. This period starts in the fiscal year following the year in which the corporation commences its activities or production.

In addition to the investment tax incentives discussed above, the Investment Law also provides for incentives in the form of ‘Free Economic Zones’ (FEZ).

Business activities established in FEZs are exempted from corporate profits tax. Businesses in the Fezs are be subject to an annual fee amounting to 1% of the value of commodities entering the free zone for storage in respect of warehousing projects, and 1% of the value of commodities on their exit from the free zone in respect of manufacturing and assembly projects.

The salaries and wages of employees of businesses located in the FEZ these projects are still liable to salaries tax as discussed in 3.1.2.

6.3. Evaluating investment incentives in Egypt

Egypt’s investment tax policy since its establishment in 1971, has been based largely on the sole use of tax holidays. As a result, the various investment laws have paid attention to the use of tax holidays as the instrument choice to encourage investments.

The introduction of the Investment Law in 1997 (i.e. Law No. 8 of 1997) saw the abolishment of various other incentives contained in the predecessor laws.

Egyptian government has favored tax holidays as a simple and effective tax incentive to attract investment but it has not paid sufficient attention to the number of deficiencies related to tax holidays.

6.3.1. Advantages of a corporate tax incentive policy

Over the years, Egypt has attained numerous benefits from the application of the tax incentives policy, especially tax holidays. Some of these benefits include:

- The increase in the establishment of businesses (e.g. industrial projects and service activities) in urban centers pursuant to the granting of 10-year tax holidays under Law No. 59 of 1979 (Law of New Urban Communities). These business activities had a significant effect in the development of the communities in which they were established and assisted in solving many socio-economic issues;
- Tax holidays have been granted under various investment laws since 1971 until now. Tax holidays have played an important role in attracting Arab and foreign capital into Egypt and thereby creating value-addition to the Egyptian economy. According to figures from the General Investment Authority, as of 31 December 1999, there were a total of 8,686

companies established under investment laws (including 867 in FTZs) with a total investment costs of more than USD222 billion;

- Tax incentives have contributed greatly to the macroeconomic stabilization program that started in 1991, as companies established under investment laws assist in overcoming unemployment, foreign currency deficits, and balance of payment deficit through their business activities; and
- Tax incentives also have had an important role in technology transfer and the modernization of Egyptian industry. The incentives have attracted many multinational companies into Egypt and the use of modern technology and management techniques by these companies to increase their profits, has also strengthened Egypt competitiveness in the world economy.

6.3.2. Disadvantages of corporate tax incentive policy

As mentioned before, Egypt’s policy for attracting investments is solely based on tax holidays and this has a number of disadvantages, such as:

- Tax holidays do not confer any benefits on activities that are prone to losses in their initial years of operation while conferring benefits to industries that are profitable. Tax holidays, therefore, do not encourage entrepreneurship and at the same time, the authorities will lose valuable tax revenue;
- The tax holiday is also a difficult incentive to police. Since such tax planning opportunities are available to domestic investors who have both types of companies (tax holiday companies and tax paying companies) as well as to foreign investors who always shift taxable income from one activity to another and from one country to another. So, even if it were desirable to target tax holiday incentives to a particular activity or country, it would be impossible to do so, because transfer pricing, financing and other arbitrage techniques will diffuse the benefits of the tax holiday to other activities or countries; and
- Tax holidays lead to a considerable erosion of government revenue. Consequently, the budget deficit will increase, and at the same time these tax incentives are against the principles of equality and neutrality.

7. Conclusion

The structure of the Egyptian tax system (i.e. a direct and indirect tax system) is similar to that in many other countries. Prior to the introduction of GST, direct taxes played a more important role in the tax structures as it raised a considerable percentage of the tax revenue. The introduction of GST resulted in a considerable change in the tax structure and consequently, the composition of the collection of tax revenue.

The current tax system, to some extent, is balanced as the share of tax revenue, from direct and indirect taxes, are approximately the same. However, there is still room for many socioeconomic objectives to be met, using direct taxes and therefore, restructuring the income tax law is a priority for the Egyptian government. A new Income Tax Bill has been prepared and is expected to be approved by the Parliament in 2004. Although the overall structure of the income tax system is to be retained, changes to the components of the structure are expected.

With regards to investment tax incentives, the current policy is characterized by:

- An Income Tax Law that provides generous tax treatments to incorporated entities as opposed to unincorporated entities; and
- Investment laws that largely use tax holidays as a measure to attract investment, without giving due consideration to other forms of tax incentives, such as investment tax credits, reduced tax rates, etc.

In Egypt, the problems that arise are not from the use of tax incentives to achieve specific objectives, but rather from the current inflexible package of investment incentives that are prone to tax planning and manipulation. In fact, the use of tax holidays as the sole mechanism for attracting investment led to negative consequences, such as an inequitable tax system and loss of tax revenue. Genuine investors do not rely on tax holidays as the only decision making factor but also rely on other factors, such as infrastructure, political stability, etc.

Therefore, a tax policy that uses tax holidays as the main stimulus for attracting investment is an inefficient policy. A more flexible tax policy will be a better choice when it comes to revitalizing economies in order to cope with changing socio-economic conditions and encourage investment and economic growth.

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