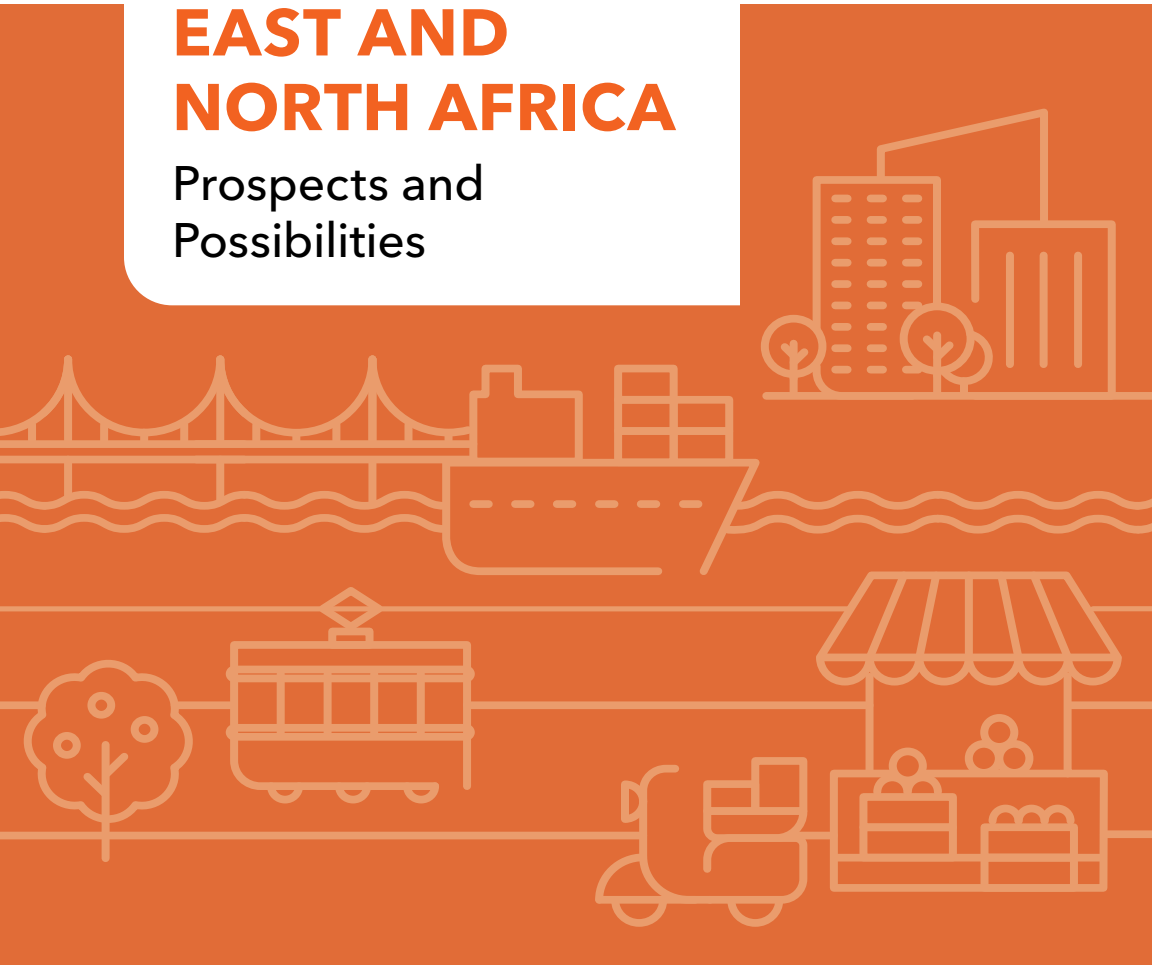
INTERNATIONAL MONETARY FUND

TAXATION IN THE MIDDLE EAST AND NORTH AFRICA

Prospects and Possibilities



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Taxation in the Middle East and North Africa

Prospects and Possibilities

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Cover design: IMF Creative Solutions

Cataloging-in-Publication Data
IMF Library

Names: Mansour, Mario, editor. | Hebous, Shafik, editor. | International Monetary Fund, publisher.
Title: Taxation in the Middle East and North Africa : prospects and possibilities / editors Mario Mansour Shafik Hebous
Other titles: Prospects and possibilities.
Description: Washington, DC : International Monetary Fund, 2026. | 2026. | Includes bibliographical references.
Identifiers: ISBN:
9798400281501 (paper)
9798400281648 (ePub)
9798400281600 (WebPDF)
Subjects: LCSH: Taxation—Middle East. | Taxation—Africa, North.
Classification: LCC HJ2279.T39 2026

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Recommended citation: Mansour, Mario, and Shafik Hebous, eds. *Taxation in the Middle East and North Africa: Prospects and Possibilities*. 2026. Washington, DC: International Monetary Fund.

Please send orders to:

International Monetary Fund, Publication Services
PO Box 92780, Washington, DC 20090, USA
Tel: (202) 623–7430 Fax: (202) 623–7201
E-mail: publications@IMF.org
Internet: www.elibrary.IMF.org
www.bookstore.IMF.org

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Foreword

Taxation is more than a fiscal instrument. It is a mirror of governance, the main lever to finance spending for development, and a powerful tool to accompany economic and social change. Max Weber defined the state as a "human community that (successfully) claims the monopoly of the legitimate use of physical force within a given territory." Charles Tilly deepened this concept by highlighting the state's capacity to tax. In the Middle East and North Africa (MENA) region—with its diverse political systems, economic structures, natural resources endowments, and institutional capacities—designing effective tax policy is both a challenge and an opportunity. This book meets that challenge with rigor, nuance, and vision.

Spanning 21 countries, the analysis offers a comprehensive and empirically grounded survey of the region's tax systems. It begins by situating MENA's fiscal landscape within its geopolitical and economic context, highlighting the persistent tax revenue gaps in fragile states and hydrocarbon-exporters, alongside the reform momentum in many countries. It then explores the core components of taxation through the lenses of revenue performance, efficiency, equity, and reform feasibility.

The book does not shy away from complexity. It confronts the low revenue performance of property and excise taxes, the challenges of value-added tax reform, and the strategic importance of modernizing oil and gas fiscal regimes. It also addresses emerging imperatives, such as environmental taxation and digitalization, offering actionable insights into how domestic tax policy can mitigate climate risks, reduce fossil fuel dependence, and improve urban quality of life.

Equally important is the treatment of tax administration. Drawing on comparative analysis and hands-on experience, the authors identify both the progress and the persistent gaps in organizational capacity, legal frameworks, and compliance management. The discussion underscores the transformative potential of digitalization and the need for coherent, transparent, and equitable enforcement mechanisms.

Ibn Khaldun, the great social scientist and philosopher of the fourteenth century, wrote extensively about the broader role of taxation, beyond its revenue function, and the (today) commonly accepted idea that through taxation, governments can be a force for development. This is one way to read this book: a contribution to a broader roadmap for building resilient, inclusive, and forward-looking fiscal systems in a region at a crossroads. It offers policymakers practical options for navigating trade-offs, making difficult choices, and designing reforms that are both technically sound and context sensitive. For scholars, practitioners,

and anyone interested in the future of public finance in the MENA—and beyond—this volume is an indispensable resource.

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Preface and Acknowledgments

This book is a survey of tax systems in the Middle East and North Africa region, 21 countries that share language and culture, but are very diverse econmically and politically. The book is organized to guide readers according to the key taxes that governments in the region use (or not) to finance their budgets. Therefore, although there are linkages across the chapters, each is self contained to facilitate using the book as a reference about the key design issues and challenges of each tax. Morevoer, most chapters reflect the diversity of countries by exploring the issues for three groups: hydrocarbon-exporters, hydrocarbon-importers, and fragile and conflict-affected states.

Chapter 1 is a summary of the book and chapter 2 is an overview of revenue developments in the region and the challenges and oportunities for tax reforms in an uncertain world. Chapters 3 to 5 cover taxes on income and wealth, commonly referred to as direct taxes. Chapters 6 and 7 address indirect taxes, that is primarily broad-based sales taxes and common excise taxes. Chapters 8 and 9 are concerned with the taxation of the production and consumption of fossil fuels, and implications for the environment and the climate transition. Finally, chapter 10 is an overview of the state and evolution of the key functions of tax administrations in the region.

Data used in each chapter does not always reach 2024; some ends in 2022 or 2023. This is to some extent inevitable for various reasons. Still, the key lessons from the book will remain relevant for years to come, and will provide, in time, a historical perspective on the evolution of tax systems in the region.

One of the privileges of writing a book with others is the learning experience and the support received from many. We are grateful for the contributing authors for sharing their knowledge and expertise on taxation. We thank the management of the IMF's Fiscal Affairs Department, in particular Vitor Gaspar and Ruud de Mooij, for their encouragement. We thank the management of the IMF's Middle East and Central Asia Department, Jihad Azour, Athanasios Arvanitis, and Zeine Zidane. The book benefited from reviews and suggestions from colleagues in the IMF's Middle East and Central Asia Department, including Kassia Antoine, Nazim Belhocine, Habtamu Fuje, William Gbohoui, Kerstin Gerling, Mahmoud Harb, Jeong Dae Lee, Iva Petrova, Brett Rayner, Nathalie Reyes, Jean van Houtte, and Ling Zhu. Their contributions were invaluable in ensuring that the book is well tailored to the macro-fiscal challenges of the MENA region. We also thank Ian Parry, Paulina Esteta Schults Antipa for the their very helpful comments on chapter 9. Grace Ashley, Ximing Dong, Yomna Gaafar, Lucienne Julian, Jad Khallouf, Kiran Rimal, and Sunalik Sunalika did excellent reseach work and collated a large amount of data on the region, which should prove useful in its own right. Finally, we thank our colleagues in the IMF's Communication Department

who provided assistance in producing this book, particularly Lorraine Coffey, Patricia Loo, and Cheryl Toksoz.

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Abbreviations

AETR	average effective tax rate
BEPS	Base Erosion and Profit Shifting
CBAM	carbon border adjustment mechanism
CFC	controlled foreign corporation
CIT	corporate income tax
CPAT	Carbon Pricing Assessment Tool
DH	Moroccan dirham
DST	digital service tax
EITE	energy-intensive, trade-exposed
ETS	emissions trading system
FCS	fragile and conflict-affected state
FDI	foreign direct investment
GCC	Gulf Cooperation Council
GHG	greenhouse gas
GILTI	Global Intangible Low-Taxed Income
GloBE	Global Anti-Base Erosion
ICT	information and communication technology
IIR	income inclusion rule
LBF	land-based financing
LE	Egyptian pound
LIC	low-income country
LPG	liquified petroleum gas
LTO	large taxpayer office
MENA	Middle East and North Africa
MLI	multilateral instrument
MNE	multinational enterprise
NOC	national oil company
OIT	offshore indirect transfer
PAYE	pay as you earn
PSA	production sharing agreement

PIT	personal income tax
PPP	purchasing power parity
QDMTT	qualified domestic minimum top-up tax
QRTC	qualified refundable tax credit
SATR	statutory average tax rate
SSC	social security contribution
SSCe	employee's social security contribution
STTR	Subject-to-Tax Rule
TADAT	Tax Administration Diagnostic Assessment Tool
TPS	tradable performance standard
UTPR	undertaxed profit rule
VAT	value-added tax

CHAPTER 1

Introduction and Summaries

Mario Mansour and Shafik Hebous

Countries in the Middle East and North Africa (MENA) region are heterogeneous in their political systems and geography—factors that have shaped their economic development and tax policy choices. Eight of 21 countries are fragile and conflict-affected states (FCSs), and 11 are hydrocarbon exporters that together hold the world's largest proven oil and gas reserves.[1] Because of this heterogeneity, taxation must be tailored to local factors and constraints while staying anchored in sound principles and empirical evidence.

This book surveys the key taxes in the MENA region's 21 countries.[2] Along with this introduction, the book includes nine chapters, each of which examines the revenue, efficiency, and equity characteristics of the taxes and suggests potential avenues for reform. Chapters 3 through 10 focus on one key component of the region's tax systems, including income and consumption taxes and tax administration.[3] Though self-contained, the chapters attempt to establish links among the many issues raised in the book. The rich spectrum of topics covered and policy lessons can be useful for countries outside the region.

Chapter 2 (by Ruud de Mooij, Mahmoud Harb, Mario Mansour, Brett Rayner, and Nathalie Reyes) provides the background for the rest of the book. It reviews the evolution of tax systems in MENA countries in the past few decades and discusses challenges and opportunities for tax policy design under different geopolitical and technological scenarios that are likely to shape the future. A key takeaway is that the region has multiple trajectories. Tax-to-GDP ratios have been persistently low in FCSs and hydrocarbon exporters, but recent developments in hydrocarbon-exporting countries—especially in Gulf Cooperation Council (GCC) countries—indicate that countries have taken deliberate policy actions to diversify government revenues, in line with policy strategies for economic diversification. By

[1] Chapter 2, Table 1, shows the classification of countries along the three dimensions of hydrocarbon exporters or importers and fragility. The IMF classifies fragile and conflict-affected states (FCSs) using a methodology that reflects several dimensions of fragility, including institutions, climate risk, and conflict and war, and that closely follows the World Bank classification. For more detail, visit the IMF's FCSs web page.

[2] The classification follows the IMF's geographical classification and comprises the following: Algeria, Bahrain, Djibouti, Egypt, Iran, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman, Qatar, Saudi Arabia, Somalia, Sudan, Syria, Tunisia, the United Arab Emirates, and Yemen.

[3] This book does not cover taxes on international trade in goods or external tariffs.

contrast, tax revenues in hydrocarbon importers (excluding FCSs) have been strong and close to 20 percent of GDP, with the highest levels in Jordan, Morocco, and Tunisia.

The chapter ends with a menu of high-level possible uses of core taxes based on four states of the future: global divide, in which innovation thrives but globalization slows or even retreats, and political fragmentation increases; slowbalization, in which the fragmentation of the global divide is accompanied by slower innovation or stagnation; grand prosperity, in which both innovation and globalization thrive, leading to global alliances and rising living standards worldwide; and regional alignment, in which innovation stagnates, but some appetite exists for political and economic cooperation, leading to regional alliances. Broad-based consumption taxes such as the value-added tax (VAT) are sound strategies to increase tax revenues in all scenarios because they are simple to implement and can tax domestic consumption effectively, whether imported or produced locally. The exception is FCSs, where simple turnover taxes as a transition toward broader VAT-like taxes is a better fit with their capacity constraints. Property taxes are also feasible and desirable in all scenarios, especially because they are primarily benefit taxes, that is, used to provide local public services. However, implementing or strengthening income taxes to mobilize additional revenue and reduce inequality in all countries is likely to be effective only under global prosperity. In the other three scenarios, FCSs are unlikely to be able to tax capital income effectively because they require substantial investments in technology and information. In slowbalization and regional alignment, hydrocarbon exporters are unlikely to implement climate mitigation policies to curb the production and consumption of fossil fuels.

In Chapter 3, Mario Mansour and Eric Zolt review personal income and wealth transfer taxes in the region, focusing on their revenue productivity and progressivity. These taxes generally play little or no role in most MENA countries. Income taxes yield on average about 2 percent of GDP in revenue, and wealth transfer taxes present in several of the region's countries—typically in the form of inheritance taxes—are negligible in their revenue yield because of high exemption levels. Countries must therefore reassess whether their tax systems are fit for the 21st century. The authors propose several options for different country groups and policy objectives.

Hydrocarbon-exporting countries without personal income taxes (PITs; mostly GCC countries) can choose to reinforce their VATs and social security contributions, which together act much like a flat tax on labor income. The countries could also introduce simple PITs with a very high exemption threshold and final withholding on labor and most capital income, together with a tax on business income—along the lines of the profit tax recently introduced in the United Arab Emirates.

Hydrocarbon-exporting countries with PITs (including FCSs and others such as Algeria and Iran) can take a gradual approach to strengthening the tax by first broadening withholding taxes on wages and then expanding the PIT base to

capital income—with capacity improvement and loosening political constraints. The overriding factor in policy design for these countries should be simplicity, for example, using only a generous basic allowance instead of itemized deductions and keeping at a minimum tax rate differentiation by income source or taxpayer type.

Hydrocarbon-importing countries, excluding FCSs, can focus on improving the neutrality of their PITs—especially regarding taxing capital income—and on coordinating PITs and social security contribution reforms to improve labor market incentives and reduce informality. These countries can also restructure their income taxes as dual income taxes in a simpler framework, including aligning top marginal tax rates with corporate tax rates. Comprehensive income taxes are unlikely to be feasible in the MENA region in the near future and could be viewed as long-term aspirations.

All countries should review the most important reason why they levy inheritance taxes because their revenue yield—if any—is insignificant. For policy decisions, determining the role of inheritance taxes is crucial. If the role is to add progressivity to income taxation, much can be achieved by improving the structure of existing or possible PITs instead of relying on ineffective inheritance taxes.

Chapter 4 provides an account of existing corporate income taxes (CITs) in the region. Shafik Hebous, Cory Hillier, and Victoria Perry frame their analysis around how to improve the design of CIT incentives to enhance investment at the lowest cost, and how countries in the region can update their CITs considering recent international developments regarding the taxation of profits of multinational enterprises. The OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting and the global minimum corporate tax (known as Pillar 2 of the OECD Global Anti-Base Erosion rules) provide MENA countries with an opportunity to revisit their CIT system designs and reduce their reliance on CIT holidays. The region can draw on alternatives such as accelerated depreciation and other types of tax incentives identified in a rich body of literature and policy evaluations. Importantly, building greater in-house capacity for rigorous tax analysis is essential to inform the CIT policy debate and guide reform choices in the region.

The chapter also addresses the important issue of how to ensure the taxation of capital gains from offshore indirect transfer of assets—gains realized on securities sold abroad but deriving their value from a country's national assets. Such transactions are infrequent but typically large-value. The issue is significant in the context of natural resources, telecommunications, and other valuable national assets, prompting the Platform for Collaboration on Tax to publish a toolkit in 2018 proposing specific legislative options to bring such gains within the tax net. The authors examine how the toolkit's options interact with new rules under the global minimum corporate tax (which result in a narrower feasible set of policy and legal design choices for taxing such gains) and conclude in favor of taxing the resident seller (deemed a seller of the asset) instead of the nonresident seller.

In Chapter 5, Riël Franzsen and Jean-François Wen review recurrent and transfer taxes on real property. They note that their revenue yield (in percent of GDP) is substantial in the European Union and some OECD countries but not elsewhere around the world, including in the MENA region, where nearly all countries levy such taxes. Several poorly designed taxes and fees on real property and exemptions from the recurrent tax for a large share of real properties (including vacant land and unoccupied housing units) result in low revenue yield in the MENA region. The authors propose a holistic approach to reforming property taxation. First, recurrent property taxes can be used as benefit taxes for local governments, rather than central government taxes, (based on value or surface area) and applied to nearly all real properties. As such, they can play a major role in funding local services overstretch because of rapid urbanization. Second, transfer taxes and the many other fees on real property can be consolidated into a single transfer tax set at very low rates, then gradually replace its revenue with a capital gains tax coordinated with the income tax system.

Pierre-Pascal Gendron and Christophe Waerzeggers devote Chapter 6 to consumption taxes, notably the VAT. A central discussion explores how VAT designs across the region with different rates and definitions of the tax base affect performance. History is a key factor that has influenced both elements significantly. The design variances help explain the wide range of VAT revenue yields, from less than 1 percent of GDP to more than 7 percent. The revenue efficiency of VATs—the yield as a percent of GDP per point of the standard rate—ranges from about 0.2 to 0.7 across countries of the region.

The authors also provide concrete suggestions and real-life examples of how to improve VAT revenue yields and efficiency in the region. However, they acknowledge the political difficulty in broadening the VAT base. Ad hoc changes with relatively minor implications of VAT design are unlikely to succeed in enhancing revenue and efficiency. Therefore, countries need to approach VAT reforms holistically and boldly.

In Chapter 7, Anne-Marie Geourjon and Patrick Petit review excise tax systems in the region, focusing on their revenue yield and customary objective to curb consumption of harmful products. The authors begin with a taxonomy of excise systems in the region, grouping them into three categories: countries without a legally defined excise tax system (primarily FCSs); countries with a legally defined excise tax system but with a narrow tax base in terms of the number of products excised or the definition of the tax base (primarily GCC countries); and countries with a legally defined and administratively developed system applying excises to a broad tax base (primarily southern and eastern Mediterranean countries). Not surprisingly, the authors found that FCSs and GCC countries perform worse in revenues than the southern and eastern Mediterranean countries, though some of those countries overextended excise taxes, sometimes on narrow-base items with doubtful policy objectives. Overall, revenue from excise taxes has declined in the region since the mid-1990s and stood at slightly more than 1 percentage point of

GDP in the early 2020s. The authors attribute this underperformance to low tax rates, which keep retail prices low, especially on fuel and tobacco products—the two largest excise tax bases in the region.

The authors suggest several future reforms. First, the need is urgent to delineate excises from other indirect taxes and have specific legislation for them instead of annexing them to general sales taxes or making them external tariffs. Second, in southern and eastern Mediterranean countries, rationalizing the number of excises and rethinking the balance between ad valorem (value-based) and specific excise rates is needed to ensure that the balance is consistent with the policy objectives, which also need to be articulated better. Third, raising revenue from the excise regime requires increasing rates well above their current levels in several countries, and countries must also be prepared in the long term to identify alternative revenue sources because the revenue yield will eventually decline with consumption. Fourth, GCC countries can benefit from expanding the use of excises.

Carole Nakhle and Thomas Benninger discuss in Chapter 8 the crucial importance of the region's oil and gas sector and its tax regimes, including the sector's future considering global and domestic climate initiatives and implications. They start by describing the sector itself, which accounts for the world's largest proven oil and gas reserves (nearly 52 percent and 43 percent, respectively) and produces 36 percent and 22 percent of global oil and gas, respectively. Together with the proximity of those reserves to land and their location in relatively shallow waters, the region enjoys a cost advantage over peers, especially those with large deepwater production such as Norway, the United Kingdom, and the United States. Because of those characteristics, governments in the region have some of the highest revenue take in the world from oil and gas.

Those regional figures mask significant divergences across countries, however. For example, more than one-third of regional oil exports come from Saudi Arabia, while Qatar accounts for about 70 percent of gas exports. These differences stem from both the distribution of reserves across the region and from production capacities and access to technology, political fragility and wars, changing geopolitics, and trade and financial sanctions. Thus, while some countries' development has benefited from oil and gas revenue, others have suffered from their existence. Incidentally, the countries that have low costs and have benefited most from oil revenue are also likely to benefit from the global climate transition because their production is expected to remain cost-competitive for longer than that in other regions of the world.

The authors also quantitatively analyze the fiscal regimes of countries in which oil and gas production are not state-owned—that is, where fiscal instruments are used to share hydrocarbon revenues with multinational companies operating under licenses or production sharing contracts. They find that some countries could benefit from shifting taxation from regressive instruments, such as royalties

and low cost recovery limits,[4] to more progressive instruments, such as profit and rent taxes.[5] This shift is particularly important for FCSs, where foreign investors might be more sensitive to the implications of the fiscal regime (or the tax mix) on both the amount and timing of the tax liabilities over the life of a particular project. Also, carbon taxes could be used to incentivize companies to reduce waste, such as flaring, and to retain revenue that could accrue to other countries, such as under the EU Carbon Border Adjustment Mechanism.

The book proceeds with Chapter 9, by Nate Vernon-Lin and Alice Pirlot, analyzing the opportunity for using taxes and subsidies to influence the demand for energy products in the region and the consequences of doing so. Opportunities lie in the relatively high cost (both direct and indirect) of fossil fuel use in the region. The authors cite research on the consequences, for example, that air pollution from fossil fuels and road vehicle accidents each result in about 90,000 deaths per year in the region (leading to annual economic costs of 4 percent of GDP), while congestion results in the average urban resident sitting in two days' worth of traffic per year (an economic cost of 0.2 percent of GDP). Global warming risks are especially acute: increases in temperature and vulnerability to droughts, natural disasters, and sea level rise are projected to be relatively large, with estimated mortality-related costs of 1.6 percent of GDP by mid-century under a moderate temperature increase trajectory. Domestic taxes can play a mitigating role in dampening these costs over time, regardless of other international initiatives. For example, nearly all MENA countries are parties to the Paris Agreement, including 11 that have pledged to transition to net zero by mid- to late century. Yet only a few MENA countries tax fossil fuels, and none fully internalize the associated externalities in the tax. Furthermore, some countries provide explicit subsidies to fossil fuel consumption by allowing retail prices below an international pretax cost benchmark.

The authors present a range of potential actions to reduce excessive fossil fuel consumption and improve the quality of life, especially in large urban areas. Reforming fossil fuel subsidies is both a first step and a top priority that can be accomplished simply by liberalizing prices and allowing VATs to apply normally, so fossil fuels are not advantaged relative to other forms of energy consumption. Explaining the rationale for such reform and their consequences to citizens is crucial for the success of this difficult undertaking. The second step is pricing externalities, which can be done gradually. The region has some success stories

[4] "Regressivity" refers to the increase in the average tax rate with profits at the company level. It is different from the standard concept of regressivity of income taxes on individuals because only individuals bear the final incidence of taxes as consumers, employees, or shareholders.

[5] Profit taxes are imposed on the total net return to capital, independent of its level—that is, whether such return is in line with risks taken. Rent or excess profit taxes are taxes that apply to profits above a "normal" return to capital to compensate investors for the risks they take. The argument in favor of rent taxes applied at higher rates than profit taxes is that such rent is generally unexpected, and investors are indifferent whether they realize it or not. However, this simple explanation contrasts with the empirical evidence that rent or excess profits are not perfectly random.

that show how effective this step-by-step approach can be (for example, Lebanon, Morocco, and Tunisia). The excise reflecting the externality can be tailored to local conditions, such as the impact of traffic and pollution. Third, offsetting policies can be considered to make the reforms revenue neutral where the need for revenue is less acute, or at least use some of the additional revenues to enhance transfers to poor households through, for example, the income tax system. Similar offsetting policies and coordination across the region can be considered to limit the impact of energy taxes on carbon leakage through competitive relocation of energy-intensive companies.

Introducing or increasing taxes on energy products should be part of a broader strategy to improve the quality of life. Taking a long-term approach to address competitiveness and distributional considerations is more likely to succeed than ad hoc policies.

Chapter 10 is dedicated to tax administration issues. Lydia Sofrona and Polina Prokof'yeva offer a comparative overview of reform efforts and key challenges in the region, building on the IMF's hands-on experience and empirical work. The authors focus on key issues related to tax administration: organization and governance, legal frameworks and procedures, compliance gaps and modernization, and compliance management. They conclude that some administrations have achieved remarkable sophistication over the years, while others have stagnated or even regressed (some FCSs, for example). Inadequate and misallocated resources tend to figure prominently in the challenges that many tax administrations face, along with constraints imposed by public service rules related to human resources management, which in some cases are inadequate for the efficient and independent functioning of tax administrations. Another common challenge is an outdated legislative framework for administering the tax system and collecting revenue, sometimes caused by the policy design itself—for example, VAT and capital gains exemptions and other forms of exceptions. Tax rulings and dispute resolution are not well developed, leading to judicial bottlenecks and weakening the trust and credibility of tax administrations. These complexities arguably lead to unequal implementation of tax laws, through which firms and individuals with greater financial resources are better positioned to navigate and benefit from them.

Digitalization can benefit tax administrations significantly in their reform efforts and even allow them to leapfrog to new organizational models, bypassing the need for gradual implementation of legacy reforms. Evidence from countries such as Algeria, Egypt, Morocco, and Saudi Arabia, to name a few, is encouraging. These countries have significantly increased the share of tax revenues collected directly and electronically through withholding mechanisms.

Countries in the MENA region have invested substantially in tax policy design and administration since the turn of this centrury, but progress in mobilizing additional revenue, enhancing equity and efficiency, and addressing environmental concerns, has been uneven or negligible in some countries. Building tax systems that are effective, equitable, and efficient remains a challenge. This book

aims to support policymakers in navigating trade-offs, making difficult choices, and crafting reforms that are both practical and context sensitive. The insights and options presented can be a valuable resource for countries as they advance their tax reform efforts.

CHAPTER 2

Challenges and Opportunities for Tax Reform

Ruud de Mooij, Mahmoud Harb, Mario Mansour, Brett Rayner, and Nathalie Reyes

INTRODUCTION

Countries in the Middle East and North Africa (MENA) region have invested considerably in making their tax systems more effective, efficient, equitable, and enforceable. Despite some progress, tax ratios in some countries remain low because of several factors, including dependence on hydrocarbons (which generate substantial nontax revenues), fragility and conflict (which affect key institutions that are important for revenue mobilization), and narrow tax bases and informality.[1]

Those factors affect countries in MENA differently and contribute to disparities in revenue composition and performance.[2] Table 2.1, which summarizes key economic and tax indicators shows that many MENA countries need to increase their tax revenue to finance their economic and social development sustainably,[3] without accumulating unaffordable debt burdens, and they have the potential to do so.[4] Increasing revenue can also help meet the objective of reducing income and opportunity inequalities and minimizing reliance on hydrocarbons revenue. Higher revenue can be achieved through a combination of tax policy and administrative reforms, along with broader reforms to advance institutional development and greater economic diversification.

Designing tax systems in the MENA region presents opportunities and challenges. Key global and regional trends—technology and digitalization, international tax cooperation, fragility and conflict, and climate change—will continue

[1] Informality takes several forms, including hiding income, concealing whole economic activities, working illegally, and consuming illegally traded goods and services.

[2] History and legal traditions may also have had an impact on how tax systems in the region have developed. For example, most countries with French legal traditions have wealth transfer or inheritance taxes and their tax administrations are organized differently from others.

[3] Tax potential in this book refers to a quantitative estimate of a country's maximum achievable tax-to-GDP ratio. Tax capacity is a wider concept, defined in Benitez and others (2023) as "the policy, institutions, and technical capabilities to collect tax revenue."

[4] See for example, Ostry, Berg, and Tsangarides (2014); Ostry, Loungani, and Berg (2019); and Cerra, Lama and Loayza (2021).

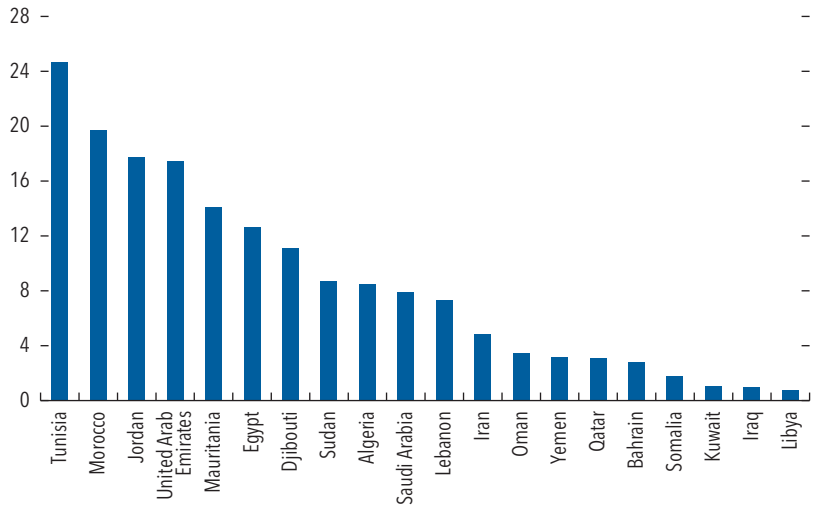
TABLE 2.1.

MENA: Selected Economic and Government Revenue Indicators

	Hydrocarbon Exporters						Hydrocarbon Importers					
	Country	Population (millions)	GDP Per Capita (PPP)	GDP Per Capita (USD)	Tax-to-GDP Ratio (%)	Revenue-to-GDP Ratio (%)	Country	Population (millions)	GDP Per Capita (PPP)	GDP Per Capita (USD)	Tax-to-GDP Ratio (%)	Revenue-to-GDP Ratio (%)
Fragile states	Iraq	42.2	11,948	6,181	1.1	39.8	Djibouti	1	6,502	3,604	11.4	19
	Libya	6.8	21,104	5,577	0.7	82.7	Lebanon	6.6	11,794	3,283	7.4	9.8
	Yemen	33.3	2,035	707	3.4	8.5	Somalia	15.6	1,928	667	1.7	5.4
							Sudan	46.7	4,366	723	6.5	12.5
							Syria	21.4	6,374	2,807	13.2	22.4
Nonfragile states	Algeria	45.3	12,900	4,307	9.7	27.6	Egypt	103.6	16,174	4,587	12.6	16.8
	Bahrain	1.5	58,426	28,781	2.8	20.9	Jordan	10.3	12,055	4,613	17.4	25.3
	Iran	85.7	18,865	4,043	4.9	8	Mauritania	4.3	7,113	2,285	13.9	23.6
	Kuwait	4.9	51,238	36,092	1.1	60.2	Morocco	36.7	9,900	3,570	19.7	26.2
	Oman	4.9	38,699	23,240	3.6	33.7	Tunisia	12.1	12,723	3,822	24	27.1
	Qatar	4.9	109,160	83,521	3.4	26.2						
	KSA	32.2	66,836	34,441	8.3	30						
	UAE	9.9	84,657	51,400	15.2	31.6						

Sources: IMF, World Revenue Longitudinal Database (November 20, 2024); IMF, World Economic Outlook Database; and World Bank, World Development Indicators Database.
Note: Total and tax revenues are averages for 2021–22 or for 2021 only, depending on data availability. Djibouti was declassified from the fragile state list in 2023, because data for Djibouti are for 2021–22, it is classified as a fragile state in this table. Population and GDP per capita (both in PPP and US dollars) are for 2022 except for Syria, whose GDP per capita is for 2010, and tax and total revenue are averages for 2009–10. KSA = Kingdom of Saudi Arabia; PPP = purchasing power parity; UAE = United Arab Emirates; USD = United States Dollar.

Figure 2.1. Tax Revenue in MENA Countries
(Percent of GDP, 2022)



Source: IMF, World Revenue Longitudinal Database (November 20, 2024).
Note: Data for Bahrain, Lebanon, and Morocco are for 2021.

to affect tax policy and outcomes in the region and are likely to inform countries' policy choices. However, uncertainty surrounds these trends, making it necessary to consider how countries might structure or reform their tax systems under geopolitical and technological scenarios that are likely to shape the future.

REGIONAL REVENUE TRENDS

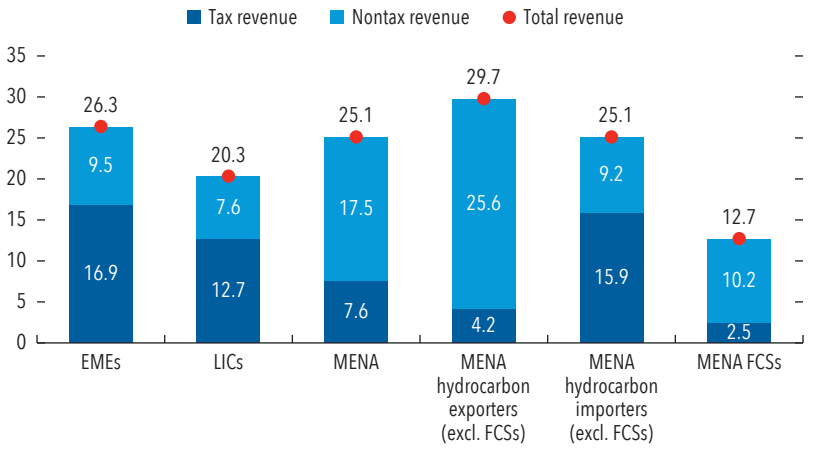
Tax Level

Tax-to-GDP ratios vary significantly across the region, ranging from as little as 1 percent of GDP in Iraq and Libya to more than 24 percent in Tunisia (Figure 2.1). In some countries, low tax-to-GDP ratios reflect deliberate policy choices (for example, the resource-rich Gulf Cooperation Council [GCC] countries, which receive abundant nontax revenue from oil and gas). In other countries, low tax ratios result partly from institutional constraints and fragility (for example, Somalia, Sudan, and Yemen).

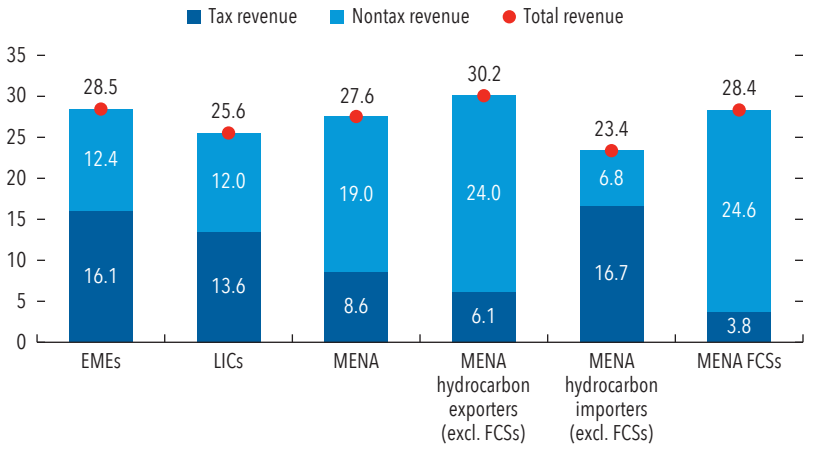
In 2022, the median tax revenue in the region was 7.6 percent of GDP, which is notably lower than the 16.9 percent of GDP observed in emerging market economies worldwide and the 12.7 percent of GDP for low-income countries (LICs; Figure 2.2, panel 1). However, total revenue is comparable to other emerging market economies and exceeds that of LICs, reflecting a relatively larger share of nontax revenue in the region from resource-related revenue, which constitutes more than half of the region's total government revenue (Figure 2.2, panel 2).

Figure 2.2. Total Revenue and Tax Revenue in MENA Region and Other Emerging Markets
(Percent of GDP, 2022)

1. Median



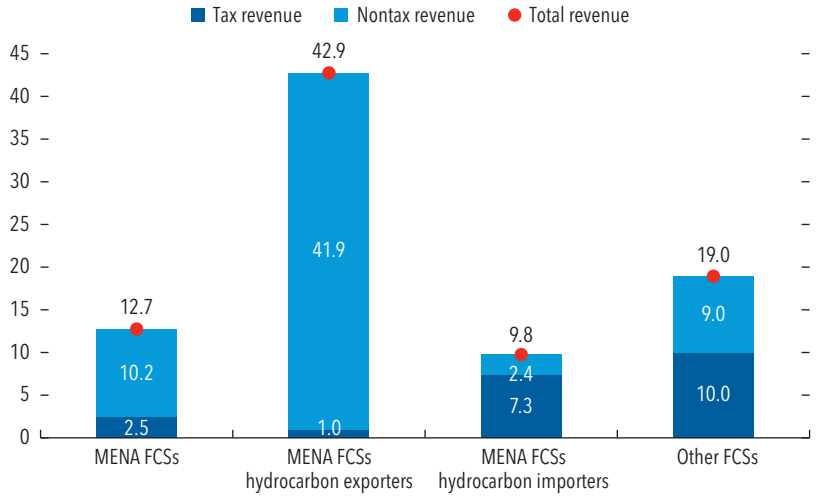
2. Average



Sources: IMF, World Revenue Longitudinal Database (November 20, 2024); and authors' calculations.
Note: The sample of countries for the MENA region excludes Syria. Data for Bahrain, Lebanon, and Morocco are available only up to 2021. For other regions, 2021 data was used if data were not available for 2022. EME = emerging market economy; excl. = excluding; FCS = fragile and conflict-affected state; LIC = low-income country; MENA = Middle East and North Africa.

Tax-to-GDP ratios are especially low in fragile and conflict-affected states (FCSs) in MENA—the median was 2.5 percent in 2022, which is about one-fourth of the median of FCSs in other regions (10.2 percent). Resource-rich FCSs in the region generate the lowest tax revenue of about 1 percent of GDP, relying

Figure 2.3. Revenue Mobilization in Fragile Countries
(Percent of GDP, median 2022)



Sources: IMF, World Revenue Longitudinal Database (November 20, 2024); and authors' calculations.
Note: Fragile and conflict-affected states exclude Afghanistan, Eritrea, Syria, and Venezuela. Data for Cameroon, Lebanon, Micronesia, and Ukraine are available only up to 2021. FCS = fragile and conflict-affected state; MENA = Middle East and North Africa.

mostly on nontax hydrocarbon revenues. By contrast, hydrocarbon-importing FCSs (Lebanon, Somalia, Sudan) have a median tax-to-GDP ratio of 7.3 percent (Figure 2.3), though with a wide range from 1.7 percent of GDP in Somalia to 8.7 percent of GDP in Sudan for 2022.

Although the region's tax levels remain low compared with other regions, some countries have increased them since 2000. Five of 11 hydrocarbon-exporting countries recorded increases in nonhydrocarbon tax revenue relative to nonhydrocarbon GDP (Figure 2.4), signaling gradual efforts to broaden the tax base and reduce reliance on oil-related revenues.[5] Similarly, some hydrocarbon importers (notably Mauritania and Tunisia) have achieved sizable gains, with tax revenue rising by more than 5 percentage points of GDP.[6]

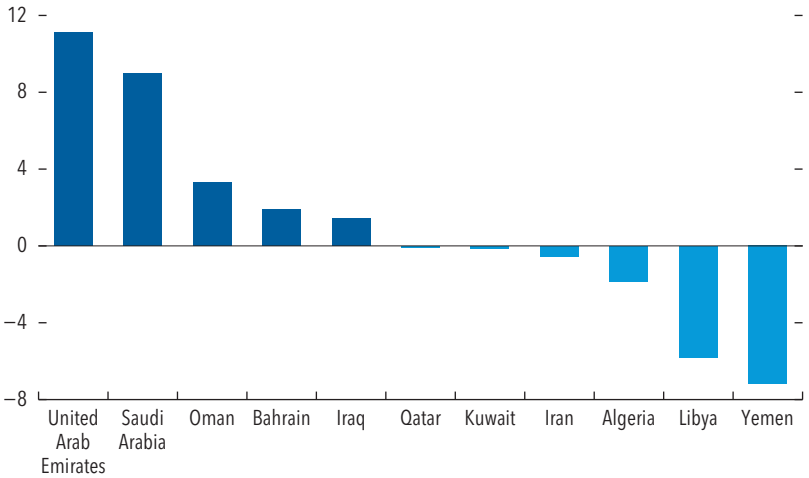
Tax Mix

In addition to the level of taxation, the tax revenue mix is an important factor determining the impact of tax systems on revenue and on growth and

[5] For this group of countries, the ratio of nonhydrocarbon (tax) revenue to nonhydrocarbon GDP illustrates the evolution of tax levels in percent of GDP more accurately, because hydrocarbon GDP (and related nontax revenues that accrue to the state) are more volatile than nonhydrocarbon or total GDP (and related tax revenue).

[6] Based on 2024 data from the IMF World Revenue Longitudinal Database, November 20, 2024 (https://www.imf.org/en/Topics/fiscal-policies/world-revenue-longitudinal-database).

Figure 2.4. Nonhydrocarbon Tax Revenue in MENA Hydrocarbon Exporters
(Percent change of nonhydrocarbon GDP, 2002–22)



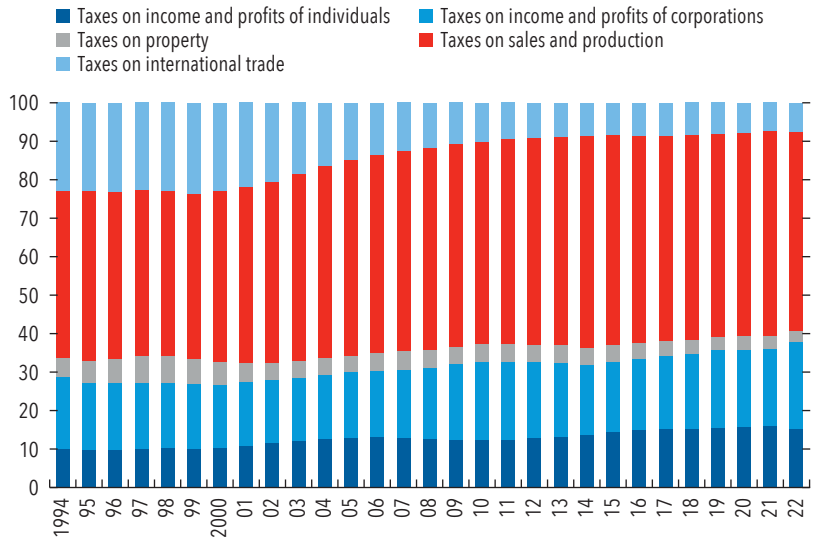
Sources: IMF, World Revenue Longitudinal Database (November 20, 2024); October 2024 *Regional Economic Outlook: Middle East and Central Asia*; and authors' calculations.
Note: Data for Bahrain compare 2010 and 2021 periods. The earliest available data for Iraq are 2004.

inequality—consumption taxes are less distortive to growth while personal income taxes are better suited for income redistribution objectives. Consumption taxes in the region generate about half of all tax revenue, and the value-added tax (VAT) is the main source (Figure 2.5). This share has increased since the mid-1990s. Some countries (Iraq, Kuwait, Libya, Qatar) do not have a broad-based consumption tax. Revenues from taxes on international trade were an important source in the 1990s but have declined over time in the context of trade liberalization (Baunsgaard and Keen 2010; Mansour 2015; Cagé and Gadenne 2018). Revenues from direct taxes on corporate and individual income are substantial and have increased somewhat since 2000.[7] However, income taxation is low or absent in some countries, mainly GCC members. Taxes on property have been low—ranging from zero to 1 percent of GDP—and have declined slightly.

Tax systems can contribute to reducing income inequality by taxing higher incomes at higher rates—that is, by increasing the average tax rate as income increases. Income taxes can be (and often are) designed to be progressive, while other taxes are often proportional to income or regressive. However, less-progressive taxes can reduce inequality if the expenditures they finance benefit mainly

[7] Profit tax revenue from corporate income taxes is part of tax revenue, including for companies operating as service providers to the upstream oil and gas sector (exploration and extraction) and to the midstream sector (oil refining and petrochemicals). Detailed sectoral data are hard to obtain, but this classification (which follows the IMF's Government Finance Statistics Manual 2014) could mostly explain the changes in Figure 2.4 in some hydrocarbon-exporting countries.

Figure 2.5. MENA Region Tax Revenue Composition by Tax Type
(Share of total tax revenue)



Sources: IMF, World Revenue Longitudinal Database (November 20, 2024); and authors' calculations.
Note: The year indicated is the end year of a five-year moving average.

low-income households. Looking at Gini coefficients for market and disposable incomes,[8] the redistributive impact of the tax-benefit system in MENA is relatively weak compared with advanced economies and other emerging market economies (Figure 2.6). This weakness is partly due to the limited progressivity of income taxes at relatively high-income levels, especially for capital income (see Chapter 3 on personal income taxes), but it also results from a lack of redistributive transfers. A more progressive tax-benefit system could help reduce poverty and enhance inclusion while helping promote more durable growth and a more stable sociopolitical environment (Shafik 2018).

Tax Administration and Tax Policy

Weak tax compliance, often linked to shortcomings in tax administrations (see Chapter 10), is a contributing factor to the low tax revenues in MENA countries, which is also reflected in increasing informality in several countries (Figure 2.7). This trend could also reflect an increasing share of self-employment, which is generally hard to tax (Cardarelli and others 2022).[9] Rising noncompliance might

[8] These are, respectively, gross earned income before tax and transfers, and net disposable income after tax and transfers.

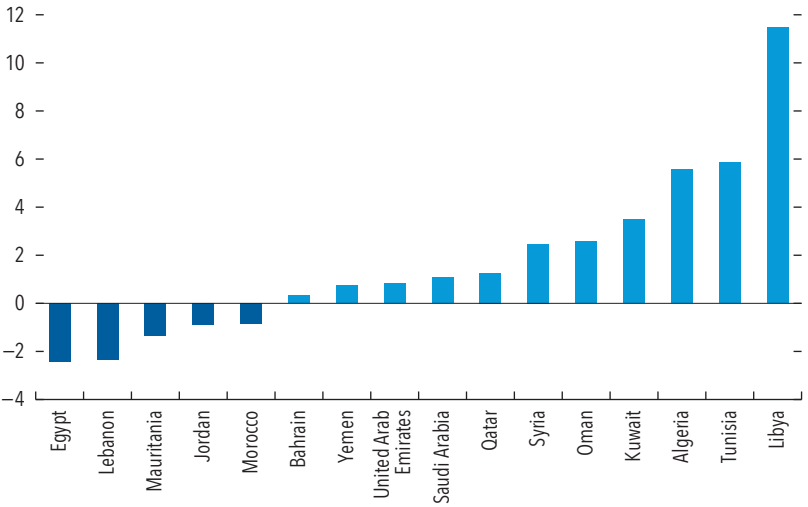
[9] Indicators of informality should be interpreted with caution, because uncertainty surrounds the methodology.

Figure 2.6. MENA Region Income Inequality and Redistribution

Source: Standardized World Income Inequality Database (Version 9.7, September 2024).
Note: Data are the latest available per country. The tax and transfer system is effective in redistributing income and reducing inequality when the Gini coefficient for disposable income is lower than that for market income.

Figure 2.7. The Shadow Economy in MENA Countries

(Percent of GDP, change between the average for 2006–08 and 2015–17)



Source: Medina and Schneider 2018.
Note: A negative value indicates that the shadow economy declined; a positive value indicates that it increased.

induce a vicious circle by encouraging compliant firms to seek tax-reducing strategies to remain competitive (Kanbur and Keen 2014).

Poor tax design is another reason tax revenues are low. Tax bases in MENA countries are often narrow because of the prevalence of tax expenditures, which are forgone revenue from special tax treatments such as exemptions, deductions, credits, preferential rates, and sometimes tax deferral (Heady and Mansour 2017). They might not always achieve their intended objectives and can result in substantial revenue loss that is hidden if governments do not report it annually.[10] For example, state-owned enterprises in the region often benefit from tax advantages and exemptions, including in Egypt, Lebanon, and Libya (Rigo and others 2021). Egypt and Jordan have established special economic zones that provide tax incentives to businesses (see Chapter 4 for more details).[11]

Resilience

Many MENA economies rely on hydrocarbon exports, which makes public revenues especially vulnerable to shocks in oil and gas prices and production. This vulnerability was evident at the outset of the COVID-19 pandemic, which had a large impact on nontax revenue from hydrocarbon exports. Governments also provided tax relief during the pandemic, which contributed to a decline in tax revenue but much less than the decline in hydrocarbon revenue. In 2020, revenues declined in hydrocarbon exporters by 5.2 percent of GDP, and in FCSs, the reduction was 6 percent of GDP, also largely because of a decline in nontax revenue (Figure 2.8, panel 1). Revenues also declined significantly for hydrocarbon exporters during the oil-price slump of 2014–15 (Figure 2.8, panel 2). For FCSs, the largest shock to revenue occurred during the Arab Spring in 2010–11. Hydrocarbon-importing countries had much more stable revenue performance during each of those episodes, indicating that tax revenue was more resilient than hydrocarbon revenues.

The recovery in tax revenue across the region in the aftermath of COVID-19 was also uneven. Only a few countries had higher tax-to-GDP revenue in 2022 compared with prepandemic years (Figure 2.9).

Tax Potential

Tax potential refers to the empirical maximum level of tax revenue achievable in a country, given its economic structure and the quality of its institutions. This analysis generally controls for factors such as trade openness, corruption perception, and the presence of hydrocarbons, which are important determinants of a

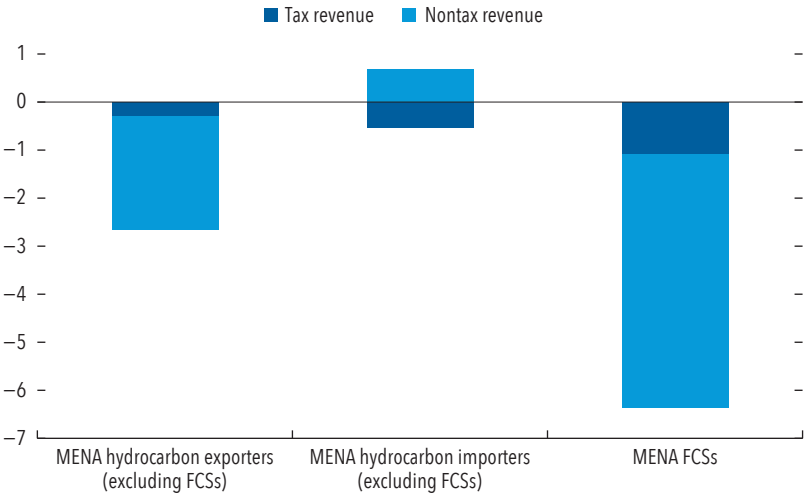
[10] MENA countries do not publish tax expenditures reports except for Morocco, which reports a tax expenditure of nearly 2 percent of GDP for taxes on goods and services and 0.75 percent of GDP for income taxes.

[11] Egypt offers a reduced turnover tax rate of 1 percent within the special economic zone, which is retained by the zone's administrative authority. Jordan's Aqaba special economic zone provides a reduced corporate income tax rate of 5 percent.

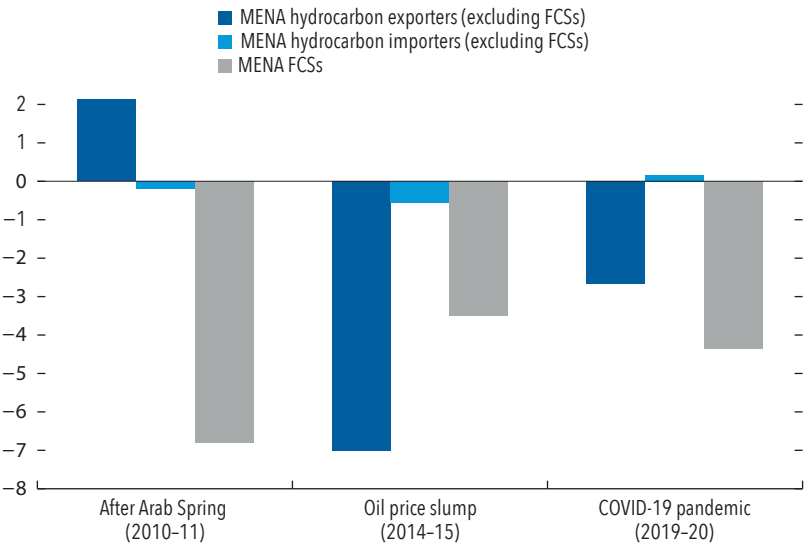
Figure 2.8. External Shocks and Changes in Government Revenue

(Percent of GDP)

1. Change in Total and Tax Revenue 2019–20

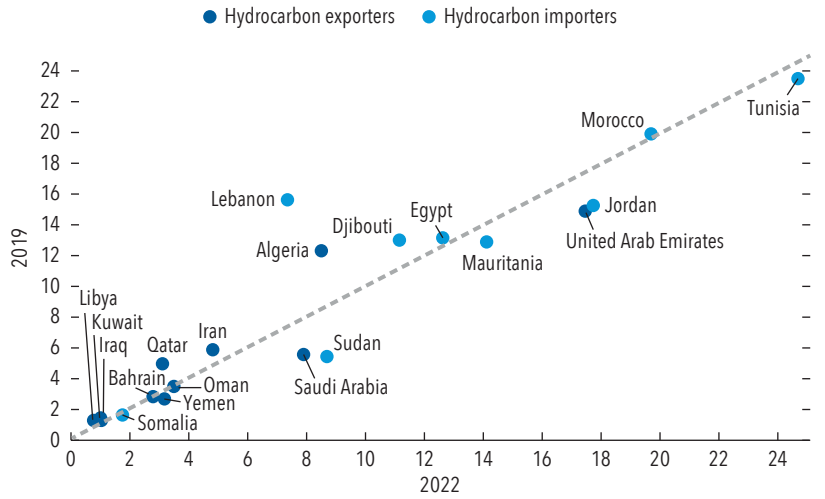


2. Change in Revenue after Selected Shocks



Sources: IMF, World Revenue Longitudinal Database (November 20, 2024); and authors' calculations.
Note: FCS = fragile and conflict-affected state; MENA = Middle East and North Africa.

Figure 2.9. COVID-19 and Changes in Tax Revenue
(Percent of GDP, change 2019–22)



Sources: IMF, World Revenue Longitudinal Database (November 20, 2024); country authorities; and authors' calculations.
Note: Countries above the 45-degree line lost tax revenue between 2019 and 2022. Data for Bahrain, Lebanon, and Morocco are included up to 2021.

country's tax potential. Comparing a country's tax potential with its actual revenue provides an estimate of the tax gap, which is the additional revenue that would be feasible compared with the current level if a country were to realize its full tax potential. Countries can reduce the tax gap through policy reforms and improvements in tax compliance.[12]

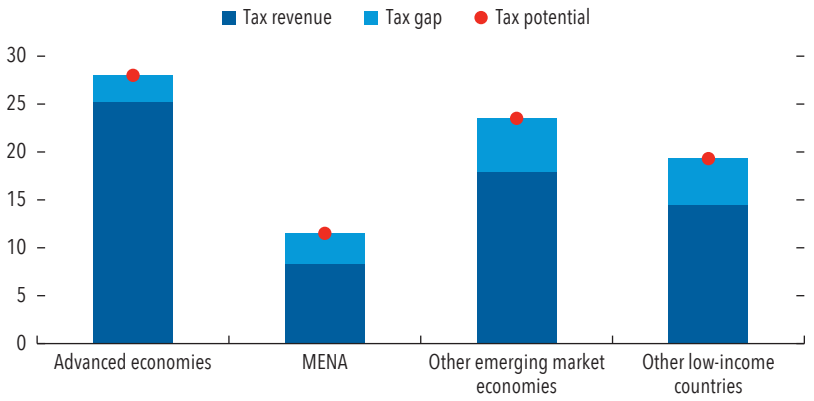
The analysis in this book uses a recent update of the IMF's World Revenue Longitudinal Database (Mansour and others 2025) and the methodology in Benitez and others (2023) to provide a fresh perspective on the tax potential and tax gap of MENA countries. Figure 2.10 presents the results, which indicate a relatively low tax potential in the region on average. For example, the tax potential of emerging market economies (EMEs) or LICs in other regions is about 20 percent of GDP but about 11.5 percent of GDP in the MENA region. This is due to several factors, such as reliance on hydrocarbon revenue and institutional fragility.

Figure 2.10, panel 2 shows that the relatively low tax potential in the region is mainly observed in hydrocarbon exporters and LICs. Hydrocarbon-importing countries (excluding LICs) have an average tax potential of 22.5 percent of GDP, similar to EMEs in other regions. However, actual tax revenue is only 16 percent

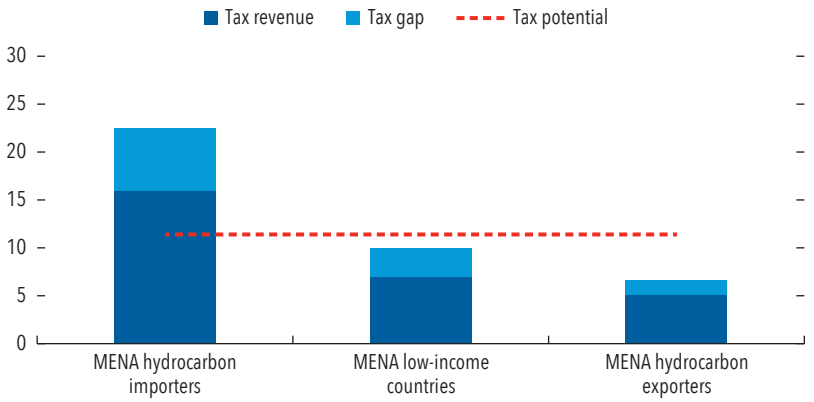
[12] A country's tax potential does not necessarily correspond to a desirable level of tax revenue. Instead, it helps to explain how a country could use policy and administrative measures to raise additional revenue.

Figure 2.10. MENA: Comparison of Actual and Potential Tax Revenue, 2021
(Average, percent of GDP)

1. Tax Revenue, Tax Potential, and Tax Gap by Country Group



2. Tax Revenue, Tax Potential, and Tax Gap in MENA Region



Sources: Authors' estimates based on IMF, World Revenue Longitudinal Database (November 20, 2024); and World Bank, World Development Indicators.
Note: In panel 1, "MENA" is excluded from the other three groups. In panel 2, "MENA hydrocarbon exporters" includes Algeria, Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates, and excludes low-income countries. "MENA hydrocarbon importers" includes Egypt, Jordan, Morocco, and Tunisia, and excludes low-income countries. "MENA low-income countries" includes Djibouti, Mauritania, and Sudan. MENA = Middle East and North Africa.

of GDP in this group, implying an average tax gap of 6.5 percent of GDP. Hydrocarbon-exporting countries exhibit a relatively low average tax potential of 6.6 percent of GDP and actual average revenues of 5.1 percent of GDP, implying

a modest average tax gap of 1.5 percent of GDP.[13] This low gap reflects the reliance on hydrocarbon nontax revenues.

The region's LICs have an average tax potential of 10 percent of GDP and actual revenue of 7 percent of GDP, implying a tax gap of 3 percent. Although this gap is smaller in absolute terms than in the region's hydrocarbon importers or in LICs in other regions, it is relatively large at more than 42 percent of their actual tax revenue.

Wide differences in tax revenue outcomes across subgroups in the MENA region underscore the need for country-tailored strategies. For example, hydrocarbon exporters could accelerate diversifying their economies, which can raise tax potential. Similarly, LICs could accelerate their efforts to improve institutions or increase trade openness—both important determinants of tax potential. Structural reforms in these areas would generate broad-based economic benefits and, together with reforms to tax policy and administration, would enhance revenue mobilization.

TRENDS SHAPING TAX SYSTEMS

Global and regional developments will shape future tax reforms in the region, and those developments will be largely outside the control of tax policymakers. Four major trends are particularly important: digitalization, fragility, climate change, and international tax cooperation.

Digitalization

Digital technologies have changed taxation profoundly. The abundance of information in digital format and the capacity of governments to process and use such information to improve tax compliance has been transforming tax administrations globally. Furthermore, new taxes have been introduced (such as on digital services) or existing taxes reformed (such as VAT on digital trade). However, growth of digital trade and expansion of intangible digital assets (such as algorithms) have also created new challenges for governments in collecting and enforcing existing taxes.[14] For example, the expansion of cryptocurrencies and the quasi-anonymity of the transactions challenges governments to redefine tax bases for VAT and income tax and rethink their enforcement mechanisms (Baer and others 2023).

[13] The results for hydrocarbon exporters should be interpreted with caution, because the tax potential methodology is not well suited for these countries. The classification of tax and nontax revenue could also have an impact on the results, because revenue from corporate income taxes, for example, is classified as tax revenue, unlike other hydrocarbon revenues, even if they have attributes similar to profit taxes—for example, dividends from state-owned enterprises and profit sharing from oil and gas activities.

[14] See Amaglobeli and others (2023), Gupta and others (2017), and IMF (2018) for a general review of challenges and opportunities for tax design and implementation (and fiscal policy more generally) in the digital age.

The progress in digitalization in tax administrations has been uneven around the world (Amaglobeli and others 2023). For example, until recently, taxpayer online registration was available in 97 percent of advanced economies but in only 50 percent of LICs, which also lag in e-filing and e-payment (Nose and Mengistu 2023). Digitalization can also help mitigate tax arrears, reduce administrative and compliance costs, and improve services to taxpayers, such as e-invoicing and prefilled tax returns. Artificial intelligence (AI) has the potential to accelerate the digital transformation and improve tax enforcement, given the critical role of information and data. For example, it could make it possible to design a personalized progressive VAT (de la Feria and Swistak 2024), implement an income tax based on lifetime income, or tax property on real-time market values. However, the speed, scope, and scale of these potential changes are still largely unknown.

MENA countries on average lag other parts of the world in digitalizing economic activity and using it in government operations. Cusolito and others (2021) find that the region's digital payments use lags comparator countries, even though it leads comparators in using digital technologies for social activities, such as Facebook. This could suggest that digital technology enablers for economic use, such as citizens' trust in financial markets and governments, are relatively low in the region. Merhej (2021) assesses digitalization efforts in three MENA countries (Egypt, Saudi Arabia, United Arab Emirates) against the OECD's Going Digital Integrated Policy Framework. The assessment finds that although some progress has been made, more improvements are still feasible, including in enabling policy areas such as structural reforms in the public sector (Egypt), frameworks and public action to increase citizen trust in online transactions (Saudi Arabia), and making more data available publicly on digital transformation indicators (United Arab Emirates).

Fragility and Conflicts

Fragility and conflicts have increased in the region and globally. The Peace Research Institute of Oslo notes in a recent study that the number of state-based conflicts globally reached 59 in 2023 and has consistently exceeded 50 since 2013 (Rustad 2024). This sharp increase comes after a decline from a peak of 50 conflicts in 1989 to 35 in 2010, and it is three times higher than the number in 1945 at the end of World War II.

Crucially, policy needs to cater to what is feasible in such an environment, keeping simplicity as the overriding objective. Mansour and Schneider (2019) study the evolution of FCSs between 2008 and 2018. Based on revenue mobilization successes and failures in these states, the authors propose a two-stage framework for building or reforming tax systems in FCSs.[15]

[15] Fragility and conflicts have broader challenges for fiscal policymaking—tax policy is just one among several policy instruments to rebuild the state. See Chami, Espinoza, and Montiel (2021) and IMF (2022b) for a comprehensive account.

In the first stage, tax design should aim for simplicity and high concentration of collection points. Indirect taxes lend themselves to this stage—for example, turnover taxes with a high exemption threshold, a few excises, simple tariff regimes, and withholding on interest income at banks. During this stage, tax policy objectives that are difficult to achieve—such as a high level of redistributive capacity of income taxes—should be avoided, because the lack of capacity to implement them will undermine the rule of law, with little revenue collection. Corporate profit taxes can be applied to large companies, including state-owned enterprises. Taxes based on cash flow are appealing because of their simplicity and neutrality properties.

The second stage depends on the progress made in resolving conflict or fragility and is most likely to occur over the medium to long term. As conflict or fragility abate, the tax system could evolve into a more modern system. Taxes could be based on the key principles of capacity to pay (progressive income taxes and narrow wealth taxes) and neutrality (taxes on broader bases through more companies and individuals participating in the tax net). For example, turnover taxes can be expanded while scaling back external tariffs by lowering exemption thresholds, introducing limited deductibility for taxes on inputs, and ultimately adopting taxes structured like VATs. The tax administration's capacity will need to be scaled up to enforce such taxes effectively.

Fragility and conflict have different implications for tax policy and administration in the region's hydrocarbon exporters and importers. Exporters can leverage nontax revenue from oil and gas to build tax capacity and institutions while keeping tax rates relatively low in the first stage. Importers do not have this opportunity and must rely on relatively higher tax rates to mobilize revenue.

Climate Change

In Paris in 2015, countries agreed to collectively reduce greenhouse gas emissions in the atmosphere and pledged nationally determined contributions to achieve their goals. More recently, several countries have also committed to targets for zero net carbon emissions by mid-century (that is, a zero balance of gross carbon emissions and negative emissions from carbon sinks, through technology such as carbon capture and storage). Yet large ambition and implementation gaps remain, and an enduring turndown in emissions is yet to materialize.

The global energy transition will have significant implications for the region's fossil fuel exporters (see Chapters 8 and 9).[16] The adverse fiscal and economic impact of a permanent decline in the long-term global demand for fossil fuels will require structural reforms and diversification strategies that support alternative growth engines and government revenue sources.

Countries will also need to consider policies to support their own decarbonization. A first step can be to phase out explicit fossil fuel subsidies, which are still

[16] Mesa Puyo and others (2024) discuss in detail the challenges faced by fuel exporters during the energy transition.

prevalent in many countries and provide perverse incentives to decarbonize. Subsequently, they can consider a policy mix of pricing and nonpricing instruments to steer their economies toward decarbonization (see Chapter 9). To the extent that carbon pricing is part of the mix, it can also contribute to domestic revenue mobilization.

International Tax Coordination

International tax coordination can help address the cross-border spillover effects of domestic tax policies, for example, tax base shifting or tax competition. Global or regional coordination can cover policy design or administrative cooperation, or apply to different tax types such as corporate, personal, or consumption.[17] Tax coordination is most common in economically integrated regions, such as the European Union, but recent developments mark progress at the global level.

Since the 2008 global financial crisis, several initiatives have attempted to advance international tax coordination with two aims: ensure a robust system for taxing the profits of multinational enterprises, including by addressing profit shifting and tax competition; and increase the transparency, volume, quality, and timeliness of information sharing between countries for tax purposes.

Regarding the taxation of multinationals, the 2015 OECD/G20 Base Erosion and Profit Shifting Project introduced minimum standards and common approaches to tackle profit shifting through stricter anti-tax avoidance rules and enhanced transparency. Negotiations later took place in the newly established OECD/G20 Inclusive Framework, which currently has more than 140 member countries. In 2021, countries agreed to go beyond the initiative's standards by introducing a global minimum corporate income tax of 15 percent, aiming to address both profit shifting and tax competition. The IMF staff estimate that this tax will raise corporate income tax revenue globally by about 6 percent.

The other recent development involves the Global Forum on Transparency and Exchange of Information for Tax Purposes, which has become the primary forum for promoting a global exchange of information based on the Common Reporting Standard. Today, the Global Forum's membership includes more than 170 countries. Automatic exchange of information has become the new global norm, and actual exchanges have been in place since 2018. The aim is to support tax administrations in fighting offshore tax evasion, and early evidence indicates that it has already had an impact on global capital flows and revenue from offshore capital income (see, for example, EU Tax Observatory 2024).

The ongoing international tax reforms allow for more effective taxation of large multinationals and wealthy individuals, providing governments with greater

[17] Keen and Konrad (2013) provide a survey of the theory and issues with coordinating capital income taxes. IMF (2022a) includes a discussion of the OECD/G20 Inclusive Framework's global minimum tax on corporate profits, the coordination of climate mitigation policies through carbon taxes, and nomad work. The European Union is the most cited example of regional tax coordination. Another example is the West African Economic and Monetary Union, about which Mansour and Rota-Graziosi (2013) provide an account.

capacity to strengthen the fairness and progressivity of their tax systems. Even though these coordination efforts will likely make a positive revenue contribution, the impact is modest compared with the large revenue needs faced by many countries and especially developing economies. More tax coordination will be important, notably by accepting simplified approaches that can help developing countries to protect their tax bases. Furthermore, significant revenue potential lies in other areas of international tax coordination such as carbon taxation, which is a powerful way to meet global climate objectives, including levies geared toward international transportation, which are currently exempt from all fuel taxes.

The future of international tax coordination and their implications for MENA countries are both highly uncertain. Pillar 1 of the global tax agreement, which aims to create a new taxing right in market countries as a way to address challenges in the digital economy, is currently on hold while the design and implementation of Pillar 2—the global minimum tax—is ongoing (see Chapter 4). For MENA countries, Pillar 2 creates opportunities for enhanced revenue mobilization. For example, the global minimum tax makes it less attractive for the countries to compete by setting a minimal or zero profit tax rate or generous tax incentives, because other countries could then levy a top-up tax to undo the (uncertain) benefits from such policies.

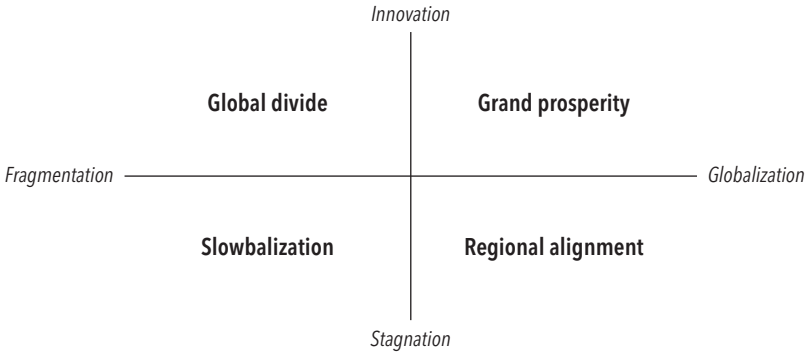
SCENARIOS FOR THE FUTURE OF TAXATION

The trends discussed in the previous section are uncertain and largely outside the influence of policymakers in MENA countries. Therefore, how should policymakers think about tax reform in the coming years and decades? To explore this question, four scenarios were developed representing alternative futures of the world. The scenarios serve as exogenously given environments in which tax policymakers will have to decide how to shape their tax systems. Figure 2.11 identifies the scenarios along two axes that reflect two key dimensions of fundamental and exogenous uncertainty.

The first key uncertainty relates to international cooperation: how geopolitical relations will evolve over the coming decades in areas such as climate, trade, international taxation, and the governance of digitalization and AI. Fragmentation versus globalization reflects this uncertainty at the two extremes (Figure 2.11, horizontal axis). At one extreme, fragmentation, the world is characterized by inward-looking nations that aim to serve their self-interest and are focused on national identities. International cooperation in policy setting stalls, and political tensions abound. Sustained fragility and conflicts also characterize this world. At the other extreme, globalization, countries engage in effective international cooperation; fragility and conflict are addressed effectively; and several FCSs can develop gradually.

The second uncertainty relates to technology (Figure 2.11, vertical axis) and is described by innovation versus stagnation. In a world of innovation, digital technology and AI evolve rapidly. Though displacing some jobs, automation through

Figure 2.11. Four Scenarios of the Future



Source: Authors.

generative AI largely supports human productivity and provides opportunities for governments to advance in policy design and implementation (for example, tax collections). Innovation also enables faster reduction in the cost of decarbonization. At the other extreme, a world of stagnation, advancements in digitalization are slower, and automation is more likely to replace jobs instead of complementing them, which then reduces the social support for new technologies. Green technologies remain expensive and uncompetitive relative to fossil fuel technologies.

Combining the two key uncertainties on the horizontal and vertical axes, four different scenarios of the future are identified: grand prosperity, global divide, slowbalization, and regional alignment. How the world evolves in each of these scenarios has implications for tax policy design and administration, including in the MENA region.

Grand Prosperity

Innovation and globalization flourish together in this scenario. Significant innovations drive the energy transition, encouraging hydrocarbon producers to expedite their shift towards alternative energy sources and related technologies, such as critical minerals essential for renewable energy. Countries successfully negotiate a climate agreement that sets the world on a trajectory toward achieving net zero emissions by mid-century. Free trade reinforces technology transfers and contributes to the sustainable development agenda. Global cooperation plays a crucial role in alleviating debt challenges faced by LICs, contributing to a more stable international landscape. As nations enhance their tax effort (their capacity to reduce their estimated tax gap), some convergence in tax-to-GDP ratios is observed globally, reminiscent of trends seen in advanced economies during the second half of the 20th century.

As revenues from hydrocarbons and trade tariffs decline, tax policy should increase revenues from property, consumption, and income taxes. These taxes will

gain a larger share in the overall tax mix, even in MENA hydrocarbon exporters and FCSs, where reformed tax systems emerge as vital sources of state revenue and state capacity. With a growing portion of consumption supplied digitally by nonresident companies through e-commerce and digital services, the need to establish or strengthen VAT-style consumption taxes has become urgent to tax cross-border digital trade effectively. Digitalization and AI will also enhance tax administration capabilities and improve tax compliance. Carbon tax revenues will rise initially but will diminish gradually as economies progress toward net-zero emissions.

Exchange of information between countries and advancements in digitalization facilitate more effective implementation of personal and corporate income taxes. As MENA countries improve tax compliance, they can move their personal income tax systems closer to a global income tax model, taxing capital income comprehensively at prevailing progressive rates or at least more effectively. As a result, income taxation contributes to addressing inequality more effectively. As the middle class becomes a larger share of the population, personal income tax revenue can be expanded in LICs. Furthermore, as countries establish an effective floor on tax competition, they can maintain some taxation at source through corporate income taxes, with likely effective tax rates of 15 to 20 percent.

Global Divide

AI develops at a rapid pace and enhances productivity in advanced economies and some large emerging market economies but not in other country groups, and diffusion of new technology across borders is limited because of fragmentation. Policies in advanced economies and emerging market economies are marked by protectionism and subsidies. Yet the new technologies displace labor, amplify market power, and contribute to rising income inequality within countries. Insufficient global cooperation hampers the green transition, but advancements in technology in advanced economies yield some progress in decarbonization, though not enough to achieve a path toward net zero emissions. Thus, the gap in living standards between countries widens, and inequality between developed and developing nations increases, fueling global and regional tension, conflict, and migration pressure.

In this scenario, nontax revenue from hydrocarbons persists at elevated levels in hydrocarbon exporters, while tariff revenue continues to play a significant role for revenue mobilization in LICs. This diminishes the urgency for the region's hydrocarbon producers to enhance their tax capacity, especially regarding income taxes. FCSs in the region would find it hard to adopt more modern tax systems and continue to rely on simple transaction and trade taxes. Limited access to information and a lack of digitalization in LICs implies that effective capital taxation also remains low.

In the more advanced economies, automation displacing labor reduces labor income tax revenue. Consequently, personal income tax remains subdued, and the overall tax system fails to address income inequality effectively. Limited international cooperation leads to rampant tax competition such as tax holidays and

tax-favored special economic zones, driven by self-interest and populism. The decline of source-based taxes prompts countries to rely more heavily on destination-based consumption taxes, such as VAT and excises. In advanced economies, the digitalization of revenue administrations and use of AI help tackle noncompliance, partially offsetting the decline in corporate tax revenues. However, with a growing digital divide, tax capacity remains low in developing countries.

Slowbalization

The world in this scenario is marked by a lack of international cooperation, coupled with limited success in innovation, and thus global growth is the weakest of all scenarios. AI displaces jobs, resulting in higher unemployment and increased inequality. Major cyber risks emerge that spill over across nations and are not addressed or mitigated effectively because of a lack of coordination. Progress in decarbonization is minimal, because new technologies remain costly, and incentives to adopt existing low-carbon technologies are weak. The slow pace of the energy transition exacerbates climate risks, especially in hotter regions such as the MENA region, where climate disasters become increasingly severe and frequent. The continued global reliance on fossil fuels helps maintain nontax revenue mobilization in hydrocarbon exporters. Development stagnates in the poorest countries. Disparities in the world create tensions and conflict, leading to substantial migration pressures.

In this scenario, tax effort is subdued. Revenue from hydrocarbons and trade tariffs remains important in several MENA countries, but they would still fall because of trade barriers and low global growth. Although new digital technologies have the potential to enhance revenue mobilization through better compliance, developing countries' investment in skills, personnel, and leadership is not enough to realize these gains. Corporate tax competition abounds, and information exchange to improve tax compliance is ineffective, thus hindering the development of more effective taxation of capital income. Consequently, taxation cannot play an effective role in reducing inequality. The main options for MENA countries to improve revenue mobilization are through enhanced consumption taxation (such as VAT and excises) and property taxes.

Regional Alignment

Countries are willing to cooperate to tackle pressing global issues such as climate change, conflict, poverty, and health challenges, but technical progress is stagnant, impairing productivity growth and hindering the effectiveness of international cooperation. For example, wealthier nations are less generous in supporting developing countries, and the goal of achieving net zero emissions is beyond reach.

Collaboration within the region is likely to expand under this scenario to address regional spillovers—including in taxation—and to avoid regional conflicts. For example, the GCC is likely to adopt a common approach toward cross-border digital trade and strengthen regional cooperation on corporate

income taxes, following models used elsewhere, such as in the West African Economic and Monetary Union.[18] Countries are also likely to strengthen information exchange. Regional coordination can help sustain and even increase tax levels, but the increase will not be enough to compensate for lower resource revenue, especially in hydrocarbon exporters and FCSs.

The scenario analysis suggests that all countries in the region can and should invest in strengthening the design and enforcement of consumption and property taxes in all four scenarios. However, the success of such undertakings is likely to vary across countries, based on whether they can acquire better technology and use it effectively to enforce those taxes, especially in the global divide scenario and particularly in FCSs. The case of income taxation is less clear cut because of institutional capacity and information asymmetries (such as in FCSs) and political considerations (such as in hydrocarbon exporters). Given the unlikely scenario of grand prosperity in the medium term, building effective and progressive income tax systems in the region could continue to be more protracted politically than building consumption tax systems. Countries in the region are also likely to be slow to adopt mitigation policies to support effective and fast climate transition.

CONCLUSION

This opening chapter surveyed the levels and composition of public revenues in the region, focusing on how the three country subgroups—hydrocarbon exporters and importers and FCSs—have evolved in shaping the outcomes of their tax systems and how exogenous factors and shocks have affected these outcomes. Overall, and despite some progress limited to a small number of countries, tax-to-GDP ratios remain low in the MENA region, particularly in FCSs and hydrocarbon exporters, and taxation plays little role in redistributing income. The factors underlying this picture include deliberate policy choices, as well as exogenous shocks and capacity constraints. Moreover, tax systems in non-FCS hydrocarbon importers have been relatively resilient, while those of the other groups have not, again, due to fragility and/or volatility of hydrocarbon revenues.

The chapter also discussed the key factors that will increasingly shape tax policy design in the region, and four scenarios under which policymakers will have to act to address the challenges of low tax revenue, low redistribution of income through taxation, and to improve the resiliency of tax systems. These scenarios provide a perspective for further analyses in the book, with each chapter dedicated to one major component of tax systems currently in place or possible systems in the future. These chapters provide the region's policymakers with options for reform to consider under various states of what could be a highly uncertain and volatile future.

[18] For more information on tax coordination in the West African Economic and Monetary Union, see Mansour and Rota-Graziosi (2013).

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CHAPTER 3

Personal Income and Wealth Transfer Taxes[1]

Mario Mansour and Eric M. Zolt

INTRODUCTION

Taxes on personal income and wealth transfers play little or no role in most countries in the Middle East and North Africa (MENA) region, yielding on average about 2 percent of GDP in revenue. Like all countries, MENA region countries must reassess how well their tax systems are fit for the 21st century. No simple answer can possibly be right for such a diverse set of countries, but with all countries facing revenue challenges the desirability of the personal income tax (PIT) and the wealth transfer tax is particularly salient. Although raising needed revenues through indirect taxes such as value-added taxes (VATs) and excise taxes is often politically and administratively easier, well-designed income and wealth transfer taxes can play an important role in raising revenue and reducing income and wealth inequalities. In the MENA region, such taxes can also substitute for natural resource revenues.

Income and wealth transfer taxes in MENA countries have evolved since the turn of the century,[2] and what they might look like in the next 20 years is uncertain. Some MENA countries face the choice of whether to introduce such taxes, while others that already have them must decide whether to strengthen them substantially, and if so, how. The direction each country takes will depend on its policy objectives for the taxes; a host of economic, demographic, institutional, and political factors; and the time horizon over which policymakers pursue reforms.

Reviewing PITs and wealth transfer taxes in the MENA region is worthwhile for several reasons. First, these taxes have received little attention from researchers (probably because of their small revenue role).[3] Over the past 20 years or so,

[1] This chapter is based on Mansour and Zolt (2023). Parts of the analysis have been updated to reflect tax systems in 2022.

[2] General net wealth taxes are not discussed. They are perhaps among the most difficult taxes to implement both technically and politically, and because possible improvements in existing income and wealth transfer taxes remain substantial. Recurrent and nonrecurrent taxes on real property (discussed in Chapter 5) are the exception.

[3] Recent studies covering some aspects of PITs include IMF (2016), Jewell and others (2015), Mansour (2015), and Verdier and others (2022). None of these studies extend the analysis to social security

policymakers have not paid much attention to taxing individual incomes, although social security contributions (SSCs) have increased in nearly all countries, and some countries introduced payroll taxes in addition to PITs. More recently, the introduction of VATs and excise taxes in Gulf Cooperation Council (GCC) countries has been the primary focus of fundamental tax changes in the region.

Second, all countries in the region face pressure to maintain or increase spending on social programs. The economic and social impact of recent shocks—including geopolitical ones—will likely increase the level of government spending and the challenges in raising tax revenue. Third, like other regions, MENA countries place greater attention on levels of income and wealth inequality, and the role taxation may play in reducing inequality. MENA countries likely have the highest levels of both income and wealth inequality in the world (Alvaredo, Assouad, and Piketty 2018).

Several developments increase the likelihood that countries could adopt or improve their personal income and wealth transfer taxes successfully. Most MENA countries have VATs that have increased tax administration capacity and effectiveness (and more recently in GCC countries), which could be transferable to income and wealth transfer tax regimes. Changes in technology and digitalization, business practices, and payment methods have the potential to improve the information available to tax authorities. Across regions, greater cooperation among tax authorities will increase transparency and provide access to information about taxpayers' activities and financial holdings outside their country of (tax) residence.

Countries have several options for adopting or reforming income and wealth transfer tax regimes, and economic and political factors can influence policy choices. Throughout the chapter, MENA countries are divided into three groups: hydrocarbon-exporting countries (which corresponds approximately to countries with no PIT or a PIT that raises little revenue); hydrocarbon-importing countries (corresponding approximately to countries with a relatively robust PIT and the tax administration capacity to collect revenue); and fragile and conflict-affected states (FCSs), which have their own particularities.

POLICY DESIGN CONSIDERATIONS

This section describes the various types of PIT regimes available to policymakers in the MENA region, and how economic, demographic, institutional, and political factors influence the choice of PIT regime and policy parameters—such as the level and progressivity of tax rates. These are important considerations, given the differences across countries of the MENA region outlined in Chapter 2.

contributions, an increasing channel through which governments in MENA have been raising taxes on labor income, or to wealth transfer taxes.

Types of PIT Systems

Personal income tax systems generally share a common approach for defining taxable income, adjusting for personal characteristics, and collecting most revenue through pay as you earn (PAYE). Despite these shared features, PIT systems diverge mainly in two ways: the types of income taxed and the share of the population subject to the tax. These distinctions reflect policy choices and the political will and administrative capacity to tax certain income types and groups of individuals.

Tax Regimes by Income Types

One type of PIT regime seeks to tax all forms of income in a uniform manner. These so-called comprehensive global PITs adopted by most developed countries are better classified as semicomprehensive regimes. The PIT systems of all countries fall far short of taxing all income. These systems provide favorable treatment for different income types (including exemptions, rate reductions, and deferral of tax liability). For example, income related to personal residences, health insurance, and retirement benefits generally receive favorable tax treatment, and a substantial portion of income from capital is generally not taxed until the gain is realized and then at favorable tax rates.

Two measures highlight the comprehensiveness of the tax base of a PIT regime: the share of total personal income taxed (adjusting for tax-free thresholds) and the relative split between revenues from different income types. Countries show wide differences in the relative amount of revenue from labor income and from capital income.

Some semicomprehensive PIT regimes are effectively limited to a tax on wages. They focus almost exclusively on taxing income from labor in the formal sector (including public sector employees). Countries generally collect taxes on wages through withholding under PAYE regimes. Although revenue collected under PAYE represents a substantial percentage of PIT revenues in developed countries, it could be higher in developing countries, because capital income is taxed lightly, and administrative capacity is weaker, especially related to taxation of unincorporated entities' business income.

A second PIT regime type seeks to tax all income but treats labor income and income from capital separately (recognizing that substantial challenges exist in separating those income types, especially in owner-employee settings). Such dual tax regimes combine a tax on wages (at progressive tax rates) with a tax on capital (generally at a single rate and often collected through withholding). This type includes both explicit dual income tax regimes (such as those of the European Nordic countries) and more ad hoc regimes that combine a tax on labor income and a series of separate regimes for different types of income from capital (more typical of what MENA countries do). Dual income taxes were first adopted to address the challenges that high-tax Scandinavian countries faced from tax rate cuts in the United States and other countries in the 1980s, and they have become an attractive alternative for many developing countries (Bird and Zolt 2011).

Countries have two primary options regarding taxing business income of noncorporate entities (sole proprietorships and partnerships). One approach—consistent with the semicomprehensive PIT regimes—taxes business income together with other income types at progressive tax rates. Another that is more typical of dual income tax regimes taxes business income at a single flat rate, typically equal to the corporate income tax (CIT) rate. The latter approach is used in Djibouti and Mauritania and for non-GCC nationals in GCC countries. Taxing business income without regard to legal status eliminates the incentive to incorporate where CIT rates are lower than the top PIT rate. Policy rationales in Djibouti and Mauritania (where the choice was made in the context of an existing PIT) differ from those in the GCC (where the choice is largely dictated by the absence of a PIT).

Tax Regimes by Taxpayer Types

Countries can design PIT regimes to target specific portions of the population. For example, a PIT can be designed as a class tax on the wealthy, imposing taxes primarily on high-income individuals. Many early PIT regimes applied only to individuals at the top of the income distribution. A PIT regime can easily be structured to exclude the nonwealthy by adopting a high exempt income threshold, which would exclude most wage earners from the taxpayer population.

Conversely, countries can design a PIT that applies to almost all individuals by adopting a minimal threshold or none at all (for example, Mauritania and Montenegro). The distribution of tax burdens across income levels in this type of mass tax depends highly on the types of income subject to tax (and the rates) and the political and administrative capacity to tax different income types.

PIT regimes that reach a substantial portion of the adult population are in between those two approaches. A substantial tax threshold excludes poor and lower-middle-income individuals but theoretically taxes everyone else. How well this type of regime succeeds in taxing the income of individuals above the threshold depends largely on the state's ability to tax certain sectors of the economy and certain income types.

Factors Influencing the Success of PIT

Several factors can influence tax potential (and tax capacity more generally) and spending levels and could contribute to adopting or expanding PITs successfully. Starting in the 1960s, researchers used cross-country comparisons to identify several factors that explain a significant share of the variance in taxes among countries. The IMF's Fiscal Affairs Department took the lead in identifying which factors were useful in determining differences in tax revenue between countries.[4] The studies focused on the supply-side factors that likely provide tax authorities

[4] See Roy W. Bahl (1971), "A Regression Approach to Tax Level and Tax Ratio Analysis," *IMF Staff Papers* 18 (3): 570–612; Raja J. Chelliah, Hessel J. Baas, and Margaret R. Kelly (1975), "Tax Ratios and Tax Effort in Developing Countries, 1969–71," *IMF Staff Papers* 22 (1): 187–205; Alan A. Tait.,

with the necessary tax handles to facilitate tax collection.[5] They included GDP per capita, trade openness (imports plus exports of goods, as a percent of GDP), the size of the agriculture sector, foreign aid, and revenue from natural resources. Those factors support an intuition that tax authorities have an easier time collecting taxes in wealthy countries—with economies that generate much activity with cross-border flows—and where agriculture (especially subsistence agriculture) plays a relatively smaller role in total economic activity. For developing countries, foreign aid and nontax natural resource revenues are usually negatively associated with tax revenue (Benedek, Benítez, and Vellutini 2022; Brun, Chambas, and Mansour 2014; Crivelli and Gupta 2014).

Another set of scholars focused on factors that influence the size of government, including those that can limit the level of social spending, which could be influenced by a combination of income levels, income distributions, relative sizes of different age groups, and political factors (Lindauer and Velenchik 1992; Lindert 1996). Those factors are associated with larger spending programs that need government revenues to fund them. For many developing countries, the challenges of meeting the sustainable development goals require significant fiscal space through increases in tax revenue to fund government programs (IMF 2019).

Table 3.1 presents observations about key factors in the empirical literature that are highly correlated with tax and spending levels, along with the direction of the correlation.[6] Challenges exist in isolating the effects of different factors on tax and spending policies, partly because of the differences in the political and economic environments across countries. Studies have found a complex and often ambiguous relationship for various factors on fiscal outcomes, including trade openness (Cagé and Gadenne 2018), levels and composition of foreign aid (Benedek and others 2014), and political factors (Dutzler, Johnson, and Muthoora 2021). Some factors (such as level of development and trust in government) have a mostly positive effect on both tax capacity and demand for public services, while other factors (such as share of agriculture and share of informal economy) affect those mostly negatively. For some factors, the impact on tax capacity and demand for public services could work in opposite directions (for example, the availability of natural resource revenues reduces tax revenues but increases the demand for public spending).

Challenges also exist in using country-specific factors on tax capacity to predict whether a MENA country can adopt or improve a PIT. Countries with higher per capita GDP, larger formal sectors, and more efficient tax

Wilfrid L. M. Gratz, and Berry J. Eichengreen (1979)," International Comparisons of Taxation for Selected Developing Countries, 1972–76," *IMF Staff Papers* 26 (1): 123–56.

[5] Later studies added explanatory variables on the demand side, including how levels of corruption, voice, and accountability affect tax revenues and compliance (Bird, Martinez-Vazquez, and Torgler 2014). Methodologies also evolved, with the use of stochastic frontier estimation models (Fenochietto and Pessino 2013; Brun, Chambas, and Mansour 2014; Brun and Diakité 2016).

[6] Some of these factors are examined more formally in Annex 3.1, using regression analysis.

TABLE 3.1.

Factors Influencing Tax Capacity and Spending Levels

Factors	Effect on Tax Capacity	Effect on Public Spending
Economic Factors		
Level of development	Mostly Positive	Mostly Positive
Trade openness [(imports + exports)/GDP]	Mostly Positive	Mostly Positive
Share of agriculture in GDP	Negative	Negative
Share of informal economy in GDP	Negative	Negative
Demographics		
Population growth	Mostly Positive	Positive
Age distribution (dependency levels)	Mostly Negative	Positive
Level of inequality (of income or wealth)	Ambiguous	Mostly Positive
Political Factors		
Democracy index	Mostly Positive	Mostly Positive
Voting participation	Mostly Positive	Mostly Positive
Trust in government	Positive	Positive
Corruption	Negative	Negative
Non-tax Revenue		
Natural resource revenue	Negative	Positive
Foreign aid	Ambiguous	Mostly Positive
Effectiveness in Taxing/Spending		
Investment in tax administrative capacity	Positive	Positive
Investment in delivery of government services	Positive	Positive

Source: Authors' compilations.

administrations systems tend to have more robust PIT regimes (at least in revenue generation) than countries without those attributes. But MENA countries and especially the GCC countries have a different combination of factors that could influence the success of PIT regimes. Although some factors lead to optimism about adopting or expanding a PIT, other factors, such as the abundance of hydrocarbon revenues, work in the opposite direction.

Several elements could contribute to the relative success or failure of a new or expanded PIT. First, governments in many countries have access to a large amount of information about potential taxpayers, possibly because they can track financial transactions, or they can collect information from state pension and subsidy systems. Providing tax administrators with access to this information will make it easier for a country to adopt or expand a PIT regime.

Second, many MENA countries have a large public sector workforce. When a substantial percentage of employees work for the government, tax administration can be relatively easy, though with no net impact on revenue. However, a large public sector payroll increases the need for higher taxes and reduces funds available for other government spending programs.

Third, many MENA countries have experienced rapid population growth, raising policy debates on income taxation and equity. Some countries (notably GCC members) have experienced large growth in the expatriate population, while others have had substantial internal displacements and migration. In most

non-hydrocarbon countries, an increasingly youthful population has grown without a corresponding expansion of accessible tax bases or the revenue to finance growth-related expenditures, such as education and health.

Fourth, income and wealth inequality are rising in many MENA countries. High levels of inequality create a paradox for countries considering a progressive PIT: they make adoption both easier and harder. Growing inequality can increase popular and political support for progressive taxes, and tax administrations can focus their resources on a relatively small group of taxpayers. At the same time, inequality makes adoption or expansion more difficult because economic elites hold substantial political power to block PIT reforms, and they are better positioned to structure their business activities and financial holdings to minimize their tax liability through avoidance and evasion.

A final factor is state capacity, especially the ability of governments at all levels to develop and implement tax policy effectively, efficiently, and equitably. Countries with successful VAT regimes have a better chance of adopting or expanding a PIT. Many of the VAT administration tasks can also apply to PIT regimes, particularly those involving professionals such as doctors, lawyers, accountants, consultants, architects, and engineers. MENA countries that have successfully digitalized their VAT regimes could administer a PIT more easily than those that still rely on manual processes and paper records. Countries that require e-invoicing for most commercial transactions also hold a clear advantage in administering a PIT over countries without such a requirement.[7] Advances in digitalization and the availability of a well-educated labor force in the region now make it more feasible than ever for most countries to create much better tax systems. The key question is whether governments have the political will—or at least the political support—to pursue substantial reforms.

Political Economy Considerations

Political factors influence the level of taxation in a country and the choice of tax instruments. Countries with different political institutions often make different decisions about the level and type of public expenditures and the taxes required to fund them. Constitutive institutions, inclusive politics, and credible leadership are political conditions that support improving tax capacity (Gaspar, Jaramillo, and Wingender 2016). The literature highlights that political institutions matter for improving tax systems (especially for PIT regimes), and that taxpayers' views of state accountability, transparency, and competency affect their willingness to comply with tax laws. The latter is especially important for PIT regimes, which provide greater opportunities to avoid or evade taxes, and for which political support relies on voters' trust in government.

[7] E-invoicing provides tax authorities with real-time information that improves VAT administration, especially identifying taxpayers who are more likely to comply only partially. Digitalizing data allows tax authorities to use triangulation (comparing point-of-sale transaction data with sales reported on tax returns) and segmentation (comparing data across similar taxpayers).

A large body of literature examines the relationship between taxation and democracy.[8] A common starting point is the social contract between the state and its citizens, particularly the fiscal component through which individuals pay taxes in exchange for protection of certain rights and provision of services. Fiscal contract models trace back to feudal bargains, when residents paid powerful kings and nobles for protection against outside invaders, followed by contracts between kings and nobles that exchanged tax revenue for protection of property rights and some influence over government policy.

Even though these models are appealing intuitively, establishing a causal relationship between taxation and democracy is difficult. Historical examples can be found of taxation's central role in promoting democratic institutions, but how transferable these relationships are to other countries (such as MENA countries) is unclear. The direction of the causal relationship is also unclear: Does democracy lead to taxation, or does taxation lead to democracy? Causation more likely runs in both directions.

Scholars focusing on tax systems' contribution to state building use several themes found in the resource curse literature, which emphasizes the negative impact of natural resources production on outcomes such as growth, institution building, and corruption. Effective tax systems are crucial in creating effective governments. In a virtuous cycle model, tax increases lead to greater spending in health, education, and infrastructure, which leads to greater economic growth and then to higher levels of tax revenues.

Adopting a new PIT or strengthening an existing one has the potential to contribute to more democratic institutions or more effective government, but many factors influence whether that potential can be realized. Pritchard (2010) presents several factors that could make constructive tax bargaining more likely in a specific country. Some factors relate to levels of trust (among diverse groups of taxpayers and between taxpayers and the government), and other factors relate to taxpayers' enthusiasm for political engagement and their belief in a link between taxes and government spending that they consider valuable. A key condition for taxes to contribute to state building requires taxpayers to have effective political organizations and the ability to bargain constructively with the government.

After MENA countries' independence in the 1950s and 1960s, their social contracts had much in common. Governments provided social and economic benefits (free health care and education, commodity subsidies, and public sector jobs for college graduates) in exchange for limited government accountability and restricted political participation (Loewe, Zintl, and Houdret 2021). The politically relevant groups that benefit from such contracts differ among MENA

[8] See for instance, Margaret Levi, *Of Rule and Revenue*, University of California Press, 1998; B. Guy Peters, *The Politics of Taxation: A Comparative Perspective*, Wiley, 1992; Sven Steinmo, *Taxation and Democracy: Swedish, British and American Approaches to Financing the Modern State*, Yale University Press, 1993; Stanely L. Winer and Walter Hettich (2003), *The Political Economy of Taxation: Positive and Normative Analysis When Collective Choice Matters*, Carleton University Economic Working Paper 02-11.

countries: educated middle-income individuals (Algeria, Egypt, Morocco, Tunisia); all citizens in the GCC economies; and members of certain sects, tribes, or clans (Iraq, Jordan, Libya, Syria, Yemen; Assaad [2014]). A meaningful tax component is notably missing from the fiscal part of the social contract in many MENA countries.

For several years after independence, MENA countries financed the costs of their social contracts through a combination of oil and gas revenues, foreign aid, and transfers from wealthy GCC countries. Declining hydrocarbon revenues, growing populations, and a decline in the quantity and quality of publicly provided goods and services strained the social contract in many countries. Several countries scaled back public sector hiring and reduced or eliminated fuel and food subsidies (Sdralevich and others 2014). The 2011 Arab Spring reflected the frustrations that various societal groups felt with social and economic policies and the lack of any meaningful political participation.

Predicting how and whether social contracts might evolve in MENA countries is difficult, but the countries will likely take different approaches. Some could adopt taxing and spending policies that reflect a new equilibrium, and other countries could try to keep the old social contract but with minor concessions. An important question for many MENA countries is what effect increases in the size of the middle-income class might have on demand for public goods and services and on individuals' willingness to pay taxes. For countries with PIT systems and meaningful political participation, a growing middle-income class will increase the proportion of the population that votes and pays taxes. As the middle-income class grows, preferences for the size of government and types of government spending programs might change, which in some MENA countries could result in moving from general food and energy subsidies to more targeted spending programs and higher-quality health care and education programs.

All countries face substantial challenges in changing social contracts, including the fiscal component, but the challenges could be even greater in many MENA countries for several reasons. First, some MENA countries have a long history of providing public services and subsidies free of charge to most or all of the population. Imposing taxes for public services that have already been available is much more difficult than imposing taxes for new public spending programs. Doing so is even more challenging in countries where the quality of public services and levels of subsidies are declining. Second, a new or expanded PIT would fall mainly on the wealthy in countries with high levels of inequality. In all countries, the challenge is to convince the economic and political elite to pay higher taxes to fund government spending programs that they do not use. Many MENA countries have little appetite or foundation for tax bargaining between governments and citizens, and without some opportunity for bargaining, using PITs to make governments more accountable and transparent is challenging.

ASSESSMENT OF PERSONAL INCOME AND WEALTH TRANSFER TAXES

Overview and Evolution of PITs since 2000

The tax laws in most MENA countries broadly define income subject to PIT. Progressive income tax rates generally apply to wages and to self-employed business income. Countries vary in their approaches to taxing income from capital—some tax certain types of capital income at flat rates, and other countries tax at progressive tax rates (which is less common). Most MENA countries with PIT regimes tax their residents on their worldwide income (including Algeria, Iran, Iraq, Morocco, Tunisia, and Yemen), but some tax their residents only on income earned in the country (including Jordan, Libya, and Syria). Countries generally collect income taxes through withholding, which is credited against the tax liability reported on tax returns for taxpayers who are obligated to file.

Tax Unit

The laws in most countries in the region define the individual as the tax unit and do not allow joint taxation. Some exceptions include Algeria and Jordan, which allow spouses to file a joint tax return with the option extending to dependent children; and Libya, which requires spouses to file jointly. In general, joint filing has a detrimental effect on individual incentives to work and earn income, especially for women, who tend to be the second (and lower) income earner in a household.[9] Because joint filing is not prevalent in the region, its implications are not discussed.

Rate Structure

The rate structure of PITs differs across MENA countries (Table 3.2). In 2022, most countries had an exempt bracket (an income tranche taxed at zero percent). Some countries provide instead a basic allowance—a deduction from income, before the application of tax rates—set according to the taxpayer's circumstances (for example, marital status, number of children).

In most countries, the tax-free allowance is well below GDP per capita. The lowest positive tax rates range from 2 percent in Djibouti and Lebanon to 26 percent in Tunisia, and the top rates range from 10 percent in Libya to 45 percent in Djibouti. In some countries, this rate is too low to raise any significant revenue and is often part of a rate schedule with a relatively high number of tax brackets (for example, seven positive rates in Djibouti and Lebanon, and six in Jordan) and an extremely low exempt bracket. In seven countries, the top tax rate applies at high income levels—more than four times GDP per capita—and likely has little impact on effective progressivity. For comparison, the average low PIT tax bracket

[9] The detrimental effect occurs because joint filing usually confers higher benefits from deductions and allowances to the higher-income earner in a household, thus providing an incentive for the lower-income earner to not work, work less, or work informally without declaring income to the tax authority.

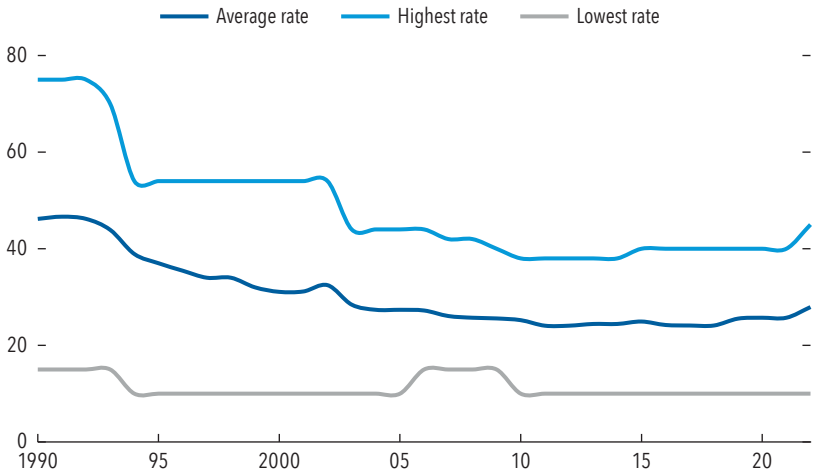
TABLE 3.2.

MENA: Personal Income Tax Rates and Brackets in the MENA Region, 2022 versus 2000

	2022						Early 2000s					
	Rates (Percent)			Brackets (Multiples of GDP per Capita)			Rates (Percent)			Brackets (Multiples of GDP per Capita)		
	Low	Top	T/L	Exempt	Low	Top	Low	Top	T/L	Exempt	Low	Top
Algeria	23.0	35.0	1.5	0.4	0.8	6.3	10.0	40.0	4.0	0.5	1.4	14.8
Djibouti	2.0	45.0	22.5	0.0	0.6	37.7	2.0	20.0	10.0	0.3	1.8	37.0
Egypt[1]	2.5	25.0	10.0	0.4	0.7	5.8	10.0	20.0	2.0	0.6	2.3	4.6
Iran	10.0	30.0	3.0	0.6	1.5	3.6	10.0	35.0	3.5	2.6	3.7	26.1
Iraq	3.0	15.0	5.0	0.3	0.4	1.5	3.0	15.0	5.0	1.3	1.5	1.9
Jordan	5.0	30.0	6.0	2.8	4.3	308.0	5.0	25.0	5.0	0.8	1.6	6.5
Lebanon	2.0	25.0	12.5	0.1	0.3	8.6	4.0	21.0	5.3	0.9	2.2	17.7
Libya	5.0	10.0	2.0	0.1	0.5	0.5	8.0	15.0	1.9	0.2	0.8	1.4
Mauritania	15.0	40.0	2.7	0.0	1.3	2.9	5.0	33.0	6.6	7.7	23.1	76.9
Morocco	10.0	38.0	3.8	0.8	1.3	4.6	13.0	44.0	3.4	0.9	1.1	2.7
Sudan	5.0	20.0	4.0	1.0	1.6	3.2	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Tunisia[2]	26.0	35.0	1.3	0.4	1.6	4.1	15.0	35.0	2.3	0.5	3.0	15.1
Yemen	10.0	15.0	1.5	0.2	0.3	0.3	10.0	20.0	2.0	0.5	1.2	3.8
Average	**9.1**	**27.9**	**3.1**	**0.5**	**1.2**	**29.8**	**7.9**	**26.9**	**3.4**	**1.4**	**3.6**	**17.4**

Sources: IMF; International Bureau of Fiscal Documentation; country tax laws; and authors' calculations.
Note: "Early 2000s" reflects the following: 1999 for Yemen; 2000 for Algeria, Jordan, Lebanon, and Tunisia; 2002 for Djibouti; 2003 for Iraq and Libya; 2005 for Egypt; and 2006 for Iran, Mauritania, and Morocco. "T/L" is the ratio of the top rate to the low rate. "Exempt" is the income amount taxed at a zero rate. MENA = Middle East and North Africa; n.a. = not applicable.
[1] Egypt increased the top tax rate to 27.5 percent starting from fiscal years 2023/2024.
[2] Tunisia applies a 1 percent solidarity tax on wages, which is not included here.

Figure 3.1. Evolution of Top Personal Income Tax Rates in the MENA Region, 1990–2022
(Percent)



Sources: Authors' compilations based on IMF; International Bureau of Fiscal Documentation; and countries' tax laws.
Note: the "average rate" is the simple average of top personal income tax rates, while the "highest rate" and "lowest rate" refer to the country that had the highest top rate and the country that had the lowest top rate in a given year.

in advanced economies is on average 0.25 times GDP per capita, and the high bracket is four times GDP per capita.

The evolution of key PIT parameters since the early 2000s also differs across countries, but three changes are common: (1) a reduction in the exempt bracket in most countries, with the average declining from 1.4 to 0.5 GDP per capita; (2) an increase in the low positive rate by 1.2 percentage points on average; and (3) a decline in the level of income at which the top tax rate applies. In principle, the first should capture more taxpayers directly and indirectly, given that the exempt bracket is not indexed regularly for changes in salaries caused by inflation.

Notably, like countries in other regions, top marginal PIT rates in MENA have declined significantly since 1990 (Figure 3.1).[10] Most of this decline took place well before 2010. The average top rate declined from 46 percent in 1990 to 25 percent in 2010, but has recovered somewhat since 2018, and stood at 28 percent in 2022.[11]

[10] See, for example, Gerber and others (2019). The trend in the reduction of top marginal rates occurred after the reduction in high-income countries in the 1980s, with landmark reforms in the United Kingdom and the United States.

[11] Top rates in the early 1980s were exceptionally high in some MENA countries: for example, 90 percent in Iran, 80 percent in Egypt and Tunisia, 75 percent in Algeria, and 70 percent in Sudan.

Income from Wages and Salaries

All MENA countries apply the progressive tax rate structures to wage income except for GCC countries, which do not tax wages.[12] Generally, "wage income" is defined broadly and includes full-time and part-time compensation and benefits, either monetary or in-kind. However, significant exemptions reduce the tax base, create distortions to labor markets, and open tax avoidance opportunities. The rules are complex and thus impractical to cover here. Examples of exemptions include subsidized employment income, income earned in specified geographical areas, pension income, income from public sector employment, in-kind benefits, and income earned from certain professions (teaching, for example). Some exemptions are partial, exempting only a portion of income (for example, pension income and public sector wages) or certain subcategories (such as in-kind benefits).

MENA countries use different types of PAYE regimes to collect tax on wages and salaries. Many (including Algeria, Djibouti, Lebanon, and Iraq) use a simple calculation method in which employers withhold taxes from wages monthly, without adjusting for wage changes in the taxable year. Some countries (including Egypt, Iran, and Libya) require employers to withhold monthly and to calculate withholding for the year on a cumulative basis—adjusting withheld amounts for each employee during the year.

Countries also differ in requiring individuals receiving wages and salaries to file annual tax returns. Several (including Algeria, Iran, Iraq, Jordan, and Lebanon) require employees to file income tax returns, but other countries (including Djibouti, Libya, Mauritania, Morocco, and Tunisia) exempt employees from filing tax returns if they do not have an additional job or substantial non-wage income.

Business and Professional Income of the Self-Employed

Most MENA countries include income from unincorporated businesses with wage income and tax the consolidated income at progressive rates, making them close to a comprehensive income tax in how they treat labor and business income. Djibouti and Mauritania apply a flat rate on income from professional and other business activities, which is set at the CIT rate. Those countries are close to a pure dual income tax system, taxing business income at a single rate, lower than the top marginal tax rate on labor income, and without regard to the legal form of the entity earning the income. Iran, Lebanon, and Yemen apply progressive rates

[12] In June 2025, Oman announced in Royal Decree No. 56/2025 that it will apply a personal income tax starting in 2028 at a flat rate of 5 percent. Its main features will include a high exemption threshold of 42,000 Omani riyals annually—roughly USD 100,000 at exchange rates prevailing in June 2025—which, according to the Omani tax authorities, would exclude about 99 percent of the population from the tax net; with deductions for housing mortgage interest, health and education expenses; exemptions for gains from the sale of primary and secondary residences; and exemptions for gifts and inheritances. The royal decree mandates the tax authorities to issue executive regulations for the implementation of the tax, in which further details affecting its design are likely to be included.

and brackets on business income that are different from the rates applied to wage income. These countries are close to a pure schedular income tax system, taxing each source of income under its own schedule and rules for assessing the tax base.

Oman, Qatar, and Saudi Arabia (all GCC countries) extend their CITs to business income earned by unincorporated businesses but only if such businesses are owned by non-GCC nationals. The United Arab Emirates introduced a profit tax on corporate and noncorporate entities (resident or nonresident) in 2023 at a rate of 9 percent. In these countries, the absence of income tax on wages and nonwage income of nationals is an important source of distortion and revenue potential and is likely to shape the design of future tax systems.[13]

Passive Income from Capital

PIT systems in the region vary in how they tax income from capital (Table 3.3). The tax rules are relatively complex and attempt to direct investment to specific use or holding horizons. They take the form of outright exemptions or low rates and include the following: exemption of interest income on time-bound savings accounts and government bonds; exemption or reduced rates on dividends paid by certain companies (based on their activities), including holding companies through which exempt profits are channeled; and exemption of or lower rates on capital gains from the sale of certain types of movable properties (for example, listed shares) or immovable properties (for example, real estate used in a business). The extent of the favorable treatment in most MENA countries makes it relatively easy to avoid capital income taxation.

The light taxation of capital income for revenue mobilization and income inequality could have profound implications, especially without effective wealth transfer taxes. On revenue mobilization, the revenues from these income sources are negligible in most countries, but the potential is likely significant. On income inequality, the potential is limited to increase progressivity of individual income taxation without significant reform of the taxation of capital income. For example, changing the taxable income brackets and rates that apply to wages and business income is likely to weigh more heavily on wage income—both directly and indirectly through the incidence of the business income tax—and would encourage taxpayers to structure their affairs to earn income taxed at lower rates.

Payroll and Social Security Contributions

An analysis of PITs would be incomplete without examining other levies on payroll, of which SSCs are the most important. All MENA countries levy SSCs on

[13] Zakat, a religiously mandated charitable donation for muslims, is excluded. In some countries, the tax authority levies Zakat on national residents. Saudi Arabia has the most established Zakat. It applies to Saudi Arabian nationals and GCC citizens resident in Saudi Arabia. It is calculated at a rate of 2.5 percent of the lower of net assets (computed using balance sheet data) and net business income, regardless of the legal form of the entity holding the assets or earning income. Zakat likely often applies to income. If so, it is proportional to income and has a limited revenue impact given the low rate. However, since the revenue is earmarked for transfers to poor individuals, Zakat can be progressive.

TABLE 3.3

Typical Tax Rates on Income from Capital in the MENA Region, 2022
(Percent)

Country	Interest Income	Dividend Income[1]	Capital Gains[4]	
			Movable Property	Immovable Property
Algeria	10	15	PIT	E
Djibouti	E	5	E	10
Egypt[2]	E	5	E	E
Iran	E	E	E	E
Iraq	PIT	E	E	PIT
Jordan	5	E	E	E
Lebanon[3]	10	10	15	15
Libya	5	E	E	E
Mauritania	10	10	25	10
Morocco	20	15	15	20
Sudan	PIT	E	2	2
Tunisia	PIT	10	10	15
Yemen	E	E	E	E

Sources: International Bureau of Fiscal Documentation (IBFD); countries' tax laws; and authors' calculations.
Note: The table shows the most common treatment of capital income for individuals in 2022, because standard or maximum rates are often inapplicable, given the prevalence of exceptions and exemptions. "E" means the income is exempt, and "PIT" means the income is included in the PIT tax base. MENA = Middle East and North Africa; PIT = personal income tax.
[1] Because dividends are paid out of taxable corporate profits (except for where such profits are exempt or taxed lightly), the dividend income tax rate at the individual level is another tax on the return to equity shares and should ideally be lower than the rate on interest income to approximate neutrality in the taxation of debt and equity. (This reasoning would not hold in the presence of imputation systems, in which the corporate-level tax is neutralized. No MENA country has imputation.)
[2] Interest on government bonds is taxed at 20 percent final withholding. Capital gains tax from sales of listed companies' shares has been suspended since its introduction. Starting in fiscal year 2023/2024, profits from trading on the Cairo stock exchange are subject to capital gains tax.
[3] Dividends from holding companies and offshore companies are exempt, which means that reported rates here are often inapplicable.
[4] Some countries apply a transfer tax on immovable property (for example, Egypt, Iran). Jordan applies a transfer tax on listed shares at a rate of 0.08 percent.

employers and employees through withholding, including GCC countries, where wages are not taxed under a PIT. The levies fund various types of social spending, including pension and old-age income, health services, and unemployment benefits. The rates (sum of employer's and employee's SSC) range from 8 percent in Bahrain to 35 percent in Algeria. A few countries apply other payroll taxes, and the rates do not exceed 2 percent of gross wages. Generally, revenue from SSCs in the region are paid directly into earmarked funds and often do not appear in central government consolidated fiscal statements.[14]

In advanced economies, SSCs are a substantial source of revenue, and their contribution to total tax revenue often exceeds that of the PIT, particularly in the European Union. However, the policy interest in SSCs goes beyond revenue

[14] The absence of consistent data (across countries and over time) on revenue from SSCs is a shortcoming in tax analysis for both the study of revenue levels and structure and the incentive implications of taxes on payroll.

because they raise equity and efficiency considerations. The economic literature on the topic is well-developed. For example, a key finding of the comprehensive review in Piketty and Saez (2013) is that differential consumption taxes have little extra redistributive benefit beyond a progressive income tax (including SSCs). That result is important for the region and especially for GCC countries, where some members have already implemented a single-rate VAT, and some are contemplating widening the application of their income taxes, which are currently limited to foreign companies' profits. In weighing revenue, efficiency, and equity considerations, which are clearly country specific, the literature points to a substantial role for joint PIT and SSCs design.

Wealth Transfer Taxes

Countries generally use wealth transfer taxes to raise revenue, reduce inequality, and break up large concentrations of wealth.[15] In OECD (Organisation for Economic Co-operation and Development) countries, on average the top 1 percent of the wealth distribution hold about 18 percent of household wealth, and the top 10 percent hold about 50 percent of household wealth (OECD 2021). Although the quality of the inequality data varies greatly, research has also found high levels of wealth inequality in many developing countries.[16] Gifts and bequests from those holding a large share of a country's household assets to future generations are a major mechanism for perpetuating wealth inequality.

Well-designed and administered wealth transfer taxes have more potential for breaking up large concentrations of wealth than PITs or annual wealth taxes, and some have argued that they can do so more efficiently (OECD 2021). The case against wealth transfer taxes rests on their limited success across countries and over time in raising revenue and reducing inequality and wealth concentrations. Countries could be more successful using political and administrative resources in taxing the wealthy under PIT regimes and narrower wealth taxes, such as real property taxes, than through adopting or strengthening wealth transfer tax regimes.

A review of wealth transfer tax regimes in MENA countries and outside the region highlights the options policymakers have when designing and administering such taxes. Among the key design considerations are (1) choice of nexus required to subject an estate or beneficiary to tax in a particular country, (2) whether to impose tax liability on the decedents' estates (or donor for gifts) or on the beneficiary, (3) what exclusion level applies (what portion of the population might be exempt), (4) whether to adopt flat or graduated tax rates, (5) whether

[15] "Wealth transfer taxes" refers to a broad category of taxes that includes estate and gift taxes in addition to inheritance taxes. It is well established that a narrow inheritance tax that does not include gifts is ineffective in raising revenue, because taxpayers would gift their wealth for no consideration. Estate taxes have a stronger nexus to a country and are taxed even when the owner or beneficiary of the estate has no nexus to the taxing country.

[16] Based on data from the World Inequality Database (https://wid.world).

TABLE 3.4.

Key Features of Wealth Transfer Taxes in MENA Countries

Country	Taxable Assets for Residents and Nonresidents	Exemptions	Tax Rates
Algeria	Immovable and moveable property within jurisdiction	DZD 50,000	Spouses and children: 3 percent Other heirs: 5 percent
Djibouti	Residents: Worldwide assets Nonresidents: Immovable and moveable property within jurisdiction	DJF 10 million. Gifts do not benefit from this exemption.	2 percent
Iran	Residents: Worldwide assets Nonresidents: Immovable and moveable property within jurisdiction	None	First-class heirs (parents, spouses, children, and grandchildren): 2 to 10 percent depending on the type of asset (financial or real) Second-class heirs (grandparents, siblings, nieces, and nephews): rates are two times the rates of first-class Third-class heirs (uncles, aunts, and cousins): rates are four times the rates of first-class
Lebanon	Residents: Worldwide assets Nonresidents: Immovable and moveable property within jurisdiction	Parents, spouses, and children: LBP 600 million Grandparents: LBP 240 million Other heirs: LBP 120 million	Children: 3 to 12 percent Other heirs: 16 to 45 percent Rates increase with the value, from LBP 90 million to 1,050 million
Tunisia	Residents: Worldwide assets Nonresidents: Immovable and moveable property within jurisdiction	Parents, spouses, and children: TND 5,000 Heirs with disabilities: TND 10,000	Children and spouses: 2.5 percent Siblings: 5 percent Uncles, aunts, and cousins: 25 percent Other heirs: 35 percent

Sources: International Bureau of Fiscal Documentation (IBFD); and authors' compilations.
Note: All descriptions refer to inheritance taxes except for Mauritania, which has gift taxes. DJF = Djibouti franc; DZD = Algerian dinar; LBP = Lebanese pound; MENA = Middle East and North Africa; TND = Tunisian dinar.

to provide preferential treatment for transfers to spouses and children, and (6) whether certain types of assets should receive preferential treatment.

Tax legislation in five MENA countries authorizes taxing wealth transfers: Algeria, Djibouti, Iran, Lebanon, and Tunisia (Table 3.4).[17] In these countries, the inheritance is divided among the heirs and taxed at their level, and the value is generally the market value at the time of inheritance.[18] Countries show two main distinctions: tax rates, which range from 2 percent in Djibouti to 35 percent in Tunisia and 45 percent in Lebanon; and tax preferences, which depend either

[17] Syria has a wealth transfer tax regime under religious laws that applies different rules to Muslims, Christians, and Druze. Mauritania taxes only gifts (excluding inheritance) at a rate of 2.5 percent.

[18] How market values are determined is not explored here in any detail, though in some countries, reference is made to cost or value on deeds.

TABLE 3.5.

Size of Personal Income Tax Revenues in the MENA Region

	Percent of GDP	Percent of Tax Revenue
Hydrocarbon-Importing Countries		
Djibouti[1]	2.5	21.9
Egypt	1.8	14.3
Jordan	0.9	5.0
Lebanon[1]	0.8	6.8
Mauritania	1.8	13.3
Morocco	3.6	18.4
Sudan	…	…
Tunisia	7.4	32.0
Hydrocarbon-Exporting Countries		
Algeria	3.9	29.4
Iran	0.9	17.0
Iraq[1]	0.5	18.0
Libya[1]	…	…
Yemen[1]	1.5	47.7

Sources: IMF, World Revenue Longitudinal Database (November 20, 2024); and authors' calculations.
Note: Figures are simple averages over 2020–22 and exclude social security contributions and Zakat.
MENA = Middle East and North Africa; … = insignificant.
[1] The country is classified as a fragile and conflict-affected state.

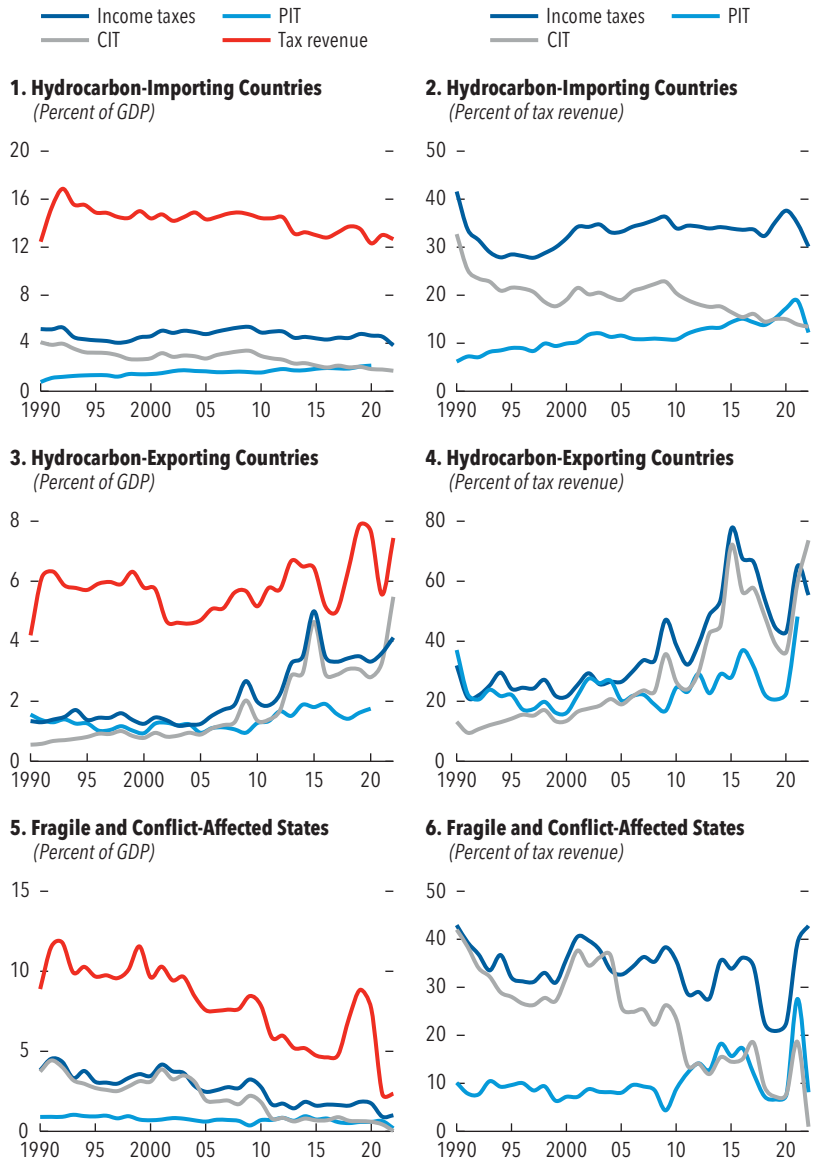
on the relationship between the deceased and the beneficiaries (usually lower for children and spouses, higher for others) or on the type of asset (real or financial). Outside the region, use of inheritance taxes has declined: All OECD countries had them before 1972, but by 2017, only 22 of 35 had retained them (Evans and others 2017).

The Revenue Contribution of Personal Income and Wealth Transfer Taxes

PIT contributions to total tax revenue differ sharply across MENA countries. As Table 3.5 shows, PITs generate significant revenue in some countries (Algeria, Djibouti, Morocco, Tunisia) but raise relatively little in most other countries.

Figure 3.2 shows how the revenue contribution of the PIT has evolved since 1990 in hydrocarbon-importing and exporting countries, and FCS countries. Hydrocarbon-importing countries all have well-established PIT regimes and tax administrations, and public sector wages do not affect their PIT revenues disproportionately. On average, the PIT yield in percent of GDP and its share of total tax revenue in this country group has doubled since the early 1990s. A closer look at the data suggests that Morocco and Tunisia are largely responsible for this increase. In Tunisia, the low positive tax rate nearly doubled, and the top-income bracket declined significantly (in GDP per capita). In Morocco, the low and top positive rates declined, and their respective income brackets increased (in GDP per capita). These two contrasting examples—the first implying an increase in average tax rates and the second implying a reduction—highlight the importance of understanding what drives changes in PIT revenues.

Figure 3.2. Contribution of Income Taxes to Tax Revenues in the MENA Region



Sources: IMF, World Revenue Longitudinal Database (November 20, 2024); and authors' calculations.
Note: Figures are unweighted averages across countries. Income taxes include revenues that cannot be allocated to CIT or PIT. Because of unbalanced data, the averages of CIT and PIT do not always add to the average of income taxes, especially for oil and gas exporters and fragile states. CIT = corporate income tax; MENA = Middle East and North Africa; PIT = personal income tax.

The revenue contribution of the PIT can also be examined together with the contributions of the CIT and other taxes on income. Empirical evidence suggests that low CIT rates relative to top PIT rates (as in the MENA region) create incentives to incorporate, especially for individuals whose income is earned from business activity (see, for example, de Mooij and Nicodème 2008). These incentives are stronger when dividends and capital gains (and other forms of payments to shareholders) are taxed lightly, because they lower or eliminate the double taxation of corporate dividends at the individual level. This shift from earning income as an individual to earning income as a corporation makes it difficult to separate changes in revenue performance of PITs and CITs. Figure 3.2 shows the revenue yield of the CIT and all income taxes, which includes those that cannot be easily attributed to CIT or PIT. For hydrocarbon-importing countries, where the PIT matters most, CIT revenues have declined, suggesting that incorporation had no impact on the legal form through which profits are earned.

In hydrocarbon-exporting countries, the PIT as a percent of GDP increased from about 1.5 percent to more than 2 percent in recent years. In this case, the effect is largely due to Algeria and to Iran to a lesser extent—in both countries, public sector wages, including state-owned enterprises, are a significant share of the PIT tax base. In FCSs, the PIT has remained relatively stable since 1990 at slightly below 1 percent of GDP.

Data on wealth transfer tax revenue in the region is unavailable but presumably negligible. Average "property taxes" in the region, including recurrent taxes on real property, are less than 0.5 percent of GDP. In OECD countries, wealth transfer taxes raise about 0.5 percent of total tax revenue in countries that apply them, and revenues exceed 1 percent of total tax revenue in only four OECD countries (OECD 2021). Factors such as exclusions and preferential treatment—and the success of wealthy and well-advised taxpayers who structure their affairs to minimize transfer taxes—create challenges in collecting the taxes.

In summary, the role of PIT in the tax system is significant in only a few hydrocarbon-importing countries in North Africa (Algeria, Morocco, Tunisia), but the role has increased since 1990. In hydrocarbon-exporting countries (excluding FCSs), the PIT revenue contribution largely reflects the use of hydrocarbon revenue to fund large public sector employment and wages. In FCSs, the PIT revenue role is small at less than 1 percent of GDP and has been unchanged since 1990. Wealth transfer taxes applied in the region yield an insignificant amount of revenue (if any) because of their design features.

Determinants of PIT Revenue Performance

The analysis of the PIT revenue performance since the early 1990s can usefully separate policy measures from exogenous economic factors. The standard empirical literature on the determinants of the tax-to-GDP ratio provides a framework for this analysis, which involves regressing PIT revenue-to-GDP ratios against a set of variables. The analysis focuses on standard economic determinants in the literature, including the natural log of per capita GDP (capturing changes in

living standards), share of the primary sector in GDP (a proxy for the difficult-to-tax share of GDP), share of self-employment in total employment (as modeled by the International Labour Organization), public wage bill as a percent of GDP, and inflation as measured by the consumer price index. Tax policy variables include the PIT exempt threshold and top tax brackets (as multiples of GDP per capita), the low and top tax rates, and the interaction between the exempt threshold and the lowest positive rate. Other control variables include CIT revenue-to-GDP and dummies for SSCs deduction, oil exporters, and FCSs. Annex 3.1 summarizes the statistical approach and presents the results of four econometric specifications or models.

The results show that tax policy variables are uncorrelated with PIT-to-GDP revenues except for the top PIT tax rate, which shows a positive correlation: An increase of 1 point in the top tax rate is associated with an increase in the average PIT revenue-to-GDP by about 10 to 14 percent—or between 0.02 to 0.05 percentage points of GDP. By contrast, the key economic variables are strongly correlated with PIT-to-GDP with the expected sign, except for the share of the primary sector in GDP, which is positive but only weakly significant.[19]

An interesting (and expected) result is the strong and positive correlation of the public sector wage bill with PIT revenues, with a coefficient of 0.42 in model (1) (column 1 in Annex Table 3.1)—that is, an increase in the wage-bill-to-GDP ratio of 1 percentage point is associated with an increase in the PIT revenue-to-GDP ratio of 0.42 percentage point. The coefficient represents both the PIT and the deductibility of SSCs from the PIT tax base, and brackets creep, which means that as public sector employees' wages increase, they are pushed into higher tax brackets because of a lack of bracket indexation. Using Algeria, Tunisia, and Morocco as examples illustrates this interaction:

- **Algeria**. Public sector wages increased from 6.8 percent of GDP in 2000 to 10.6 percent of GDP in 2018, which translates into 1.6 percentage points in the PIT-to-GDP ratio (3.8 × 0.42). During the same period, the PIT-to-GDP ratio increased from 0.85 percent to 4.5 percent, which means that 43 percent of the increase in the PIT-to-GDP ratio is associated with the increase in the public sector wage bill.
- **Tunisia**. Public sector wages increased from 11 percent of GDP in 2000 to 14 percent of GDP in 2018, which translates into 1.25 percentage points in the PIT-to-GDP ratio (3 × 0.42). During the same period, the PIT-to-GDP ratio increased from 3 percent to 4.75 percent, which means that about 70 percent of the increase in the PIT-to-GDP ratio is associated with the increase in the public sector wage bill. The result should be interpreted as an upper bound, because (unlike Algeria) other direct tax revenue—which

[19] Agriculture's share of total value-added in the economy is negligible in GCC countries and ranges from 5 percent to 15 percent in North African and Eastern Mediterranean countries. An explanation for the correlation of this variable with PIT revenue is not provided.

cannot be easily attributed to individuals and corporations—also increased in Tunisia, from about 0.7 percent to 3.3 percent of GDP.

- **Morocco**. Unlike the previous two examples, the public sector wage bill in Morocco remained stable between 2000 and 2018 at slightly more than 11 percent of GDP (with some fluctuation in between), yet the PIT-to-GDP ratio increased from 2.9 to 3.9.

The examples highlight the importance of understanding the underlying factors affecting PIT revenues and their interpretation, considering the nature of the PIT contribution to tax revenue and the overall progressivity of the tax system.

Are PITs in the MENA Region Progressive?

A PIT is progressive if the average tax rate increases with incomes. Measures of progressivity can be statutory or effective. Statutory progressivity reflects what policy prescribes in law. It is useful as ex ante analysis of how policy choices affect economic outcomes and incentives, especially for assessing how individuals are likely to respond to policy in their real decisions (for example, participation in the labor market) or financial decisions (for example, concealing income without changing employment or business decisions). Comparisons of statutory progressivity across countries often use a common income distribution—such as multiples of per capita GDP or income denominated in one currency—so that progressivity measures reflect only the impact of the tax factor.[20]

However, effective progressivity reflects the impact of all factors affecting tax liability, including the interplay among tax rates, tax brackets, and income distributions. It requires administrative data (from tax returns or household income surveys), and large samples of income distributions, which can be either country-specific or representative of a group of countries. Effective progressivity is useful for analyzing how PIT systems affect actual distributions of pretax incomes, which in a dynamic setting depend on taxes themselves. Vellutini and Benitez (2021) and Gerber and others (2019) summarize the literature on several measures of statutory and effective progressivity indicators and their uses in tax analysis.

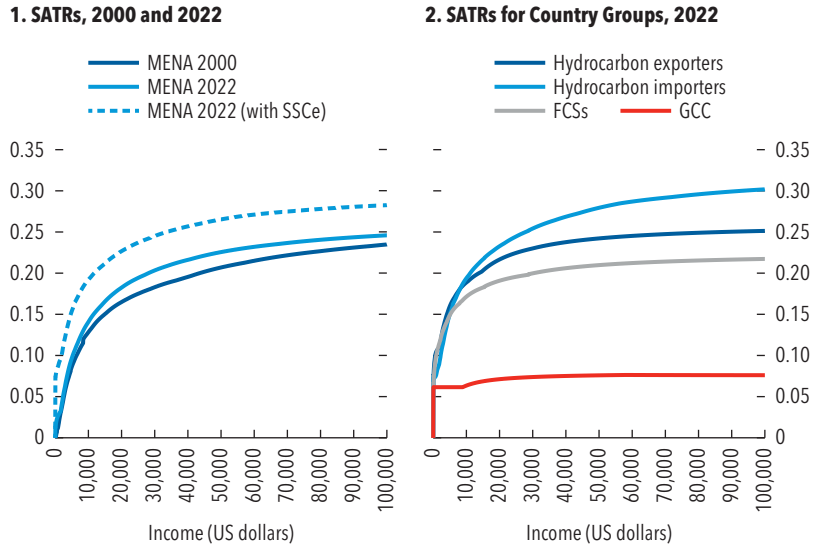
Statutory Progressivity

Figure 3.3 shows the statutory average tax rates (SATRs) in the region with and without the employee's social security contribution (SSCe) for 2000 and 2022 and by country subgroups for 2022 only.[21] The figures are representative of tax rates applicable primarily to wage income; capital incomes are often taxed at flat

[20] Using a common currency for such comparisons is preferable because income taxes can affect GDP itself through individuals' work-leisure decisions.

[21] The analysis includes PITs and social security contributions of employees but excludes other taxes and spending policies, which also affect progressivity (see, for example, Engel, Galetovic, and Raddatz 1999, in the case of Chile).

Figure 3.3. MENA Region Statutory Average Tax Rates



Source: Authors' calculations.
Note: Each data point represents the average tax rate on income across all countries. GCC countries are excluded from panel 1 because they do not have PITs; in panel 2, they are included as a subgroup only, for which the SATR shows the average SSCe rate. Sudan was excluded from the SATR in 2000, because data were unavailable. FCS = fragile and conflict-affected state; GCC = Gulf Cooperation Council; MENA = Middle East and North Africa; SATR = statutory average tax rate; SSCe = employee's social security contribution.

low rates, or exempt. For comparability across countries, the rates were estimated over incomes ranging from $0 to $100,000 in increments of $50.[22]

PIT systems are progressive in a statutory sense. The progressivity is steep at low-income levels and rises gently at levels of about $10,000 (2.8 times the average GDP per capita in 2022, excluding GCC countries), with the SATR reaching a maximum of about 25 percent at income levels greater than $100,000. Compared with the early 2000s, the SATR curve shifted upward by about 3 percentage points and is steeper at income levels of less than $10,000. Two factors explain this shift: the increase in the average lowest positive PIT rate (from 7.9 to 9.1 percent), and the reduction in the average exempt threshold by about 0.9 percentage point of GDP. Note that both changes would be expected to raise more revenue from lower income individuals, earning primarily wage income. Yet, PIT revenues have remained constant on average since the early 2000s. This suggests that PIT systems have difficulties raising revenue from higher income individuals.

[22] Income of $100,000 amounted to 42.2 times average GDP per capita in 2000 and 28.03 times in 2022, excluding GCC countries.

Adding SSCe has a dramatic effect on the level and slope of the SATR curve.[23] Because most countries have ceilings on salaries subject to SSCs,[24] the curve is steeper at low-income levels. The incentives implications of marginal tax rates exceeding 17 percent at the lowest income levels (essentially from the first dollar earned to about $3,500, about average GDP per capita) are arguably profound and could partly explain the low labor participation rates observed in the region, at least in the formal sector.[25]

Figure 3.3, panel 2 shows the same distribution of SATRs for hydrocarbon-importing and exporing countries, FCSs, and GCC countries for 2022. Steep progressivity at low-income levels is present in all these country groups (except for the GCC, where the curve shows the average SSCe rate), but the level of the SATR at higher incomes is higher in hydrocarbon-importers.

Average SATRs and their evolution since the early 2000s differ across countries, illustrated in Figure 3.4 with three examples. In Morocco, the PIT plays a strong revenue role, while in Libya (an FCS), PIT revenues are negligible. In Jordan, both economic conditions and tax administration capacity are present to have a meaningful PIT, but the PIT revenue yield is exceptionally low. The PIT in Morocco (excluding SSCe) is progressive at relatively low income levels, and top rates are comparable to advanced economies. The PIT also provides for an exempt threshold equal to 0.77 GDP per capita (higher than all countries except for Jordan and Sudan), ensuring that individuals with wages close to average incomes pay little tax. By contrast, Jordan has a much higher exemption threshold (at 2.75 times per capita GDP) that potentially exempts a large share of the population from income tax, and its top tax rate bracket is nearly 308 times GDP per capita.[26] The design features of the PIT in Jordan explain its low revenue yield. The Libyan SATR curve is even flatter and lower, a direct result of its low top rate of 10 percent.

Changes in marginal tax rates (the progression of SATRs) in these three countries also provide interesting lessons. In Morocco, marginal tax rates have declined relative to the early 2000s, yet revenue performance has held up—a virtuous circle in which tax design benefits from economic growth and vice versa, allowing countries to reduce marginal tax rates over time while preserving or even increasing revenue and improving compliance.

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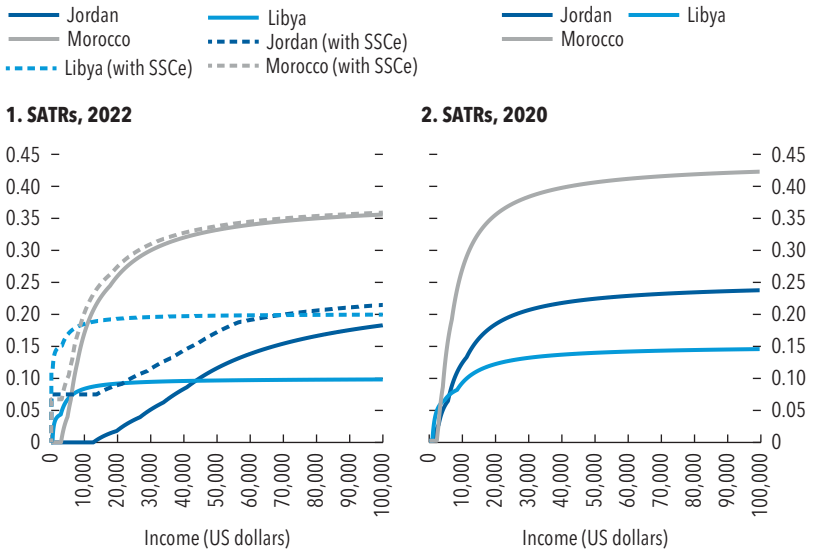
[23] SSCs paid by employers are excluded because they are relevant for the total cost of labor but less so for individual posttax income. SATRs including SSCe account for the deductibility of SSCe from the income tax base and, where applicable, floors and ceilings on the calculations of SSCe.

[24] Only Egypt and Kuwait have floor wages below which SSCs do not apply (in addition to a ceiling). Egypt's floor is equivalent to 0.6 times the exempt PIT threshold. Several countries have ceiling wages, which average about 3.8 times GDP per capita (excluding GCC countries) and 7.5 (including GCC countries).

[25] The labor force participation rate in the region (excluding GCC countries) was 49 percent in 2019, compared with a world average of 67 percent.

[26] Jordan is a good example of why changing the top tax rate does not always improve progressivity. See Gale, Kearney, and Orszag (2015) for an empirical study of the US PIT.

Figure 3.4. Statutory Average Tax Rates in Jordan, Libya, and Morocco



Source: Authors' calculations.
Note: Each data point represents the average tax rate on income across all countries. Social security contributions are excluded from the estimates of SATRs. SATR = statutory average tax rate; SSCe = employee's social security contribution.

Including SSCe in the SATRs changes the shape of the curves significantly for Jordan (which caps SSCs at the highest incomes) and Libya (which does not cap SSCs), while SSCs in Morocco are capped at 1.9 GDP per capita—the second highest income tax bracket.

Effective Progressivity

Effective progressivity is achieved when effective average tax rates increase with income levels. Measuring effective progressivity is challenging because it requires information on actual pretax and posttax income distributions, reflecting all sources of individual income from labor, capital, and wealth transfers. The most common method to estimate it uses tax return (administrative) data, which contains pretax income and all the tax rules affecting the passage from pretax to posttax incomes. A drawback of this measure is that it makes comparisons across countries difficult. Because the results depend on country income distributions, progressivity can be achieved in many ways, which is why actual income distributions are most appropriate to calibrate PITs to properly reflect country realities and policy choices.

An alternative method combines country tax parameters with a representative distribution of pretax income, the so-called transplant-and-compare method. It

allows for calculating a progressivity index,[27] which reflects primarily the shape of the estimated SATR curves as it applies to plausible pretax income distributions. It also allows for estimating a redistribution index, which accounts for the PIT's revenue importance, measured as PIT revenue per taxpayer divided by GDP per capita. Intuitively, a PIT that yields an insignificant amount of revenue—even if it is progressive in law—is unlikely to have a significant redistributive role (for example, Libya, Jordan, and Yemen). IMF (2022) uses this method, with results broadly consistent with the results reported above. PITs in most MENA countries are progressive, but their redistributive capacity is small because of the PIT's small revenue contribution (except for Morocco and Tunisia). One caveat of this method is that it does not account for the PIT revenue sources. A PIT that has drawn most of its revenues over the past two decades from higher government employment and wages can have the same redistributive capacity as a PIT with revenues from private wages.

WHERE NEXT FOR PIT AND WEALTH TRANSFER TAXES?

The analysis so far has shown that PITs in the region differ significantly in their revenue contribution and progressivity and thus effective redistributive capacity. Generalized one-size-fits-all policy options are therefore unlikely to be useful or successful. Policy options will vary depending on a country's relative weighing of PIT objectives (revenue, efficiency, equity, and state building) and administrative capacity, and they will reflect a country's history, the starting point of reforms, and the ability of political institutions to adopt tax and spending policies that enable inclusive economic growth. Countries considering PIT and wealth transfer tax reforms need to improve tax administration capacity for them, because higher tax burdens will create incentives for tax avoidance and evasion. Making PIT reform more prominent in the political debate over fiscal policy is also important, (Moore 2004), and countries have made progress in this regard since 2000, especially in the GCC region.

Competing PIT Objectives

The current role of the PIT has a strong influence on PIT options, which should be considered in the context of a country's existing tax regime. For example, developed countries and some developing countries (including several MENA

[27] See Vellutini and Benitez (2021) for a detailed description and application of a simplified transplant-and-compare method to a large sample of countries. The authors examine some of the method's limitations, including compliance issues that affect the revenue contribution of the PIT (especially challenges in taxing nonwage incomes of higher-income individuals, including passive capital income and active business income). The challenges make the approach more useful in examining the progressivity of labor income taxation in a somewhat similar fashion as the SATR analysis presented in this chapter.

TABLE 3.6.

Personal Income Tax Objectives and Policy Choices

Objective	Tax Threshold	Types of Income Subject to Tax	Top Marginal Rates	Investment in Tax Capacity
Maximize Revenue	Zero or low, subject to administrative constraints	Broad coverage, subject to compliance constraints	Revenue maximizing rate	Substantial, depending on timeframe
Reduce Income Inequality	Relatively high to exempt low-income individuals	Broad coverage (especially capital income), subject to compliance constraints	Relatively high	Substantial
State-Building	Low, to maximize taxpayer/citizen overlap	Broad coverage, subject to compliance constraints	Relatively high, but lower than the revenue maximizing rate	Substantial

Source: Author's compilations.

countries) had a PIT in place before adopting a VAT, which allowed them to adjust the PIT to address potential VAT regressivity concerns. By contrast, several MENA countries adopted VATs without an existing PIT.

Countries can use the PIT to achieve objectives such as raising revenue, reducing income inequality, and state building. Table 3.6 matches PIT policy objectives with four PIT design elements. If raising revenue is a country's primary goal, the basic PIT design would include broad coverage of both persons and types of income subject to tax. Countries can increase the share of the population subject to income tax by adopting a zero or relatively low PIT threshold. Taxable income would include both capital income and foreign source income.

Diamond and Saez (2011) provide a useful framework for choosing a revenue-maximizing top PIT tax rate, which requires balancing the deadweight burden of higher tax rates against the increased revenue. The challenge is determining the tax elasticities of taxpayers in the top tax bracket. These elasticities depend on economic responses of taxpayers and the availability of opportunities to avoid or evade paying taxes. When opportunities for tax avoidance and evasion are many, the optimal tax rate would be lower.

Countries seeking to maximize revenue would invest in tax capacity to improve enforcement and compliance, for example adopting or improving reporting and withholding regimes, facilitating electronic or return-free filing, and improving audit and collection capabilities. Policymakers' time horizons are also important, because revenue-maximizing strategies (especially investment in tax capacity) can depend on short-term and long-term revenue objectives.

Countries seeking to use the PIT primarily for redistribution purposes would choose progressive tax rates and a relatively high PIT threshold. Selecting a top marginal rate requires balancing the equity gains from higher taxes on high-income individuals and the efficiency losses from changing work and investment

decisions.[28] A relatively high tax threshold would reduce or eliminate the income tax burden on low-income individuals. Effective taxation of high-income individuals requires a broad tax base that includes income from capital and foreign sources, along with effective taxation of sole proprietorships and partnership income (either in the PIT or included in a business enterprise tax covering business income from corporate and noncorporate entities).

Focusing on more than just the tax system (or the progressivity of a single tax instrument) is important when using fiscal policy to reduce inequality. Spending programs can be more effective than taxes in reducing inequality. For many developed countries with effective social spending programs, it could make sense to have less progressive (or even regressive) taxes to fund progressive spending programs (Kato 2009), as in GCC countries, for example, where tax revenue is likely to remain small for the foreseeable future.

If countries want to use the tax system to improve government transparency and accountability, increasing coverage of the PIT to increase the taxpayer–voting citizen overlap is desirable. Increasing the transparency of taxes and spending programs and gaining a better understanding of the incidence of taxes and beneficiaries of spending programs will strengthen the fiscal component of the social contract.

Possible Approaches in the MENA Region

Beyond the key policy parameters discussed, countries can focus on four main considerations in adopting or expanding a PIT regime:

- Whether to adopt a semicomprehensive PIT or a dual income tax regime that applies different tax rates to income from labor and from capital. Choices made on taxing passive and active business income have a strong influence on this decision. Assessing in advance whether the income tax system is closer to a comprehensive tax or a dual tax can be useful.
- How to tax active business income of sole proprietorships and partnerships. The two primary options are to tax noncorporate business income under the PIT or to adopt a business profits tax that would apply to all business income regardless of organizational form.
- How to tax passive income, such as dividends, interest, rents, royalties, and certain types of capital gains. Such income could be included in the individual's income tax base (similar to labor income) and taxed at progressive rates. Another option applies a separate flat rate to certain types of passive income, which can be the same across all types or differ by capital income type; calibrating the rate with the top PIT and CIT is important for effective design. Countries could require the individual receiving the income to pay

[28] To reduce income inequality, many developed countries use tax subsidies to increase investment in human capital and encourage low-income workers to work more. A high exempt threshold in the early years of a PIT could be the most effective means of not taxing low-income workers, but in later years, using the tax system to subsidize low-income workers could be considered.

tax directly, or they could collect taxes through withholding by the payor. Withholding is a more effective collection method, especially because digitalization enables direct collection from third parties.

- The type of PAYE regime to apply to wages and salaries. The simplest regime provides for final withholding by employers with few or no adjustments for personal circumstances or other income. At the other end, the PAYE regime provides for provisional withholding, and employees must still file income tax returns. Between these approaches are regimes that allow employers to adjust for personal circumstances and provide for provisional withholding for employees with substantial income from second jobs or other sources.

In all cases, countries should design tax laws that provide clear guidance to taxpayers and tax authorities about potential obligations under the PIT, and adopt administrative regimes that make compliance and enforcement as simple and effective as possible. The following discussion suggests possible PIT design and policy choices by country grouping.

Hydrocarbon-Exporting Countries without PITs

This group of countries (GCC countries) has the most flexibility in PIT design. Political (not administrative) constraints play a major role in PIT design and policy choices. Policy options for this group include mimicking a PIT with other tax instruments or adopting a basic, starter PIT.

Mimic a PIT without a PIT

This approach taxes personal income under tax instruments other than a PIT. Economists have long recognized that consumption taxes are similar to taxes on labor, given the high correlation between income and consumption, which is strongest for low-income groups. Several GCC countries (Bahrain, Oman, Saudi Arabia, United Arab Emirates) have recently adopted VATs and excise taxes on tobacco, alcoholic drinks, and sugar-sweetened drinks. All GCC countries also apply SSCs. When these contributions are not tied to benefits returned to individuals, they function as a flat tax on labor income. The combination of SSCs and consumption taxes operates as a stealth, relatively flat PIT.

GCC countries can also tax nonlabor personal income without a PIT by extending to GCC nationals the business income tax that applies to sole proprietors and partnerships (including professionals) of non-GCC nationals in Oman, Qatar, and Saudi Arabia (where it currently applies). A similar tax could be introduced in other GCC countries.[29] Flat-rate taxes on business income that apply regardless of organizational form are similar to the business tax regime adopted in Djibouti and Mauritania (where they coexist with a broader PIT).

[29] IMF (2016) estimates that the revenue yield of a business profit tax for GCC countries would be about 3 percent of GDP.

An advantage of this option in the GCC is that the combination of VAT, SSCs, and business profit tax can mimic a progressive income tax because individuals with business income could face a higher tax rate on income relative to individuals earning only (lower) wage income. Although this option would make the entire tax system progressive, the spending side of the budget would still offer potential for greater redistribution until conditions allow the introduction of broad-based progressive PITs.

GCC countries can also adopt schedular taxes on certain types of portfolio income (through final withholding), real property taxes, and wealth transfer taxes as proxies for taxing personal income directly. Several forms of real property taxes already exist in some countries, but taxes on wealth as proxies of income taxes are likely to face more political challenges than introducing a PIT. Therefore, the more realistic approach in the short term is to focus on how to build the tax system toward explicit and effective PITs.

Starter (or Basic) PIT

A starter PIT begins with a simple PAYE final withholding tax with a high threshold exemption on public and private employees' labor income—this is essentially the income tax that Oman announced in June 2025, which will apply at a flat rate of 5 percent on annual incomes in excess of roughly USD 100,000. Initially, it could apply at a relatively low tax rate that will gradually increase to align PIT and top marginal rates on profits. Policymakers would need to examine the combined tax burden on labor income of a new PIT with existing SSCs to calibrate the basic design elements of the PIT (threshold and rates). Countries can combine the labor withholding tax with a tax on business income and final withholding taxes on certain types of passive income.

Hydrocarbon-Exporting Countries with PITs

For hydrocarbon exporters with PITs (all FCSs except for Algeria and Iran), a gradual approach that considers administrative capacity and political economy factors is likely the most feasible. FCSs face the greatest tax reform challenges and have the fewest options (Mansour and Schneider 2019). The starting point is to examine the current tax regime's strengths and weaknesses and assess how political challenges and fragility disrupt tax collection.

For FCSs needing to reset their tax regime, a PAYE withholding tax is the likely centerpiece, with flat or few progressive rates applied to wages of public sector employees and those of larger employers, including state-owned enterprises. In those countries, it can make sense to defer taxing nonwage income under a PIT, except for schedular taxes on certain passive income (final withholding taxes on interest and dividends).

Given administrative capacity and political instability, simplicity in tax design and collection should be the overriding guide. Minor taxes that raise little revenue but create substantial administrative challenges and costs should be eliminated to reduce compliance costs and improve enforcement, which is especially important for earmarked taxes. Those taxes fall on wages or turnover of businesses

(incorporated or not) and weaken the key taxes that should raise the largest share of revenues. Equally important is to eliminate exceptions and exemptions from the withholding tax on income and avoid deductions from the tax base (or tax credit), except for the bracket taxed at zero percent.

Depending on administrative capacity, countries could consider delegating some taxing and spending responsibilities to local governments to strengthen the link between where taxes are collected and where the revenues are spent. That approach also makes sense in the context of asymmetric political fragility across the region, such as in Iraq. In effect, this amounts to vertical tax integration to lessen the impact of fragility on the central government's role in providing local services.

Unlike other oil-exporting countries, Algeria's PIT revenue-to-GDP ratio was about 4 percent in 2022 (compared with less than 1 percent in 2000). Understanding what caused tax revenue to increase and how it relates to the public sector versus the private sector is crucial to considering how to improve Algeria's PIT. A possible reform is to improve the policy and administration related to taxing nonwage personal income under the PIT (passive capital income and business income of unincorporated businesses).

Hydrocarbon-Importing Countries

The revenue contribution from PITs differs sharply across non-FCS hydrocarbon importers. Countries raising substantial PIT revenue, should focus reforms on enhancing PIT neutrality in taxing the various forms of capital income, and on redistributive capacity, in coordination with SSCs. Countries can expand the tax base by taxing active business income and passive capital income more effectively and limiting deductions (which are regressive) to achieve specific policy objectives. For countries not seeking additional revenues, top marginal tax rates on labor income (combined PIT and SSCs) could be reduced to enhance labor market incentives—for example, as Morocco did with its top PIT since 2000.

Hydrocarbon-importing countries that tax the active business income of sole proprietorships and partnerships under the PIT should compare relative tax burdens for business income under the PIT and CIT regimes and consider options to reduce it. As proposed, countries could consider removing active business income from the PIT and taxing it under a business profits tax instead, one that applies to all business income regardless of organizational form.

The PITs of several hydrocarbon-importing countries function as dual income tax regimes that tax labor income at progressive tax rates but tax most forms of capital income (generally through withholding) at different rates ranging from 0 to 25 percent. Moving toward a formal dual income tax system eliminates differential tax treatment across types of capital income.

Wealth Transfer Taxes

MENA countries with existing wealth transfer taxes can evaluate their strengths and weaknesses and identify reforms that could make them more effective. As in

other countries, the question is whether the revenue raised and effectiveness of these taxes in reducing inequality and wealth concentrations justify the political and administrative challenges they create.

If the primary objective is to increase the tax burden on high-net-worth individuals, improving the design and administration of taxing capital income under the PIT could be more effective than adopting wealth transfer taxes. However, if the objective is to break up large wealth concentrations and reduce inequalities, wealth transfer taxes can play an important role.

A wealth transfer tax could be designed as part of existing or future PITs by taxing gifts and inheritances as income to the beneficiaries. A flat, low tax rate would avoid bunching income that could lead to higher tax liability under a progressive income tax system. The PIT could also treat transfers of appreciated property (whether by gift or inheritance) as taxable to the transferor, which would prevent deferral of tax on any unrealized gains from appreciated property.

CONCLUSION

PIT revenues have remained stagnant on average in the MENA region since 2000, but the taxation of individual income has shifted. Top marginal tax rates on individuals' labor and business income have declined substantially. This trend started in the 1980s, when tax rates were high in MENA countries, and it mirrors rate reductions found in advanced, emerging, and developing countries worldwide.

SSCs are important elements of MENA countries' tax systems. On average, rates have increased by 2 percentage points for employees and 2 percentage points for employers, and some countries have added low-rate payroll taxes. In GCC countries, where VATs now exist, the combination of SSCe and VATs is economically equivalent to a flat tax on labor income in the formal sector, with combined rates ranging from 9 percent in Qatar to 25 percent in Saudi Arabia. This will strongly influence how GCC countries will shape personal income taxation.

PITs in the region are highly progressive at low wages, while income from capital and business activities are taxed lightly or not at all. Revenue from these sources remains low, estimated at less than 1 percent of GDP on average and concentrated in hydrocarbon-importing non-FCS countries. As a result, regional tax systems do little to shift the tax burden to higher-income individuals and raise more revenue.

Wealth transfer taxes are also insignificant in the region. Based on international experience and the region's limited taxation of capital income, such taxes appear unlikely to be adopted, or where they exist, made more effective revenue instruments for reducing wealth concentration.

The prospects and possibilities for adopting or strengthening PITs in the region depend largely on policymakers' time horizon and their enthusiasm for using PITs for redistribution and state-building or narrowing the gap between the high taxes on formal sector labor and the much lower taxes on other income

sources. Policymakers focused on short-term revenue needs and with little interest in using PITs for other purposes are likely to rely on existing VATs and excise taxes to raise revenue and to address inequality and redistribution through targeted social spending programs. Policymakers with a longer-term perspective likely see a significant role for PITs in a country's tax regime.

Countries must start somewhere. Small steps taken in the next few years—as in the United Arab Emirates, which recently applied its corporate profit tax to individuals' business income—could increase the likelihood of a more robust PIT later. Given the wide economic and political differences across the region and the varied paths countries have taken to raise revenue to fund government operations, choices on PIT reforms will almost inevitably diverge in the coming decade.

ANNEX 3.1. DETERMINANTS OF PERSONAL INCOME TAX REVENUE

The methodology for estimating the economic and policy factors associated with changes in personal income tax (PIT) revenues follows Benedek, Benítez, and Vellutini (2022). The following equation was estimated using two-stage least squares with lagged instrumental variable to address the simultaneity problem, and robust standard errors to correct for heteroskedasticity:

$$pit_{it} = \alpha + \beta \cdot e_{it} + \gamma \cdot p_{it} + \mu_{it},$$

where pit is PIT revenue in percent of GDP; i and t are country and time subscripts, respectively; e is a vector of economic variables; p is a vector of tax policy variables; and μ is an idiosyncratic random and uncorrelated error term.

Economic variables include the following (with parentheses indicating expected sign of correlation):

- The natural logarithm of GDP per capita (positive): A measure of the level of economic development, it typically correlates positively with PIT revenues: As income levels increase, PIT revenue in percent of GDP also increases, if PIT design allows for capturing this growth. This variable could also capture other state characteristics such as quality of institutions and corruption levels, but not always—for example, oil wealth could be negatively correlated with PIT revenues and positively correlated with corruption.
- The public wage bill in percent of GDP (positive): This is a measure of the public sector employment size, which is relatively easy to tax. It captures only what is accounted for as government wages in governments' financial operations tables and might not include wages of state-owned enterprises and other quasi-public entities.
- Inflation (positive): Inflation can be positively correlated with PIT revenues when taxpayers are pushed into higher tax brackets because of increases in the price level. Most countries do not index their tax brackets to inflation (Beer, Griffiths, and Klemm 2023).

- Agricultural or primary sector value added in percent of GDP (negative): This is a measure of the hard-to-tax and often exempt sector of the economy.
- Self-employment in percent of total employment (negative): Self-employed individuals are hard to tax in developing and transition economies. The higher their share of total employment, the lower the expected PIT revenue.

Policy variables include the following (with expected sign of correlation in parentheses):

- Exempt (or taxed at zero) income bracket, in percent of GDP (negative): All else equal, the higher the exemption threshold, the lower the PIT revenues in percent of GDP.
- The top income bracket, in percent of GDP (negative): This is the income level (in percent of GDP) at which the highest tax rate applies, and thus its effect depends on the rate structure. The higher this ratio, the lower the PIT revenue. This relationship would be expected to be strong in MENA countries, where capital income is taxed lightly, and therefore wages must reach high levels for the top tax rate to apply.
- The lowest nonzero tax rate (positive): An extremely low rate implies less revenue than a higher rate.
- The top tax rate (positive): A high top rate implies more revenues than a lower rate.

The analysis controls for country-specific dummies for the deductibility of SSC from the PIT base, hydrocarbon importers, and non-FCSs. Other controls used include CIT revenue in percent of GDP (ambiguous sign) to account for policy choices, such as raising more from CIT than from PIT and tax planning through incorporation (in which case the expected sign is negative) or to reflect changes that affect all tax sources positively, such as improvement in tax administration (in which case the expected sign is positive) and the difficulties in separating the economic meaning of PIT and CIT relative to their accounting classification.

Data on tax revenues are from the IMF's World Revenue Longitudinal Database (Mansour and others 2025), which separates (to the extent data are available) revenue from nonrenewable resources (oil, gas, and mining) from nonresource (tax and nontax) revenues. These data are from IMF article IV consultations, in which countries report their fiscal data to the IMF, following (broadly) the IMF's Government Finance Statistics classification. PIT rates and tax brackets are from the PIT database maintained by the IMF's Fiscal Affairs Department; these data are collected from various sources, including the International Bureau of Fiscal Documentation; PwC Worldwide Tax Summaries Online, and countries' tax laws. Economic variables are from the IMF's World Economic Outlook database.

Annex Table 3.1.1 reports the results. Invariably to the specification used, per capita GDP, the public wage bill, and the top marginal tax rates are all significant,

ANNEX TABLE 3.1.1.

Policy and Economic Determinants of Personal Income Tax Revenue in the Middle East and North Africa, 1990–2020

	PIT Revenue (percent of GDP)			
Variables	**(1)**	**(2)**	**(3)**	**(4)**
GDP per capita (log of constant USD)	**2.089*** **	**2.420*** **	**1.640** **	**1.919** **
	(0.70)	(0.83)	(0.76)	(0.87)
Primary sector value added (% of GDP)	0.206	0.271	0.369*	0.425*
	(0.160)	(0.166)	(0.223)	(0.221)
Self-employed (% of total employment) (ILO estimate)	0.030	0.021	−0.015	−0.023
	(0.067)	(0.062)	(0.073)	(0.067)
Public wage bill (percentage of GDP)	**0.419** **	**0.427** **	**0.342*** **	**0.349*** **
	(0.176)	(0.177)	(0.130)	(0.131)
Inflation, consumer price index (annual change in %)	0.174	0.164	0.151	0.142
	(0.186)	(0.179)	(0.152)	(0.147)
Exempt income to GDP per capita	0.582	0.375	0.644	0.469
	(0.392)	(0.393)	(0.401)	(0.436)
PIT lowest positive rate	1.496	0.191	0.829	−0.276
	(8.661)	(8.409)	(8.757)	(8.340)
PIT lowest positive rate times exempt income to GDP per capita	−8.518	−6.968	−5.066	−3.744
	(7.024)	(6.583)	(6.241)	(5.832)
PIT top marginal rate	**10.55** **	**9.839***	**14.14** **	**13.55***
	(5.227)	(5.023)	(7.188)	(7.058)
CIT revenue (% of GDP)	0.103	0.0621	0.11	0.0756
	(0.159)	(0.181)	(0.155)	(0.174)
Top PIT bracket to GDP per capita	0.000	0.001	0.001	0.001
	(0.001)	(0.001)	(0.001)	(0.001)
Ratio of exempt income to top PIT bracket	−0.424	0.416	−1.073	−0.364
	(2.872)	(2.964)	(2.620)	(2.760)
SSC deduction dummy	−2.542	−2.737	−2.846	−3.011
	(1.815)	(1.830)	(1.821)	(1.892)
Hydrocarbon-importer dummy		0.528		0.446
		(0.464)		(0.454)
Nonfragile states dummy			−1.994	−2.000
			(1.884)	(1.914)
Constant	−24.08***	−27.00***	−18.61**	−21.07**
	(8.227)	(9.238)	(7.575)	(8.582)
Number of observations	69	69	69	69
R^2	0.786	0.797	0.810	0.815

Sources: Authors' estimation based on data from IMF, World Revenue Longitudinal Database (November 20, 2024); IMF World Economic Outlook Database; and World Bank, World Development Indicators Database.
Note: Robust standard errors are in parentheses. CIT = corporate income tax; ILO = International Labour Organization; PIT = personal income tax; SSC = social security contribution.
* $p < .10$; ** $p < .05$; *** $p < .01$.

and all other variables are not except for the primary sector value added, which is weakly significant in specifications (3) and (4), with an unexpected positive sign. These two specifications also suggest that isolating FCSs and oil-rich countries tends to increase the importance of the top tax rate's effect on PIT revenue relative to that of public sector wages and GDP per capita, which suggests that the top tax rate (a policy parameter) plays a more important role in the PIT revenue yield in non-FCS hydrocarbon-importing countries.

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CHAPTER 4

Corporate Income Taxation

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INTRODUCTION

Approaches to the corporate income tax (CIT) in the Middle East and North Africa (MENA) region differ beyond hydrocarbon exporter status. They reflect the historical sources of the legal system, the presence or absence of fragility or conflict, and the level of institutional capacity. This chapter presents a brief account of corporate taxation in the MENA region, focusing on CITs applied to privately owned corporations outside of the extractive sector.[1] Generalizing about the nonhydrocarbon CIT is difficult, but the chapter makes a few broad observations and extends the discussions to subgroups of MENA countries.

Perhaps most salient is that despite reasonably high statutory CIT rates in the region, effective rates and the CIT revenue productivity are low because of tax incentives, including generous tax holidays (Figure 4.1) and potentially profit shifting.[2] In some cases, this pattern results from a historic absence of a CIT (Bahrain) or challenges in fragile states (Libya, Yemen). The second section of this chapter outlines the history and existing CITs in the region.[3]

Ongoing global transformations in the energy market could have a significant impact on the future role of taxes in MENA countries, including the CIT. The possibility that global demand for fossil fuels will decline because of efforts to combat climate change is most significant for hydrocarbon exporters. The timing of the impact of this structural change could vary across countries—for example, initial cuts elsewhere could give a temporary boost to some MENA countries' market shares (see Chapter 8). However, in the long term, this development will increase the pressure to diversify the economy and substitute hydrocarbon revenues with tax revenues. Structural revenue transformation can be read in this context.

Another global development with initial effects already apparent is the ongoing multilateral effort to reform the taxation of multinational enterprises (MNEs; see section "Recent International Developments and Implications for the

[1] See Chapter 8 for a discussion of fiscal regimes and taxation of hydrocarbon production.

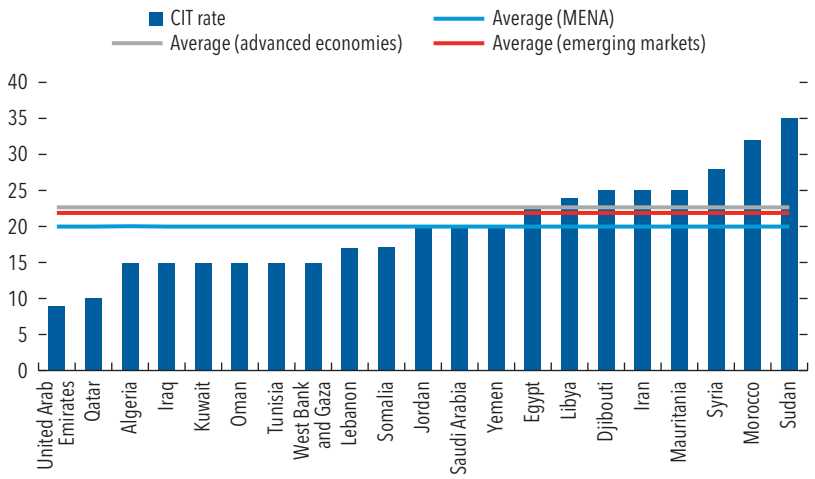
[2] Profit shifting cannot be ruled out as another reason for the low revenue productivity of the CIT, at least in countries where tax rates are relatively high.

[3] The discussion in this chapter covers primarily country-specific CIT changes up to 2024 and touches on more recent international developments in the taxation of multinational enterprises.

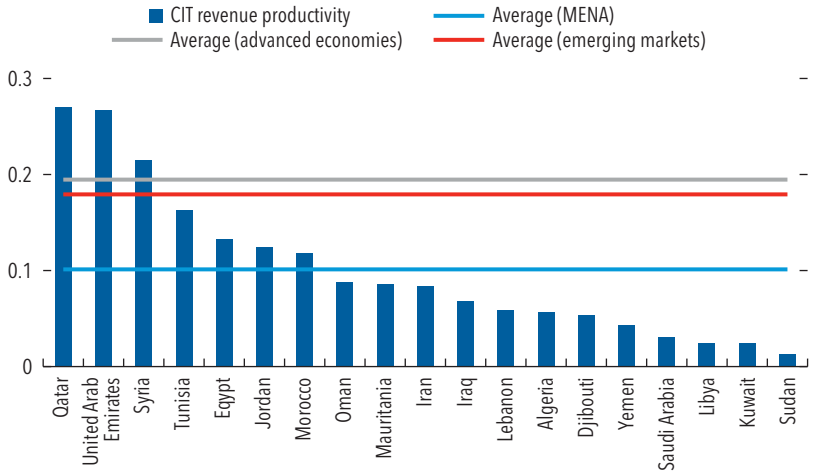
Figure 4.1. MENA Region CIT Rates and Productivity

1. Statutory Corporate Income Tax Rates

(Percent)



2. Corporate Income Tax Revenue Productivity



Sources: IMF, World Longitudinal Revenue Database (November 20, 2024); International Bureau of Fiscal Documentation; and authors' calculation.
Note: Statutory CIT rates are for 2024. CIT productivity = (CIT revenue ÷ GDP) ÷ CIT rate. This indicator shows CIT revenue in percent of GDP generated per each point of the CIT rate, excluding revenue from special (non-CIT) fiscal regimes for the hydrocarbon sector. It is computed based on data availability; information on nonhydrocarbon CIT revenue is unavailable for Qatar and the United Arab Emirates. Data are the latest available (2021 or 2022) except for Syria (2010). CIT = corporate income tax.

Region"). A critical mass of countries adopting the minimum corporate tax of Pillar 2 in the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) means that the extremely low effective rates of CIT found across the region might no longer incentivize foreign direct investment (FDI) or permit the establishment of investment hubs (without certain alterations). In response to the changing landscape of taxing MNEs, several MENA countries have made or are considering significant changes in their approaches to CITs, as with the new United Arab Emirates CIT. Another aspect of Pillar 2 is the subject-to-tax-rule (STTR) that can potentially apply to bilateral tax treaties, and it also has an impact on the rates and design of domestic CITs in some countries.

OVERVIEW OF CORPORATE INCOME TAXES ACROSS THE MENA REGION

Gulf Cooperation Council Countries

The tax systems of the six Gulf Cooperation Council (GCC) countries—Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates—differ enough from those of other MENA countries to warrant separate discussion. A brief history of their CITs shows multiple shifts since the mid-20th century. In recent years, the GCC has been known for having little or no taxation outside the resource extraction sector, but that is starting to change. The low-tax environment has served more than one function: It was designed both to attract investment into the region and, in some jurisdictions, establish a conduit investment hub through combining low taxes with a rich tax treaty network.[4] Box 4.1 examines the CIT in the United Arab Emirates and its recent reforms.

The introduction of modern taxes in the region began in the 1950s. Notably, Saudi Arabia introduced taxes on personal income and capital gains and on corporations in 1950 on both Saudi nationals and nonnationals. However, the tax law was reformed almost immediately to exclude nationals, and in 1975, income taxes on foreigners were also suspended.[5] From 2010 to 2015, between 50 percent and 90 percent of government revenues in the six countries came from hydrocarbons, with nonhydrocarbon tax revenues averaging only about 1.7 percent of GDP across all taxes. Companies engaged in oil and gas extraction are subject to profit taxes and special fiscal regimes (such as production-sharing contracts) at rates that could reach up to 85 percent (for example, in Saudi Arabia and the United Arab Emirates), regardless of ownership.

Profit taxes in the GCC at the beginning of 2023 applied only to foreign nonhydrocarbon enterprises, except for Bahrain (which still does not impose a general CIT) and Oman (which applies a CIT at 15 percent to both domestic and foreign companies above a size threshold, defined using capital, gross income, and

[4] A conduit investment hub attracts a substantial amount of FDI that is channeled to other countries.

[5] See IMF (2016) and Mansour (2015).

number of employees). However, tax incentives reduce the effective tax rates on companies across the GCC substantially, sometimes to zero.

Saudi Arabia's income tax applies only to persons engaged in resource production and extraction and foreign persons engaged in other activities in the country at a statutory rate of 20 percent and at 50 percent to 85 percent on income from hydrocarbon production. The standard CIT of 20 percent is levied on the portion of profits attributable to non-GCC ownership. In contrast, Zakat (a form of wealth tax paid by Muslims) is mandatory and chargeable to GCC-owned companies resident in Saudi Arabia at 2.5 percent of total company capital resources not invested in fixed assets.[6] However, the statutory 20 percent tax on the income of foreign nonpetroleum companies is far from universal because of generous incentives. In April 2023, the Saudi Arabian government announced the launch of four special economic zones spread across the country, some of which focused on technology. A 5 percent CIT rate applies within these zones for up to 20 years, with no withholding tax on repatriation of profits to foreign countries. In 2021, the government also announced that government contracts would not be awarded to companies that did not relocate their regional headquarters to the country—a strong incentive to do so. Then in December 2023, it announced that relocating companies would be granted a 0 percent CIT rate for 30 years, along with no withholding on repatriated profits. The Saudi authorities have been considering modernizing their CIT, and more changes could be expected.

Kuwait's income tax applies at 15 percent to income realized in Kuwait by foreign entities conducting trade or business in Kuwait (except for GCC entities fully owned by GCC citizens). In November 2023, Kuwait announced its intention to extend its 15 percent CIT beyond foreign-owned businesses to all business entities that are in scope for Pillar 2, starting in 2025. Kuwait has broad tax incentives—activities in free zones are not subject to the income tax, and investment projects licensed under the Foreign Direct Investment Law of 2001 (Law No. 8/2001) were previously granted 10-year tax holidays (which was changed in 2013 to a 10-year tax credit mechanism for new investments). Recent updates in 2024 and 2025 reintroduced the 10-year tax holiday, with complex eligibility criteria based on a scoring system that attempts to evaluate an FDI project's benefits to Kuwait.

Oman currently taxes only the income of businesses, including Omani companies and permanent establishments of foreign companies operating in Oman, while individuals' nonbusiness income is not taxed. Generally, the income tax rate is 15 percent on a worldwide basis, with reduced rates of 3 percent or zero for small and medium enterprises if they meet specific conditions. More income tax incentives are provided through a range of tax and nontax legislation, including tax holidays.[7]

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[6] Zakat is paid by Muslim individuals at 2.5 percent of net wealth above a threshold ("Nisab"). In Saudi Arabia, Zakat is legally mandatory for both individuals and companies; elsewhere in the GCC it is voluntary. Zakat revenues are typically earmarked for social and charitable activities.

[7] Oman recently announced a personal income tax of 5 percent on individuals' income (see Chapter 3).

The **United Arab Emirates** did not have a corporate income tax until 2023 (although taxes on the petroleum sector applied and will continue to exclusively apply at the sub-federal emirates level). In December 2022, the country announced that a new CIT would be imposed at 9 percent on profits above a low taxable threshold, effective for tax years beginning after June 2023. However, qualifying income of free zone entities are taxed at 0 percent (thus the 9 percent tax applies only to mainland entities.) Free zone entities are prohibited from generating active income from dealings with unrelated mainland entities.[8] Free zones exist within all the emirates and include two financial free zones in addition to those focused on commercial and industrial activities. Box 4.1 provides more details on the new United Arab Emirates regime and its interactions with aspects of Pillar 2 of the OECD/G20 Inclusive Framework on BEPS.

Qatar levies a 10 percent CIT on foreign-owned companies, though wholly Qatari- and GCC-owned companies are generally exempt. Companies established in free zones could benefit from tax holidays of up to 10 years or from preferential tax rates.

Bahrain does not have a CIT, but it recently adopted the global top-up tax on multinationals that are in scope of the Inclusive Framework minimum corporate tax.

Interaction with Personal Income Tax

Countries that introduce domestic CITs without personal income taxes (in the region, mainly the GCC countries now under consideration) face a challenge and atypical situation. In principle, the tax system should be neutral regarding the sources of income (across capital incomes—including dividends, interest, and capital gains—and forms of labor income, mainly wages and bonuses) and the legal form of the business (a corporation or limited liability company, among others). Countries with CIT rates lower than personal income tax rates (as in several European countries) often have anti-avoidance rules to prevent corporations from being used as holding companies for income-producing wealth, such as passive investment income. However, issues in this reverse case could arise if individual domestic (or GCC) shareholders in domestic corporations exert enough control to strip income from their companies—for example, by lending funds to the company subject to deductible high-interest payments or by providing services for which excessive (deductible) payments are made. This issue is especially relevant to closely held companies, requiring adequate anti-avoidance rules. Interactions with the Zakat for individuals must also be considered.

[8] Mainland entities are those registered with the Department of Economic Development of a specific Emirate, as opposed to a Free Zone Authority.

Box 4.1. The New Corporate Income Tax in the United Arab Emirates

The United Arab Emirates instituted a corporate income tax (CIT) in 2023, but before that, it had a network of more than 100 bilateral tax treaties in force. Fifteen of these treaties entered into force in the 1990s and another 14 between 2000 and 2010. All others came into force or had decrees issued starting in 2010. Several that were signed in 2021 have not yet been entered into force. Most of the treaties afford a zero rate of withholding tax on interest payments, with most dividend withholding rates at 0 or 5 percent, but a few are as high as 10 or 15 percent.

The treaty network represents a deliberate and successful effort to create an investment hub, as confirmed by foreign direct investment flows through the country. In 2021, inbound investment totaled approximately 41 percent of GDP, with outbound flows at 52 percent of GDP. The flows also constituted the 19th and 17th highest flows in absolute terms in the world, respectively, even though the United Arab Emirates represented less than 0.5 percent of worldwide GDP in that year.

The OECD/G20 Inclusive Framework's Pillar 2 minimum tax lowered the appeal of no CIT. Regarding the subject-to-tax rule, the country's choice of 9 percent CIT coincides with the subject-to-tax rule rate of 9 percent, which means that a developing country could have requested a change to the treaty withholding tax rates with the United Arab Emirates—from a level lower than 9 percent—if the United Arab Emirates had not imposed the 9 percent CIT. However, entities benefiting from tax holidays can remain in the scope of the subject-to-tax rule if they do not have sufficient economic substance or if a particular regime applied in the United Arab Emirates is considered harmful under OECD criteria.

However, the effective minimum tax of 15 percent—on a country-by-country basis—will have an impact on foreign investment into the country by in-scope multinational enterprises. Those entities (if headquartered in an implementing country) face a top-up tax equal to the difference between the country's tax charged (9 percent in the mainland or zero under a CIT holiday regime) and the 15 percent effective rate of Pillar 2. For some entities, the substance-based income exclusion can be large enough to dwarf the top-up tax (when the foreign direct investment is invested in substantial tangible assets and payroll inside the country).

The United Arab Emirates could capture this difference in tax liability by adopting a qualified domestic minimum top-up tax, which it did after public consultations on Pillar 2 in 2024. It adopted a domestic minimum top-up tax, effective for financial years starting on or after January 1, 2025, that is expected to qualify as a qualified domestic minimum top-up tax for Pillar 2 purposes and will apply to constituent entities that are members of

a multinational enterprise group operating in the country with annual global revenues of €750 million or more.

Sources: Based on Hull (2023), MOET (2024), Peter (2022), and UAE (2022).
Note. "Developing countries" in this chapter are those with a gross national income per capita of $12,535 or less in 2019, based on the World Bank Atlas method. The Inclusive Framework agrees that this definition would also apply to 2020 to 2023 (OECD 2023a).

Lower- and Upper-Middle-Income Countries

Algeria, Djibouti, Egypt, Iran, Jordan, Morocco, and Tunisia are lower- and upper-middle-income countries that largely have standard CIT structures (though needing modernization, in some cases) with statutory rates aligned more with the rest of the non-low-tax jurisdictions in the world. The rates range from a low of 15 percent (Iraq, Tunisia) to 31 percent (Morocco has progressive rates on net taxable income exceeding the equivalent of $100,000). CIT rate trends in the region and worldwide have been downward sloping (for example, Tunisia's current rate of 15 percent has fallen from 35 percent in 2005).[9] Total tax revenue outturns for some countries—Egypt, with 12.5 percent on average over the past decade—resemble those in developing countries. However, Morocco and Tunisia generate tax revenues of 22 percent to 23 percent of GDP, and Jordan was in between in 2022 at 17.6 percent. The CIT in these countries contributes 15 percent to 30 percent of total tax revenues, so generalization is difficult.

Broadly, the countries' tax systems in this group have many exemptions and incentives that make effective CIT rates considerably lower than the statutory rates would imply. The incentives' discretionary elements and their sheer volume create an environment that enables rent-seeking and corruption (a situation not unique to MENA countries). However, scope exists to increase the revenue outturn of the CIT, a focus of several countries.

Algeria's principal statutory CIT rate is 26 percent, with rates of 19 percent applying to manufacturing (10 percent for reinvested profits) and 23 percent to building and tourist activities. Algeria's corporate tax is on a worldwide basis. Although the rate regime is complex, and the system of tax incentives is even more so, the law itself lacks certain features such as a foreign tax credit (though available under treaties) and controlled foreign corporation (CFC) rules. Algeria inserted a new provision into the 2019 Finance Law that limits interest deduction as a result of (but not the same as) the thin capitalization measures under Action

[9] Morocco has announced in the 2023 Finance Bill that rates will gradually converge (by 2026) to 20 percent for companies with net taxable income of less than DH 100,000,000 (equivalent to about $9,000,000) but gradually increase to 35 percent (from 31 percent) for companies with net income exceeding that level.

Item 4 of the OECD/G20 BEPS Project. Tax incentive regimes are broad, generous, and discretionary and include, for example, tax holidays of 10 years for companies investing in specific zones and for companies making large investments described as potentially creating jobs and wealth. In 2023, fishing and aquaculture cooperatives were granted a permanent exemption from CIT, and profits from Islamic finance investment accounts were granted a new five-year tax holiday. The trend is thus toward expanding incentives rather than reducing them.

Djibouti's statutory CIT rate is 25 percent. However, the tax code is outdated and has not been updated regularly (for example, insufficient anti-abuse rules), and it is often incoherent (for example, confusion between taxation of rental income and real property). Incentives are available under the Investment Code and apply to all economic sectors to different degrees, and also under the Free Zone Code (Law No. 53/AN/04). The generosity of tax incentives granted under the Investment Code increases with the level of investment, with investors falling under either Regime A (smaller investments) or Regime B (larger-scale investments). Concerns have arisen over the governance framework related to granting incentives under the Investment Code, including the discretionary nature of some provisions or their interpretation, insufficient monitoring of compliance with filing obligations and paying the minimum tax, and opacity related to revenue foregone because of tax exemptions offered. The Free Zone Code grants a renewable 50-year tax holiday to qualifying companies operating in the zones. Similar governance concerns plague this incentive regime and result in large yet unmeasurable revenue foregone.

Egypt's statutory CIT rate is 22.5 percent, which is nearly the OECD average, but the base is narrow because of the many incentives and exemptions, especially in the private nonresource firms. More than half of CIT revenue—which is higher than the regional average—is generated from three major state-owned enterprises. The World Bank has estimated the cost of CIT expenditures at about one-third of CIT revenue collected from private firms, though others have suggested somewhat smaller numbers. Egypt, like most MENA countries, does not publish tax expenditures estimates. The existing incentives are complex; some take the form of deductions for actual investment (accelerated depreciation and allowances), which are generally considered a relatively effective form of incentive. Free zones provide CIT holidays, which are generally viewed as poor (and inefficient) targeting instruments to encourage investment (PCT 2025). Furthermore, entities in free zones can sell a portion of their goods and services domestically, which undoubtedly leads (as elsewhere) to leakage and distortion of competitive markets. Also, the design and administration of these exemptions often involve a significant degree of ministerial discretion.

Iran taxes corporate profits at 25 percent on a worldwide basis. Income from dividends and interest is exempt, and the country does not have transfer pricing rules. The country's many tax incentives include reduced CIT rates based on earnings growth rates; tax holidays of 5 to 13 years (at least) for companies in mining, manufacturing, and selected service areas; a reduced rate between 0 and

12.5 percent that started in 2022, based on a complex formula regarding paid-in capital for mining, manufacturing, tourism, transport, and health; permanent exemption of earnings from the export of nonhydrocarbon finished goods and services if the foreign currency proceeds are returned to Iran; indefinite tax exemption for the agricultural and carpet sectors; and zero rate for tourism. The range of incentives reduces the revenue outturn considerably—in 2020, CIT revenues were only 1.37 percent of GDP.

Jordan's basic CIT rate is 20 percent, but higher rates apply to certain sectors, such as telecoms, insurance, financial intermediation, electricity, banking, and mining. The rate and revenue outturn is not out of line with countries at Jordan's income level, but many incentives and exemptions, including sectoral and in economic zones, narrow the CIT base. The government has committed to tax-base broadening, including by rationalizing incentives. Improved compliance and administration efforts regarding these incentives will be helpful, but structural policy changes are also needed. Jordan, unlike most other MENA countries, publishes a summary of tax expenditures with its annual budget, though its coverage is incomplete. Overall tax expenditures total nearly 10 percent of GDP, but the CIT contributes only a small part.

Morocco began comprehensive CIT reform in 2023 that will continue through 2026, consolidating the variety of complex sectoral and size-related rates to 20 percent and 35 percent (for companies with net profits of more than $9 million) and reducing the tax on distributed dividends to 10 percent—higher flat rates still apply to banking, insurance, and telecommunication. Morocco's Casablanca Finance City is the largest investment center in Africa, and companies established there have a five-year CIT holiday (after which they are taxed at 20 percent) and exemption from withholding tax on dividends paid to residents and nonresidents.

Tunisia reduced the general CIT rate to 15 percent in the Finance Law of 2021. Before that, enterprises operating in strategic sectors were subject to a rate of 13.5 percent, but it was increased in 2021 to match the overall 15 percent rate. A similar increase from 10 percent to 15 percent was made in 2023 for agricultural activities and cooperatives. A higher rate of 35 percent applies to banks and financial institutions, offshore financial institutions providing services to nonresidents, insurance companies, telecom operators, services related to the hydrocarbon sector, car dealers, and franchisees of foreign brands or trademarks. However, tax holidays for companies are established in the regional development zones. In this multifaceted context, the corporate minimum tax is 0.2 percent of domestic turnover, with a lower rate of 0.1 percent for companies subject to the 10 percent rate, but the minimum tax does not apply to companies with tax holidays.

Fragile and Conflict-Affected States

Iraq, Lebanon, Libya, Sudan, Syria, Yemen, and West Bank and Gaza share fragility but are also fragile in their own ways. Libya is the wealthiest country on the African continent based on GDP per capita. Libya's wealth is due to its vast oil

and gas reserves. Sudan and Yemen are the two poorest countries on the continent and among the poorest in the world. Income distribution in Sudan is uneven, and the country has large regions of extreme poverty. After the IMF's Heavily Indebted Poor Countries decision point completion in June 2021, Sudan's military seized power in October 2021 and then descended into civil war in April 2023, leading to what is now one of the largest humanitarian crisis in the world.

Without generalities, advice for fragile and conflict-affected states regarding taxation typically focuses on establishing administrative controls at the border and over the largest taxpayers, relying on presumptive taxes in some cases (such as turnover taxes), prioritizing consumption taxes (such as few excises or single-stage sales taxes), and turning only later to the management of complex tax bases such as income taxes.

Most fragile and conflict-affected states have CITs that raise insignificant revenues because of implementation issues or very low effective tax rates—in some cases, a deliberate choice driven by the abundance of hydrocarbon revenues.

Iraq, a major oil producer, derived 71 percent to 83 percent of total GDP from oil revenues between 2021 and 2023, while nonhydrocarbon tax revenues were about 1 percent of GDP, and direct taxes made up at most one-third of that, including its 15 percent CIT.

Libya, the other major oil producer in this group, derives about 95 percent of both its exports and government revenues from oil.

Lebanon has been in a severe economic crisis since 2020. Government revenues have collapsed from about 20 percent of GDP to an estimated 6 percent in 2022. In 2018, the tax revenue ratio was only about 15 percent—much lower than Morocco and Tunisia and more in line with developing countries. The statutory CIT rate is 17 percent, but exemptions are prevalent. Lebanon offers a reduced CIT rate for reinvested profits and profit-based incentives under its Investment Law (including generous tax holidays), but it has not conducted a systematic cost-benefit analysis or published tax expenditures.

Other fragile states—notably the West Bank and Gaza and Yemen—face extremely difficult war situations and humanitarian crises. Syria opened a new chapter in its history in December 2024 after its first change in political regimes in more than 50 years. The CITs in all these countries would require a complete overhaul at the appropriate time.

The overview of the region's CITs suggests that despite country-specific differences, all countries have room to improve how they design tax incentives. Exploring alternatives to CIT holidays is critical for safeguarding revenue while better targeting the incentives to investment rather than profits. The empirical literature generally finds that cost-based incentives—such as accelerated depreciation—can reduce the effective tax on investment successfully without eroding the tax base (PCT 2015). Strengthening the capacity to evaluate CIT incentives and guide CIT reforms regularly remains a top priority in the region. In addition, stronger protection of the CIT base is essential, which in some MENA countries requires addressing legal design gaps and upgrading anti-tax avoidance rules. International tax developments reinforce this theme.

RECENT INTERNATIONAL DEVELOPMENTS AND IMPLICATIONS FOR THE REGION

The Base Erosion and Profit Shifting Project

This chapter does not provide a comprehensive explanation of either the original OECD/G20 BEPS Project or the ongoing digital economy taxation project (Pillars 1 and 2). Instead, it examines actions taken by MENA countries related to those international projects and associated issues that could be relevant to them in the future.

The BEPS Project concluded in 2015 and focused on closing loopholes in the existing international tax arrangements to limit MNEs' profit shifting into low- or no-tax jurisdictions. The project did not intend to fundamentally change the underlying system. At the implementation stage, other countries were invited to participate in designing the implementation process, and the Inclusive Framework was formed, which now encompasses 147 jurisdictions, including all GCC countries and Djibouti, Egypt, Jordan, Morocco, and Tunisia.[10]

The outcome of the BEPS Project was a list of 15 action items, and countries agreed on 14 of them. The first item, taxation of the digital economy, stalled and was later confronted with renewed vigor in the current Inclusive Framework project consisting of the two-pillar solution. Of the original 14 items, only four were made minimum standards, meaning that all members of the Inclusive Framework agreed to implement them. The others remained advisory only. The minimum standards include provisions to reduce harmful tax practices, provisions to prevent tax treaty abuse, country-by-country reporting by MNEs, and incorporation of mutual agreement procedures for dispute resolution. Action Item 15 provided for implementing a multilateral instrument (MLI) that would allow the minimum standards and other items to be adopted efficiently in bilateral treaties.[11]

Economic Substance Legislation and Harmful Tax Practices

Compliance with the BEPS Project Action Item 5 on harmful tax practices requires enacting appropriate domestic legislation and peer review of the legislation and its implementation. Though aimed especially at low- or no-tax jurisdictions, it applies more broadly regarding specific provisions in many countries. Complying countries generally enacted legislation starting in 2019, which they had to implement to avoid the European Union or the Inclusive Framework deeming them noncooperative or as having harmful tax practices. Countries must also show that they are implementing the rules properly. MNEs can receive fines for failing to meet substance rules enacted in jurisdictions that have implemented such legislation. Substance rules generally require adequate levels of expenditure,

[10] Of the MENA countries, only Saudi Arabia,(as a G20 country) participated in the original project.

[11] The MLI is not a multilateral treaty that would override existing bilateral treaties but was designed as a more efficient way to modify them.

presence of employees and actual premises, and evidence of income-generating activities in the jurisdictions. The rules were aimed especially at activities that derive income from intellectual property but apply more broadly, and the tests can be somewhat subjective.

Several MENA countries have taken steps to comply with the rules. Jordan, Morocco, Qatar, Tunisia, and the United Arab Emirates have done so and have been reviewed. They have amended multiple noncompliant regimes (or abolished the regime in one case), especially concerning differentially favorable treatment of foreign investors (ring-fencing). Even Bahrain, which does not have a CIT, adopted economic substance legislation. All of these countries' regimes were deemed nonharmful as of November 2024.

Country-by-Country Reporting for MENA Countries

All MNEs with group income in excess of €750 million are required to prepare a country-by-country report with aggregate data on the global allocation of income, profit, taxes paid, and economic activity among tax jurisdictions in which they operate. Under bilateral exchange of information agreements, the report must be shared with tax administrations for use in high-level transfer pricing and BEPS risk assessments. The local reports must not be used for actual transfer pricing assessments but only for risk flagging. Countries are also not permitted to receive their local reports unless they can satisfy certain legislative and (importantly) administrative implementation requirements to ensure that the information will be kept confidential to the tax authorities and not misused or released. As of October 2023, only six developing jurisdictions had qualified to receive those reports.

Among the MENA countries, Egypt (partially), Jordan, Morocco, Tunisia, and all GCC countries (except for Kuwait) have established the mandatory legal reporting framework, which is required to receive local reports, even in countries that do not host the headquarters of any in-scope MNEs. Only Morocco and Saudi Arabia (as of November 2024) had achieved reciprocity regarding the reports—in addition to having the legal framework, reciprocity requires signing the Competent Authority Agreement to enable the automatic exchange.

The MLI, Treaty Abuse, and MENA Countries

Treaty shopping refers to indirect FDI routes designed to minimize cross-border taxes over the life of the investment and to limit capital gains taxation on exit. In recent decades, treaty shopping has become one of the main avenues of profit shifting. Thus, the Action Item 6 provisions are especially salient to source countries that are trying to attract FDI. The anti–treaty abuse item is one of the important and now mandatory provisions that applies to implementing Action 6. As the OECD states:

> "Members of the BEPS Inclusive Framework commit to include in their tax treaties provisions dealing with treaty shopping to

> ensure a minimum level of protection against treaty abuse." (OECD 2021, p. 117)
>
> "The minimum standard on treaty shopping requires jurisdictions to include two components in their tax agreements: an express statement on non-taxation (generally in the preamble) and one of three methods of addressing treaty shopping." (OECD 2020, p. 15, para. 36)

Egypt, Jordan, Morocco, Tunisia, and all GCC countries have signed the MLI. Algeria and Lebanon have indicated their intent to sign. However, the MLI simply provides a framework for bilateral negotiation of new or modified provisions in existing bilateral tax treaties on several topics. Countries seeking to negotiate must determine with whom they want to seek modifications and on which provisions. Countries so far have not accepted or agreed with treaty partners on such provisions, and not all agreed positions have entered into force. However, the treaty-abuse provisions are subject to a regular and elaborate peer review process to ensure compliance.

The Inclusive Framework Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy

The BEPS Project's two-pillar solution to address the tax challenges arising from the digitalization of the economy addresses the two things that the original BEPS Project stated to be out of scope. Pillar 1 would fundamentally change the long-standing international tax architecture (to a limited extent) by allocating a portion of taxable corporate profits of the world's largest MNEs (more than 100 of them) to the location of consumption (market jurisdictions), giving them taxing rights even without an MNE's physical presence (a destination-based principle). It would accomplish this using a formula for apportioning those reallocated profits based on sales (rather than the arm's-length method of allocation). Pillar 2 would impose, also to a limited extent, a minimum level of corporate income taxation on MNEs' profits (with annual turnover exceeding €750 million) on a country-by-country basis.

Achieving agreement on those aspects of the Inclusive Framework is quite a remarkable breakthrough. However, on January 20, 2025, the United States took action to withdraw previous commitments to the OECD-led two-pillar agreement, which means that implementation of Pillar 1 is unlikely to come into effect at this time. Pillar 2 was implemented across the European Union and in most other major economies in 2024. The United States will continue to impose its own different form of minimum tax on the foreign earnings of its headquartered companies rather than the Pillar 2 form. On January 5, 2026, the OECD/G20 Inclusive Framework announced an agreed package of revised arrangements relating to the minimum tax on large MNEs, which effectively exempts United States parented MNEs from most of the minimum tax rules adopted by other countries, and which will be available to other jurisdictions in the future. The package also treats substance-based tax incentives more favorably.

Pillar 1

Pillar 1 applies to all economic sectors except for the extractive industries and regulated financial services. However, it covers only MNEs with global revenues exceeding €20 billion and profit in excess of 10 percent of their global revenue. Furthermore, the national revenue threshold to participate in a Pillar 1 reallocation of profits from any MNE is €1 million (and €250,000 for jurisdictions with a GDP of less than €40 billion). The intention was to apply this only to the largest 100 or so MNEs in the world. After much debate and negotiation, Pillar 1 would apply to both the so-called digital MNEs and to all MNEs meeting the criteria stated. Defining and ring-fencing such MNEs has proved difficult.

The original impetus for Pillar 1 was two-fold. First, it sought to reallocate a portion of a corporation's excess profits to the locations where the products or services were consumed (or used)—a classic example is the taxation of profits from streaming services or social media in the locations of their users. The proposed allocation of consolidated excess profits circumvents the need for physical presence as a tax nexus by using a sales-based allocation formula. Second, before the announcement of Pillar 1, several countries (starting with France and India) had implemented digital services taxes (DSTs) on MNEs to collect revenues from companies' transactions that would traditionally be allocated to the MNEs' headquarters (or intermediary) jurisdictions. These taxes are generally based on turnover or allocable online advertising revenues or both and thus differ from standard CITs. The United States, for example, announced that it will not grant foreign tax credits for such taxes.

As of April 2025, 141 jurisdictions (out of 147 members of the Inclusive Framework) had signed on to Pillar 1 (adjusting for the United States withdrawing its previous commitment in January 2025). The OECD has continued to press ahead with technical implementation plans, including the new multilateral treaty that would be needed to override the relevant income allocation provisions of all existing bilateral tax treaties. Those signing agreed not to implement DSTs until the beginning of 2025 (postponed in July from 2024). By July 2025, Canada and India had repealed their DSTs, while France and Italy maintained theirs. Inclusive Framework countries are obligated to repeal their DSTs once Pillar 1 comes into effect.

Despite the OECD's pursuit of implementation, most observers now find it highly unlikely that the Pillar 1 agreement will come into effect any time in the near or medium term, especially given the recent US withdrawal. Even if the US commitment were renegotiated and renewed, the United States would have to agree to the treaty and ratify it, which is improbable. Much controversy has also arisen over whether lower-income countries would gain more revenue from a domestically adopted DST or from a possible allocation under Pillar 1, with the DST generally seen as more beneficial. As of November 2025, the MENA region's members of the Inclusive Framework, by virtue of their membership, have agreed not to impose DSTs while awaiting the possible implementation of Pillar 1. Of

the MENA countries, only Tunisia has legislated a DST, while others are adopting a wait-and-see approach.

Pillar 2

The two components of Pillar 2 are the global minimum corporate tax (governed by a set of rules called the Global Anti-Base Erosion [GloBE] rules) and the STTR, a provision aimed at the use of tax treaties to avoid taxation in developing countries.

The global minimum corporate tax is different from Pillar 1 in several ways. For example, it would apply to a much broader swath of MNEs—all those with annual revenues in excess of €750 million (the same threshold for the country-by-country reporting and including those in the extractive sectors). Implementing the core rules of the tax does not require treaty alterations or an MLI but rather enactment of domestic legislation in individual countries. Also, it will increase overall tax revenues rather than just reallocate some of them. The tax entered into effect in 2024 in several economies and thus will potentially have an impact on MENA countries that host FDI.[12]

The original statements of purpose for the GloBE involved putting a floor on tax competition, but as it has developed the purpose is clearly to avoid the artificial shifting (similar to the BEPS Project) of "excess" profits of MNEs which typically arise from the use and positioning of exceptionally valuable intangible assets, which is not an actual minimum tax on corporate profits. However, despite provisions that limit its scope, the GloBE could affect many MENA countries significantly.

The GloBE minimum tax takes the form of a top-up tax, calculated for each jurisdiction that hosts a constituent entity of an in-scope MNE group. Constituent entities within a single jurisdiction are consolidated to determine the existing effective rate, calculated as covered taxes (essentially corporate income tax) divided by the financial accounting base in that jurisdiction. If that rate is less than 15 percent, countries can impose a top-up tax on the MNE group. However, the actual base for the top-up tax is not *all* modified financial profits but only excess profits—making the modified financial accounting profit less of a carveout for a deemed return on real investment. This carveout is the substance-based income exclusion.[13] The carve-out makes plain that the goal is not to impose a minimum tax on all international corporate profits but rather to impose that tax on taxable profits generated by more mobile intangible assets. In essence, the

[12] The European Union adopted a directive requiring all member countries to implement Pillar 2 in 2024. Australia, Canada, Japan, Korea, and the United Kingdom implemented such legislation starting in 2024. Hong Kong and Singapore started in 2025.

[13] The carve-out is equal to 10 percent of payroll costs and 8 percent of the carrying value of tangible assets in a jurisdiction. Over the next 10 years, these ratios phase down to 5 percent each.

substance-based income exclusion permits continued tax competition for real investments within the range of taxable profit carved out by the exclusion.[14]

A key question is how MENA countries can or should react to the minimum tax. The minimum tax is optional (meaning that a country can commit to respect other countries choosing to adopt the tax but without necessarily adopting the tax themselves), but a case can be made for adopting some GloBE rules to ensure revenue collection in the FDI host country. Where the top-up tax will be collected ultimately depends on the application of the qualified domestic minimum top-up tax (QDMTT). If a country adopts a QDMTT (which would need to essentially mirror the scope and terms of the basic GloBE in order to qualify), the country gets the first bite at any top-up tax generated in its jurisdiction. If it does not adopt a QDMTT, the first bite goes to the headquarter countries of the MNEs (if it adopts the Pillar 2 income inclusion rule [IIR]), and then to the highest intermediate subsidiary in the chain of ownership if the host country does not adopt the GloBE. Failing any of those, it goes to other jurisdictions in which the MNE group operates, allocated on a formulaic basis (the last of those provisions, the undertaxed profit rule [UTPR],[15] being on a delayed implementation schedule). Thus, in theory, adopting a QDMTT as a backstop to a well-designed CIT does not generally have a downside because of this hierarchy. In practice, though, a QDMTT cannot replicate a dollar-for-dollar tax in all cases (for example, because of the way non-wholly-owned structures are treated under an IIR compared with a QDMTT), so countries should not fixate on seeking to impose only the bare minimum tax.[16]

In addition to considering the GloBE rules, the minimum tax is an opportunity for MENA countries to revisit the design of tax incentives, given that prevailing statutory CIT in most of them is above 15 percent.

Pillar 2 and Tax Incentives

The discussion in this subsection, including Figure 4.2, is based on the GloBE design and guidance available prior to the OECD/G20 Inclusive Framework's 2026 side-by-side agreement.

Tax holidays and reduced CIT rates are common in the region, despite their general ineffectiveness,[17] but the minimum corporate tax rules as they stood in 2025 negate such profit-based incentives. Instead, cost-based incentives would generally raise the effectiveness and efficiency of the profit tax design in the

[14] For a detailed discussion of tax competition under the minimum tax, see, for example, Hebous and Keen (2023) and Perry (2022).

[15] The IIR allows the country where the ultimate parent company is located to impose the top-up tax on the foreign subsidiary taxed below an effective 15 percent, while the UTPR gives other countries along the ownership chain of the MNE group the right to collect the top-up tax if the IRR in the headquarter country has not been fully applied (OECD 2023b).

[16] See Hebous, Hillier, and Mengistu (2024) for a detailed discussion of countries' potential reactions to the minimum corporate tax.

[17] PCT (2015, 2025) discuss the effectiveness and efficiency of different types of investment incentives.

region. The key advantage of cost-based incentives is that they directly target investment (or whatever other spending to which the incentives are tied). Considering two firms with equal profitability, the firm with the higher level of investment will reap more benefit from cost-based incentives than from a reduced CIT rate.

The GloBE rules lend additional support to cost-based incentives. Immediate expensing (at the time of the investment) or accelerated depreciations are treated as a temporary measure that does not influence the calculation of the Pillar 2 effective tax rate, making their use appealing. Furthermore, GloBE rules provide for qualified refundable tax credits (QRTCs) as a form of tax reduction tied to investment costs. QRTCs are refundable for loss-making companies and are similar to a subsidy (if they are large enough or combined with immediate expensing). Therefore, QRTCs should be reserved strictly for activities that generate positive spillovers (that is, having positive societal impacts beyond what the investors find attractive in their private decisions). Research and development investments are the leading example of such activities. However, research and development activities are determined by a vector of other factors (such as the supply of skilled labor), and a subsidy by itself would not be effective without fulfilling such prerequisites.

One way to measure effectiveness of tax incentives under Pillar 2 is the forward-looking effective tax rates that consider tax base provisions in addition to the statutory CIT rate (Figure 4.2). Based on the rules prior to the January 2026 side-by-side agreement, tax holidays clearly fail in yielding a zero effective tax on in-scope MNEs because they would be subjected to the top-up tax. Tax credits yield different outcomes depending on whether they are refundable. A nonrefundable tax credit tends to generate a higher top-up tax than an equivalent amount of a refundable tax credit. It can even trigger top-up taxes for statutory tax rates well above 15 percent. Figure 4.2 also shows that the refundable tax credit—even under the minimum tax—can generate a negative marginal effective tax rate (that is, a subsidy).

The Inclusive Framework's 2026 side-by-side agreement introduces a substance-based tax incentive safe harbor, under which the jurisdiction's adjusted covered taxes may be increased by the amount of the incentives used, subject to a cap computed by reference to payroll and tangible assets in the jurisdiction. The safe harbor reduces (and can even eliminate) top-up tax, reflecting the view that incentives tied to substantive activity pose lower BEPS risk. Consequently, the discussion here, in Figure 4.2, and Box 4.3 primarily illustrate the rules before the January 2026 side-by-side agreement.

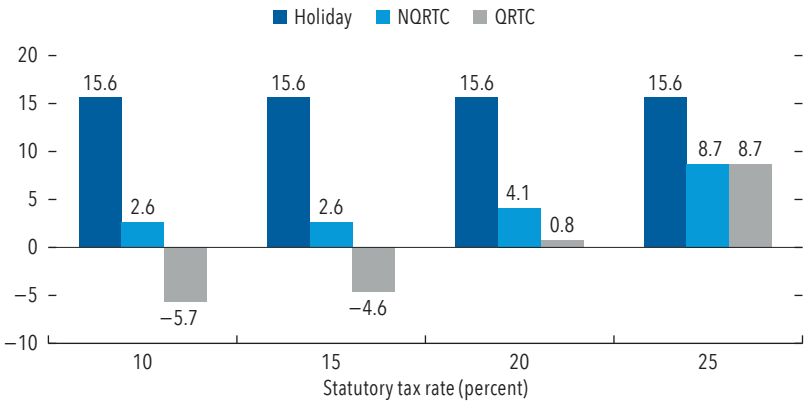
Overall, and regardless of Pillar 2, any tax incentive should ideally be subject to a rigorous evaluation of its costs and benefits. The MENA region would generally benefit from strengthening capacity in tax analytics to guide and inform tax reforms.

Phasing out or abolishing tax holidays would need to respect existing fiscal stability clauses, and Pillar 2 could offer an opportunity to renegotiate them. Affiliates that will be subject to the top-up tax anyway (under IIRs or UTPRs)

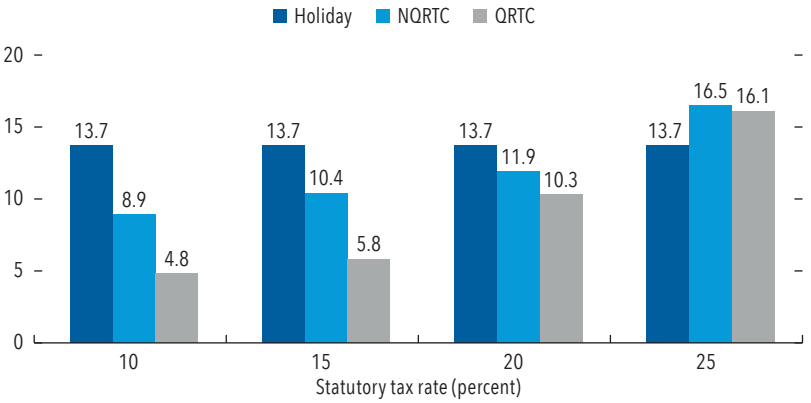
Figure 4.2. Tax Incentives with Pillar 2 Minimum Tax

(Percent)

1. Marginal Effective Tax Rates



2. Average Effective Tax Rate



Source: Authors' computation, following Hebous and Mengistu (2024).
Note: The figure shows forward-looking marginal effective tax rates and average effective tax rates under a tax holiday (with a corporate income tax rate of zero), a qualified refundable tax credit, and a nonqualified refundable tax credit, based on the 2025 rules. The January 2026 side-by-side agreement of Pillar 2 allows more generous substance based tax incentives, which could lower the stylized effective tax rates presented here. The amount of the credit is 2 percent of the (depreciated) value of the asset each year. NQRTC = nonqualified refundable tax credit; QRTC = qualified refundable tax credit.

might be open to considering paying the tax in the host country instead of abroad. Countries should at least consider not granting new CIT holidays for in-scope MNEs.

Regional coordination can enhance the benefits of a minimum tax by effectively reducing regional tax competition and profit shifting and possibly facilitating administrative cooperation on tax matters between MENA countries.

Ultimately, every country will need to analyze for itself how the GloBE will affect it. The effect depends to some extent on the nature of the investments it hosts and even the location of the investors' home countries (for example, US investments are subject to different considerations, given that the United States retains its own minimum tax, the Global Intangible Low-Taxed Income [GILTI]).

Pillar 2 Minimum Tax Implementation

Where the region stands now regarding Pillar 2 implementation status varies: GCC countries are slowly revealing their status (Box 4.2), but other Inclusive Framework jurisdictions in the region have yet to announce their plans. Morocco's increases in its lower CIT rates from 10 percent and 15 percent to 20 percent might be a reaction to Pillar 2 (partly), yet Morocco also retains a 5 percent CIT rate that applies to investments in the Casablanca Financial Center.

As can be seen from Box 4.2, the minimum tax has already had a large influence on the actions of all GCC countries. For example, Kuwait has announced the extension of its 15 percent CIT beyond only foreign-owned businesses to all business entities (effective in 2025) and adopted a QDMTT as a first step for

Box 4.2. Implementation of the Global Anti-Base Erosion Rules in Selected Jurisdictions

Global Anti-Base Erosion (GloBE) adoption plans are ongoing, especially in Gulf Cooperation Council countries. As Table 4.2.1 summarizes, many of the countries that are the main sources of foreign direct investment into the Middle East and North Africa region have implemented the GloBE rules (in 2024). European Union members adopted an income inclusion rule from 2024, an undertaxed profit rule from 2025, and a qualified domestic minimum top-up tax with different adoption dates. Outside the European Union, main adopters include Japan, Korea, Singapore, and the United Kingdom. Some foreign direct investment source countries announced implementing a general corporate income tax before or along with specific GloBE rules (notably the United Arab Emirates with a general corporate income tax from 2023 and domestic minimum top-up tax from 2025). Although Gulf Cooperation Council countries are adopting part of the GloBE rules, other Middle East and North Africa Inclusive Framework members (Djibouti, Egypt, Jordan, Morocco, and Tunisia) have yet to announce any plans. The United States has a unilateral minimum tax that is so far not recognized as an income inclusion rule (work is underway to find a side-by-side arrangement for both minimum tax regimes), but recent US presidential executive action has challenged the undertaxed profit rule specifically.

TABLE 4.2.1.

Implementation of the Global Anti-Base Erosion Rules in Selected Jurisdictions

Country	IIR	QDMTT	UTPR
Gulf Cooperation Council Countries (GCC)			
United Arab Emirates General CIT: Adopted CIT (at 9 percent, matching the subject-to-tax rule rate) on annual taxable profits of more than 375,000 Emirati dirhams (effective 2023), with adoption of a QDMTT (at 15 percent) from 2025.	No IIR plans	QDMTT (2025)	No UTPR plans
Saudi Arabia General CIT: Non-Saudi investors are liable for CIT (at 20 percent) in Saudi Arabia, with Saudi investors liable for Zakat (2.5 percent, also a covered tax under the GloBE rules). A new CIT has been proposed (possibly from 2025) without specific GloBE rules.	No public IIR plans	No public QDMTT plans	No public UTPR plans
Kuwait General CIT: Proposal to adopt general CIT (at 15 percent), with QDMTT adopted as first step from 2025.	No public IIR plans	QDMTT (2025)	No public UTPR plans
Bahrain No general CIT; but QDMTT (2025). Businesses (local and foreign) in extractive industries are taxed at 46 percent.	No public IIR plans	QDMTT (2025)	No public UTPR plans
Qatar General CIT: Non-Qatari investors are liable for CIT (10 percent) in Qatar, with an IIR and a QDMTT from 2025.	IIR (2025)	QDMTT (2025)	No public UTPR plans
Oman General CIT: CIT is payable on profits (at 15 percent) by Omani companies and foreign entities with Permanent Establishment (PE), with adoption of IIR only from 2025.	IIR (2025)	No public QDMTT plans	No public UTPR plans
Other Top FDI Countries (in Addition to GCC Countries)			
United Kingdom	IIR (2024)	QDMTT (2024)	UTPR (2025)
United States US GILTI regime qualifies as a blended CFC tax regime under GloBE rules. A domestic corporate alternative minimum tax was adopted (at 15 percent) on the adjusted financial statement income of companies with profits greater than $1 billion.	No legislative plans	No legislative plans	No legislative plans
Other Notable Countries (with Existing CIT Regimes)			
Singapore	IIR (2025)	QDMTT (2025)	UTPR (2025)
Cyprus IIR and domestic minimum top-up tax (not qualifying as a QDMTT) were adopted as a top-up tax on existing CIT (12.5 percent), with allocation for foreign CFC taxes (for example, under the US GILTI).	IIR (2024)	No public QDMTT plans	UTPR (2025)
Netherlands	IIR (2024)	QDMTT (2024)	UTPR (2025)

TABLE 4.2.1. (continued)

Implementation of the Global Anti-Base Erosion Rules in Selected Jurisdictions

Country	IIR	QDMTT	UTPR
European Union Must transpose EU Directive end 2023 with IIR and UTPR (but can defer application to end 2029 if have no more than 12 ultimate parent entities).	IIR (2024)	QDMTT (optional)	UTPR (2025)
Switzerland	IIR (2025)	QDMTT (2024)	UTPR (delayed)
Other Notable Countries (without Existing CIT Regimes)			
Bermuda General CIT: Adopted general CIT (at 15 percent) for MNE groups with revenues of €750 million or more (2025). Final law removed credit for the US GILTI but has temporary US CFC income exclusion instead. QRTCs are also proposed.	No public IIR plans	No public QDMTT plans	No public UTPR plans
Jersey General CIT: Adopted general CIT (at 15 percent) for MNE groups with revenues of €750 million or more (2025), with blended CFC amount (for example, under US GILTI) being creditable (capped at 7.5 percent of net GloBE income), and it also provides for QRTCs.	IIR (2025)	No public QDMTT plans	No public UTPR plans

Source: Authors' compilation.
Note: CFC = controlled foreign corporation; CIT = corporate income tax; FDI = foreign direct investment; GILTI = Global Intangible Low-Taxed Income; GloBE = Global Anti-Base Erosion; IIR = income inclusion rule; MNE = multinational enterprise; QDMTT = qualified domestic minimum top-up tax; QRTC = qualified refundable tax credit; UTPR = undertaxed profit rule.

large entities in scope for the GloBE in 2025. Oman, which has a CIT on both foreign and domestically owned corporations at 15 percent, also considered this approach but chose an IIR and might consider a QDMTT in the future. Again, without detailed company and investor information, determining exactly how the top-up tax would apply and to whom is difficult.

When assessing the feasibility of adopting appropriate top-up tax rules, a useful first step is to map the existing CIT law with the GloBE rules to determine the potential exposure for in-scope MNEs to top-up tax elsewhere, and then identify actions needed in domestic legislation to fully reap the benefits from adopting defensive top-up tax rules. Box 4.3 outlines key areas to scrutinize: alignment of scope between the existing CIT law and GloBE, identifying covered taxes to determine effective tax rates under GloBE, mapping the tax base of the existing CIT law to the GloBE base, and identifying tax measures that lower the marginal effective tax rate of the CIT regime in a GloBE-compatible manner, such as through immediate expensing of tangible assets and possibly QRTCs.

Box 4.3. Summary of High-level Mapping of Income Tax Law with GloBE Rules

In-scope MNEs	GloBE Rules	Recommended Action
Tax rate	Requires an effective tax of 15 percent on the GloBE tax base in the jurisdiction (essentially financial accounting profits) for in-scope MNEs (with annual revenues in excess of €750 million)	If headline CIT rate is below 15 percent (even before tax base mapping), consider feasibility of adopting appropriate top-up tax rules for in-scope MNEs to collect revenues rather than transferring them to investor jurisdiction where GloBE rules are adopted; even more conducive to efficiency: a rate that prevents application of the minimum tax, with appropriate tax base provisions and adoption of the QDMTT as a backstop
Accounting standards	Requires use of international accounting standards (of the ultimate parent entity) or another acceptable or authorized financial accounting standard (with certain conditions)	Need to confirm alignment with local accounting requirements, especially if contemplating a qualifying top-up tax rule as a backstop (for example, QDMTT)
Covered taxes	CIT, rent taxes, and nonresident withholding taxes; alternative minimum taxes (for example, Tunisia) and CIT-like taxes to the extent they are imposed to substitute for a generally applicable income tax	Assess scope of top-up tax liability for in-scope taxpayers by calculating GloBE effective tax rate (covered taxes divided by GloBE income, based on financial accounting)
Excluded taxpayers	Excludes qualifying investment funds, shipping companies (qualifying for the international shipping income exclusion), and governmental entities	Assess how CIT-law exemptions align with the GloBE rules, consider aligning with specific qualification rules
Preferential tax treatment/special zones	Top-up tax triggered for in-scope taxpayers subject to an effective tax rate below 15 percent because of preferential tax regimes (common where profit tax exemptions apply, for example, tax holidays)	Reconsider preferential CIT treatment in the general CIT; adopt appropriate top-up tax rules as a backstop to prevent fiscal transfer to investor jurisdiction where GloBE rules are adopted
Tax depreciation	Follows financial accounting but provides adjustment to covered taxes for tax timing differences (for example, for immediate tax expensing on tangible assets)	Consider reforming CIT to lower marginal effective tax rate through immediate expensing of tangible assets, at the same time as reconsidering preferential tax treatment or zones
Tax credits	Provides for more favorable treatment of QRTCs (no adjustment to covered taxes; addition to GloBE income) when compared with nonrefundable credits	Consider well-designed QRTCs (only in cases of positive externalities, for example, research and development), which could also replace certain cross-cutting zones

In-scope MNEs	GloBE Rules	Recommended Action
Foreign source income exemptions	Excludes dividends from other entities except for dividends arising from short-term portfolio shareholdings; also excludes equity gains or losses from investments in other entities (except for those arising from portfolio shareholdings) and business profits and losses of a Permanent Establishment (PE) in another jurisdiction	Consider appropriateness of general CIT aligning with internationally consistent foreign source income exemptions (such as those for nonportfolio dividend and equity gains and for foreign branch profits); should also achieve broad alignment with the GloBE rules
Deduction denials	Disallows expenses related to illegal payments and amounts for fines and penalties (with €50,000 de minimis threshold), triggering a positive adjustment to GloBE income	Denial of deductions (through legislative amendment or administrative practice) for illegal payments and amounts for fines and penalties, to align with good practice and the GloBE rules; other policy-disallowed expenses in the general CIT law not disallowed under the GloBE rules: generally increase covered taxes and the GloBE effective tax rate.
Tax losses	No specific provisions for loss carry-forwards (besides on transition or in the context of a GloBE loss election) but rely on the deferred tax provision in the financial accounts (that is, when the losses are incurred, a deferred tax asset is created, which is released when used in later years through a debit to the deferred tax provision in the profit and loss account to increase the tax charge in those later years to provide GloBE effective tax rate recognition)	Appropriate tax loss utilization rules in general CIT law; achievement of appropriate tax outcomes (such as deferred tax asset recognition) for financial accounting purposes

Source: Authors' compilation.
Note: CIT = corporate income tax; GloBE = Global Anti-Base Erosion; MNE = multinational enterprise; QDMTT = qualified domestic minimum top-up tax; QRTC = qualified refundable tax credit.

Pillar 2: The Subject-to-Tax Rule

Before the introduction of the QDMTT concept allowing source countries to capture the top-up tax for their jurisdiction (if any), the STTR was intended as a benefit to low-income countries. It comprises a tax treaty–based rule that enables these countries to impose a top-up tax on specific cross-border payments if the foreign nominal CIT rate is below 9 percent (OECD 2023a). Developing countries (as defined) that can request the inclusion of the STTR in their tax treaties with other Inclusive Framework members (applying nominal CIT rates below 9 percent to covered payments) include Djibouti, Egypt, Jordan, Morocco, and Tunisia. Covered payments as provided in the new multilateral treaty draft

promulgated in October 2023 include, among others, interest, royalties, certain rental payments, certain financial fees, and (importantly) payments for services. The latter has become a prime method of stripping income from developing countries. Unlike the GloBE top-up tax, an overall effective rate is not calculated. The STTR would apply only if the payee is a "connected person," defined relative to the OECD and United Nations model treaty definition of "closely related parties"—that is, to intragroup transactions. It would also apply if the nominal rate of tax applicable to the payment is less than 9 percent, such as under a tax treaty.

The OECD description of the STTR specifically contrasts with its intent—to reduce profit shifting—with the idea of allocating a greater proportion of tax to source countries. The STTR is explicitly not intended to "[revisit] the current allocation of taxing rights between source and residence States."[18]

If any treaties remain that would be subject to amendment under a new STTR MLI,[19] after changes in the payee countries, the low-income country must decide whether to apply the ex post annualized charge to bring the total tax on the payment up to at least 9 percent. Unlike the QDMTT, applying this widely would have a negative competitive impact, because it increases the tax rate on gross flows of interest, royalties, and service payments out of developing countries. Withholding provisions in treaties between source-only countries and more advanced economies or tax-planning hub jurisdictions are not always two-way streets. Low withholding provisions are designed to set the stage for stripping the tax base from the higher tax country to a low-tax jurisdiction, which essentially is another way of profit shifting through the design of the STTR. Developing countries would have to decide in this case what position they want to adopt regarding continued tax competition.

Similar to the global minimum tax, the three groups of MENA countries will be in different positions relative to the STTR. The fragile states—most of which meet the developing country criterion—will have more important issues to address in their tax systems in the medium term, even if they have treaties with provisions that fall within the scope.

The GCC countries are above the developing country (GDP-per-capita) threshold. Thus, to the extent that they have treaties with developing countries that would result in nominal taxation of payments out of these countries, they could be asked to revise those provisions and would have to comply. But as long as the payments received are subject to a nominal rate of 9 percent, they will not be in scope for revision. This underlies the adoption of the 9 percent rate for the CIT by the United Arab Emirates. The country has a wide network of bilateral treaties, developed over the last 25 years, designed to position it as a hub for investment and profit placement.

[18] See OECD (2023b), p. 2.

[19] The first signing ceremony of the STTR MLI took place on September 19, 2024, but no Inclusive Framework members from the region became signatories and parties to the STTR MLI.

The other MENA countries all meet the income criterion for requesting modification of treaty withholding rates that do not result in a total of at least 9 percent nominal tax to the treaty partner. They would have to decide if it would be to their advantage to insist on closing that gap.

THE INCREASED IMPORTANCE OF TAXING CAPITAL GAINS FROM OFFSHORE INDIRECT TRANSFERS

A complex issue arises in the context of a common international tax planning practice to avoid taxes on gains derived from the disposal of assets (or properties) by transferring shares of foreign companies that hold such assets or properties.[20] This scheme is commonly referred to as offshore indirect transfers (OITs). Instead of having the resident company that owns the immovable assets sell those assets directly (or sell that company), an OIT occurs when a nonresident (that owns the company) sells them to a nonresident. Such transactions can be infrequent, but when they happen, substantial amounts are often at stake, and media attention can be extensive. Examples include the acquisition of the Peruvian oil company Petrotech Peruana and the case of telecom Celtel Uganda that involved the Kuwait Investment Fund.[21]

Several tax law frameworks in the region (for example, Algeria and Oman) seek to tax resident companies' gains on disposal of business assets, including moveable or immovable property and extractive rights, but they typically do not capture disposal by a foreign shareholder. The implication is that the gain on the sale of those shares—derived from those same underlying taxable assets—would not be subject to tax in the local jurisdiction. It is unlikely that a general anti-avoidance rule (where present) could be easily used as a basis for taxing such transfers. Thus, overall, the lack of the appropriate framework poses important tax leakage concerns for the region, especially given the significance of the extractives industry and other national high-value immovable assets such as real estate and the telecommunication sector.

MENA countries should therefore consider adopting robust provisions in their CIT laws to tax gains from OITs, considering which tax mechanism to use and the asset types to cover (whether assets should be limited to real estate and natural resource rights or expanded to include other asset types such as telecommunication licenses). Box 4.4 includes more details on OITs and summarizes possible legal designs—including the pros and cons of each option—in response to such transfers. PCT (2020) provides a fuller exploration of legal designs.

[20] The full details of this issue are beyond the scope of this chapter.

[21] The acquisition of Petrotech Peruana (an asset of Offshore International Group) by Ecopetrol Colombia occurred in 2009, when Peru's income tax law did not tax OITs. A congressional investigation led to a change in the law. In Uganda, the Appeals Court ruled that the Uganda Revenue Authority does have the jurisdiction to assess and tax the offshore seller of an indirect interest in local assets.

Box 4.4. Legal Models for Taxing Capital Gains from Offshore Transfers of Assets

The Platform or Collaboration on Tax (PCT; 2020) presents two models for taxing offshore indirect transfers.

- **Model 1 (taxation of a deemed direct sale by a resident):** This model seeks to tax the local entity that directly owns the asset in question, by treating that entity as disposing of, and reacquiring, its assets for their market value where a change of control occurs (for example, because of an offshore sale of shares or comparable interests). This model considers the fact that a capital gain has been realized through the indirect transfer, triggered by a change of control. The relevant taxpayer under this model is not the seller entity, which effectively disposes of the shares, but rather the entity which owns the assets from which the relevant shares derive their value. Model 1 needs to be supported by a deemed disposal and reacquisition rule of the assets from which the shares disposed of derive their value.
- **Model 2 (taxation of the non-resident seller):** This model seeks to tax the non-resident seller of the relevant shares or comparable interests via a non-resident assessing rule. Model 2 must be supported directly or implicitly by a source of income rule, which provides that a gain is sourced in the location country where the value of the interest disposed of is derived, directly or indirectly, principally from immovable property located in that country. A source rule relating to gains from the disposal of other assets may also be considered, including substantial shareholdings in resident companies. A source of income rule may be further supported by a taxable asset rule dealing with such matters as whether taxation only applies to disposals of substantial interests (such as a 10 percent shareholding rule) so as to exclude from the scope of tax changes in ownership of portfolio investments. The rule can also prescribe whether the entire gain will be subject to tax when the value of the indirect interest is less than wholly derived from local immovable property or, alternatively, whether the gain will be subject to tax on a pro rata basis.

Source: PCT (2020).

PCT (2020) provides a detailed discussion of the legal design options to capture OITs in the domestic law of the location country. Although a country's domestic law remains the basis for ensuring a country's taxing rights over OITs, depending on the legal design chosen, existing bilateral tax treaties could still

Box 4.5. Case Study: Oman and Morocco: Selecting an Effective Model for Taxing Capital Gains from Offshore Transfers of Assets

This box presents a case study with a high-level review of the presence and formulation of Article 13(4) in the bilateral tax treaties of Oman and Morocco. Article 13(4) matters chiefly for Model 2—it supplies the treaty-based source taxing right to reach offshore indirect transfers—whereas Model 1 generally operates via domestic law without needing Article 13(4). For Model 2, Article 13(4) is essential because it preserves source-country taxing rights over gains from disposals of shares or comparable interests that derive—directly or "indirectly"—most of their value from local immovable property. The word "indirectly" matters because it covers offshore tiered holding structures.

Oman

A review of 35 available bilateral treaties entered into by Oman found the following:

- Sixteen treaties do not contain Article 13(4) regarding taxation of capital gains on shares related to immovable property, pointing to the implementation of a Model 1 taxing mechanism provided by PCT (2020) that would ensure taxing rights in Oman (when seeking to tax offshore indirect transfer of Omani assets) through domestic tax law.
- Seventeen treaties follow the model treaties and include Article 13(4); they would not conflict with domestic law if Oman chose to adopt either a Model 1 or Model 2 tax mechanism.
- Two treaties (with Canada and France) include Article 13(4) but without referring to shares that derive their value "indirectly" from immovable property (which would also point toward the adoption of a Model 1 taxing mechanism).

Morocco

A review of 68 available bilateral treaties entered into by Morocco found the following:

- Sixteen treaties do not contain Article 13(4), pointing to the implementation of a Model 1 taxing mechanism.
- Thirty-nine treaties follow the model treaties and include Article 13(4), and would not conflict with domestic law if Morocco chose to adopt either a Model 1 or Model 2 tax mechanism.
- Thirteen treaties include Article 13(4) but with deficiencies or ambiguities when compared with the language in the model treaties (which would also point toward the adoption of a Model 1 taxing mechanism). Specifically:

- At least 10 tax treaties do not refer to shares deriving their value "indirectly" from immovable property (for example, treaties with Bulgaria, Canada, Gabon, Indonesia, Korea, Poland, Romania, Russia, Switzerland, and Türkiye).
- At least six tax treaties also depart from the standard threshold when seeking to tax offshore indirect transfers, which is when the shares "principally" (or more than 50 percent) derive their value from immovable property in Morocco. For example, treaties with Bulgaria, the Czech Republic, Indonesia, Korea, and Türkiye require the value of those shares to be "essentially" from immovable property in Morocco, and the tax treaty with Singapore also has a relatively high (more specific) threshold of at least 75 percent of the value of the shares being derived from immovable property in Morocco.

Assuming that existing treaties are not renegotiated, both reviews reveal that the balance is tilted toward adopting a Model 1 taxing mechanism, because a Model 2 would be hampered by the absence of Article 13(4)—or deviations within—in many existing treaties. Adopting Model 1 would strengthen the domestic law in both Oman and Morocco to enable taxing capital gains from offshore indirect transfers of local immovable property without being overridden by their tax treaties.

Source: Authors.

undermine domestic provisions if a specific article in the treaty is absent,[22] or if it deviates from standard text in an ambiguous way. If the taxing right in existing tax treaties is absent or ambiguous, then the balance would be tilted toward using a domestic taxing provision following Model 1 in Box 4.4, which preserves a country's taxing rights over OITs without relying on the existence of Article 13(4) in bilateral tax treaties. Box 4.5 presents case studies of Morocco and Oman that support the adoption of a Model 1 taxing mechanism for OITs.

Pillar 2 GloBE rules influence the choice of the OIT taxing mechanism in Box 4.4. Although both models are designed to give the same outcome, a careful study of the GloBE rules reveals a potentially differential treatment of Models 1 and 2. Specifically, the OIT tax under Model 1 should, in principle,[23] be recognized as a covered tax but not under Model 2. Under Model 1, the taxable event

[22] Specifically, Article 13(4) of the OECD and United Nations model tax treaty regarding the taxation of capital gains on shares related to immovable property.

[23] Because the "deemed" sales income under Model 1 might not be included in the constituent entity's financial statements (which could be interpreted as evidence of an intention to be excluded from GloBE income in the hands of the entity actually owning the shares [just like under Model 2]), it is unclear whether the OIT tax under Model 1 should definitely be treated as a covered tax for GloBE

TABLE 4.1.

Offshore Indirect Transfers and Pillar II Minimum Tax		
Likely Treatment	**Model 1**	**Model 2**
Are gains from OITs GloBE income?	**Yes**[1]	**No**
Are taxes on gains from OITs covered taxes?	**Yes**	**No**

Source: Authors' compilation.
Note: Models 1 and 2 are the legal models for taxing capital gains from offshore transfers of assets (see Box 4.4.) GloBE = Global Anti-Base Erosion; OIT = offshore indirect transfer.
[1] Assuming the deemed disposal is also reflected in the relevant financial statements.

is the sale of a local asset, which is treated as GloBE income, and therefore any CIT on this sale is covered. By contrast, under Model 2, the taxable event is a gain on nonportfolio equity, which is intended to be excluded from GloBE income, and therefore a CIT paid on it would not be covered. Thus, gains from OIT would not be part of the GloBE effective tax rate calculation, which stands in contrast to the tax on the OIT under Model 1, which would lead to an increase in the GloBE effective tax rate and thus a decrease in the top-up tax. Without additional guidance, which could otherwise seek to align the treatment of the two models, a country would probably favor Model 1 based on the current draft of the GloBE rules. Table 4.1 presents the likely treatment.

The conclusion is that MENA countries—especially those with high-value national immovable assets—should therefore focus on preserving their taxing rights over OITs in domestic law, especially given that the design of the GloBE rules does not reinforce the right of source countries to tax such gains. If source countries (and residence countries) choose not to tax OITs, then in a world governed by Model 2, gains from OITs could go untaxed, and not even the Pillar 2 minimum tax would apply to these gains.

CONCLUSION

MENA countries are navigating a complex shift in CIT policy. For some, the reform priority is to mobilize revenue in a growth-friendly way, and for others, the priority is the need to diversify revenue sources away from hydrocarbons. Recent global developments are also reshaping the region's CIT landscape, prompting MENA countries to be cognizant of (and respond to) global efforts to curb tax avoidance and set a minimum corporate tax, along with addressing other key issues such as the STTR and the growing importance of capital gains from OITs. Fragile and conflict-affected states can prioritize CIT policy reforms gradually as they recover from their fragility.

The shared CIT narrative among the region's countries is the need to reassess the costs and benefits of their CIT incentives. To be effective while aligning with international standards, MENA countries are being urged to explore alternatives

purposes. However, as currently drafted, the OIT tax under Model 1 would likely constitute a covered tax (whereas the OIT tax under Model 2 clearly would not).

to the long-standing, poorly designed tax holidays, specifically enhancing cost-based incentives such as accelerated depreciation and CIT credits.

In considering the appropriate response to Pillar 2 minimum tax, this chapter presented a mapping exercise between existing CIT laws and the GloBE rules to refine necessary domestic legislative actions to fully benefit from top-up tax rules—an exercise that could be useful for any country, not just the MENA countries. Having guided and informed the domestic CIT design, also enacting a QDMTT as a backstop would allow countries to capture top-up taxes on profits below the 15 percent minimum tax rate, ensuring that they do not leave tax revenue on the table for other jurisdictions.

The STTR is another key issue affecting MENA countries. It is designed to help developing countries tax cross-border payments that are subject to low tax rates, such as royalties, interest, and services. Some MENA countries are usually not eligible for the STTR because of their higher per capita income levels, while others (Djibouti, Egypt, Jordan, Morocco, and Tunisia) could seek to leverage the rule to amend their tax treaties to benefit from the STTR. The nontaxation in the prevalent special economic zones in the middle- and upper-income MENA countries could trigger requests to revise their treaties with developing countries, and they must comply because of their commitment to the Inclusive Framework.

The taxation of capital gains from OITs is a growing concern for MENA countries with substantial natural resources or high-value assets such as real estate and telecommunications. To safeguard their taxing rights, countries need to strengthen their domestic tax laws by enabling the taxation of a deemed direct sale by a resident (Model 1 of PCT 2020), especially to overcome existing tax treaty constraints. Following another route (Model 2 of PCT 2020), based on the taxation of the nonresident seller, capital gains would not be recognized as a covered tax under Pillar 2 and would be constrained by many existing tax treaties, likely resulting in nontaxation of such gains.

Strengthening tax analytics and using country-specific evaluations of alternative CIT reform options (including impact assessments of tax treaties) are indispensable for many MENA countries to guide their tax policy decisions and responses to global developments regarding taxing MNEs. An important step in this direction is for the law to require publication of tax expenditures' estimates (including gauging the revenue forgone from tax incentives) to enhance transparency and form the basis for cost-benefit analyses of any preferential CIT treatments.

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CHAPTER 5

Recurrent and Transfer Taxes on Real Property

Riël Franzsen and Jean-François Wen

INTRODUCTION

Real property taxes have received renewed attention globally, and for good reason.[1] Recurrent property taxes are relatively efficient, with almost no distortions to investment or consumption decisions because of the relative immobility of the tax base.[2] They are also consistent with the benefit principle, whereby those who benefit from public services should contribute to paying for their costs. Real property taxes can be designed to be progressive (based on property wealth) when the base is linked to market values and small-value houses are given some relief. Thus, property taxes can complement the role that income taxes play in shaping the tax system's overall fairness (see Chapter 3).

Many countries, including in the Middle East and North Africa (MENA), need to diversify their revenue sources and raise more revenue to deal with fiscal pressures and public service needs of increased urbanization. Hydrocarbons (and related public revenue) are finite, and their consumption will likely diminish sooner than expected because of decarbonization (see Chapters 8 and 9). Some of the hydrocarbon-exporting countries (Bahrain, Kuwait, Oman, Qatar, United Arab Emirates) especially will have to look elsewhere for revenue. Countries such as Egypt currently use land sales extensively to design and develop new cities, but the supply of unused land is also finite.

The two most important forms of property tax are the real estate transfer tax (levied as a tax or stamp duty whenever a property changes hands) and the recurrent tax on immoveable property (an annual tax on the capital value or rental value or the size [area] of a property). Numerous other levies or fees (often taxes by another name) are imposed on the ownership, occupation, and transfer of real estate.[3] Taxes on vacant land and a variety of land-based taxes and charges also have a role to play in diversifying revenue sources. Country case studies of

[1] Broadly defined, "taxes on property" includes a range of taxes such as recurrent, property transfer, and estate and gift; and taxes on financial transactions (OECD 2022).

[2] For evidence on the efficiency of property taxes, see Acosta-Ormaechea, Sola, and Yoo (2019).

[3] Unlike recurrent taxes, these taxes are relatively inefficient.

property tax practices in the MENA region can illustrate how the taxes are applied and highlight policy and administration issues and implications for the region.

KEY FEATURES OF PROPERTY TAXES IN THE MENA REGION

REVENUE CONTRIBUTION

From a global perspective, property taxes (broadly defined) have increased in importance since 2010 in OECD countries and the European Union but not in other regions (Table 5.1). In MENA countries for which data are available (Table 5.2), property taxes are generally insignificant as a percentage of GDP. However, property taxes differ widely across the region, much like total taxes (see Chapter 2), especially between hydrocarbon exporting and importing countries.

KEY DESIGN FEATURES OF TRANSFER AND RECURRENT TAXES

Taxes on Real Estate Transfers

Taxes on real estate transfers are levied nationally in all MENA countries (Table 5.3) and therefore are not tied to obvious local services or benefits. Legal liability for paying these taxes can be on the buyer (Morocco, Oman, Qatar), the seller (Egypt), or both (Jordan, Iraq, United Arab Emirates). However, who bears its ultimate burden depends on its effect on the transaction price, not on who is legally liable to pay it.

Some countries have several taxes and fees on real estate transfers (Algeria, Jordan, Lebanon, Morocco, Syria, Tunisia). This mix can produce a high effective tax rate on some transfers, and adding other nontax transactional fees (registration, notary, and estate agent fees) increases the overall cost of property transfers.[4] The high costs and high levels of informality (for example, Egypt and Somalia) can slow the development of a transparent property market.

Globally, evidence shows that high real estate transfer taxes encourage declaring property values below their true value and discourage or undermine the formalization of land markets and the legalization of land titling or deeds registration (Franzsen 2020).[5] A global trend has emerged since the 2000s to reduce real estate transfer taxes and, in some cases, related fees and costs. Some MENA countries have lowered tax rates on real estate transfers (for example, Bahrain, Djibouti, and Jordan) or related fees (for example, Algeria) during this period (World Bank 2020).

[4] In many cases, the third-party fees include value-added tax.

[5] High transfer taxes can also undermine the tax base of recurrent taxes that rely on declared capital values, but most MENA countries currently do not base their recurrent property taxes on declared capital values.

TABLE 5.1.

Taxes on Property
(Percent of GDP)

Region (no. of countries)	2010	2014	2015	2016	2017	2018	2019	2020
European Union (27)	1.9	2.3	2.3	2.3	2.3	2.4	2.2	2.3
OECD (38)	1.6	1.9	1.9	2.3	1.9	1.9	1.8	1.9
Africa (31)	0.4	0.4	0.4	0.4	0.3	0.3	0.4	0.3
Asia-Pacific (28)	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Latin America (26)	0.8	0.9	0.9	0.8	0.9	0.8	0.9	0.8
Middle East and North Africa (21)	0.3	-	0.3	0.3	0.2	0.2	0.2	0.3

Sources: OECD, Global Revenue Statistics Database (2022); and EC (2020).
Note: Trends such as these can be observed for property taxes as a share of total taxes. OECD = Organisation for Economic Co-operation and Development.

TABLE 5.2.

Taxes on Property in MENA Countries
(Percent of GDP)

	2000	2005	2010	2015	2016	2017	2018	2019	2020	2021
Oil-Exporting										
Algeria	–	–	–	–	–	–	–	–	–	–
Bahrain	0.1	–	–	–	–	–	–	–	–	–
Iran	–	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.6	–
Iraq	–	–	–	0.0	0.0	0.1	0.0	0.0	0.0	–
Kuwait	0.0	0.0	0.0	0.0	0.1	0.0	0.2	0.1	0.0	0.0
Libya	–	–	–	–	–	–	–	–	–	–
Oman	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Qatar	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Saudi Arabia	–	–	–	–	–	–	–	–	–	–
United Arab Emirates	–	–	–	0.0	0.0	0.0	0.0	0.0	0.0	–
Yemen	–	0.0	0.0	–	–	–	–	–	–	–
Average	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**	**0.2**	**0.0**
Oil-Importing										
Djibouti	0.5	0.4	0.5	0.3	0.3	0.3	0.3	0.4	0.4	0.3
Egypt	0.0	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Jordan	0.8	1.3	0.5	0.5	0.4	0.4	0.3	0.3	0.2	–
Lebanon	1.1	1.3	1.9	1.6	1.6	1.8	1.4	1.1	1.5	–
Mauritania	–	–	0.1	0.2	0.2	0.2	0.1	0.1	0.1	0.2
Morocco	1.3	0.7	1.0	1.3	1.2	1.1	1.1	1.0	0.9	0.9
Somalia	–	–	–	–	0.0	0.0	0.0	0.0	0.0	0.0
Sudan	–	–	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Syria	0.1	0.2	–	–	–	–	–	–	–	–
Tunisia	0.0	0.0	0.1	0.3	0.3	0.3	0.3	0.3	–	–
Average	**0.6**	**0.5**	**0.5**	**0.5**	**0.4**	**0.4**	**0.4**	**0.3**	**0.4**	**0.3**
Overall Average	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.3	0.2

Source: IMF, World Longitudinal Revenue Database (November 20, 2024); and IMF Country Report (for Syria).
Note: MENA = Middle East and North Africa; – = missing data; n.a. = not applicable.

TABLE 5.3.

Real Estate Transfer Taxes in MENA Countries

Country	Tax Type	Tax Rate (percent)	Comments
Algeria	Registration fee	5	
	Publication fee	1	
Bahrain	Stamp duty	2	The rate is only 1.7 percent if paid within 60 days.
Djibouti	Transfer fee	3	The tax rate before 2019 was 10 percent.
Egypt	Transfer fee	2.50	The seller pays.
	Registration fee		The maximum is LE 2,000.
Iran	Transfer tax	5	A fixed formula per square meter of value per square meter is used.
Iraq	Transfer tax	0, 3, 4, 5, 6	The seller pays according to a sliding scale.
	Transfer fee	3	The buyer pays.
Jordan	Registration fee	5	The seller pays.
	Land sales tax	4	The buyer pays.
Kuwait	Registration fee	0.5	
Lebanon	Transfer tax	5 plus fixed fees	
	Municipality fee	5 of transfer tax	This fee is a 5 percent surcharge on the transfer tax.
Libya	Stamp duty	5, 8, 10	
Mauritania	Registration fee	0.25 to 15	
Morocco	Registration fee	6	The buyer pays.
	Stamp duty	1	The buyer pays a minimum of DH 500.
Oman	Registration fee	3	
Qatar	Transfer fee	0.25	The buyer pays.
Saudi Arabia	Transfer tax	5	The seller pays.
Somalia	Transfer tax	5 in Somaliland, no tax in Puntland	Somaliland: 2.5 retained nationally and 2.5 remitted to districts.
Sudan	Registration fee	2.5 to 6	The rate depends on the finalization period of the transfer.
Syria	Transfer tax	13	The seller pays based on official values, not price.
	Stamp duty	0.80	
	Registration fee	9.87	
	Local tax	3.80	
Tunisia	Registration fee	5	The buyer pays
	Registration fee	1	
United Arab Emirates	Transfer tax	4 (Dubai)	A fixed amount for a title deed is also paid.
Yemen	Transfer tax	1	
	Fees		Several fixed and ad valorem fees are paid.

Sources: Deloitte (2022); Franzsen (2020); Global Property Guide (2023); and World Bank (2020).
Note: Transfer tax, transfer fee, and registration fee might simply be different names for what is essentially the same type of tax. DH = Moroccan dirham; LE = Egyptian pound; MENA = Middle East and North Africa.

Recurrent Taxes on Real Property

Countries across the region levy recurrent property taxes except for oil-rich Bahrain, Kuwait, Oman, Qatar, and Saudi Arabia (Table 5.4). The tax is levied on the annual rental value (except for Somalia, Sudan, and Tunisia). Somalia's

TABLE 5.4.

Recurrent Real Estate Taxes in Selected MENA Countries

Country	Tax Base	Valuation and Assessment Responsibility	Setting Tax Rates	Collection Responsibility	Revenue
Algeria	Annual rental value	n.a.	Central	n.a.	n.a.
Djibouti	Annual rental value	n.a.	Central	n.a.	n.a.
Egypt	Annual rental value	Assessment committees	Central	Central	Central (75 percent), local (25 percent)
Jordan	Annual rental value	Assessment committees	Central	Central	Local
Lebanon	Annual rental value	Tax office (Ministry of Finance)	Central	Central	Local
Libya	Area	Self-assessment	Central	Central	n.a.
Mauritania	Annual rental value	n.a.	Local	n.a.	n.a.
Morocco	Annual rental value	Regional commission	Central	Central	Central (10 percent), local (90 percent)
Somalia	Area	Local	Local	Local	Local
Sudan	Area and use	Local	Local	Local	Local
Tunisia	Annual rental value	Central and taxpayer	Central	Central	Local
United Arab Emirates	Actual rent	Not applicable	Local	Local	Local
Yemen	Annual rental value	Assessment committees	Central	n.a.	n.a.

Sources: Franzsen and McCluskey (2017); International Bureau for Fiscal Documentation (2022); TAG (2019); and World Bank (2016).
Note: In Lebanon, the tax office assessments are done in response to taxpayers' self-declarations of values. In Morocco, only the residence tax is considered, not the other recurrent property taxes. Although the United Arab Emirates does not have a recurrent property tax, certain emirates charge a municipality fee (a city-level property tax), which differs by emirate. For example, the Emirate of Dubai levies a municipality fee of 5 percent on the annual rental value of residential property. This fee is included proportionally in the monthly utility bill (electricity and water) for the property (Deloitte 2024). n.a. = not available.

Puntland and Somaliland use simplified area-based approaches, a footprint measure that could include the building height multiplied by a tax rate with or without adjustment according to urban locations (Fleck, Sheikh, and Said 2023). Tunisia applies a simple system in which the tax base constitutes 2 percent of the reference price per square meter multiplied by the total area of the building.

Globally, countries with value-based real estate tax systems use different methods to determine taxable values. In most cases, capital or rental values are supposed to reflect or approximate market values, but rental values present challenges where land tenure and administration are issues (for example, Morocco), markets are nontransparent, and informality is common. In these cases, a simplified and transparent assessment system could be more appropriate, at least as an interim measure, as suggested by Somalia's system (Haas 2017; Fleck, Sheikh, and Said 2023).

Countries globally use multiple service providers to determine taxable values, such as a national ministry, the revenue authority, an autonomous government valuation agency or corporation, local government, or the private sector (Bahl, McCluskey, and Franzsen 2022a; McCluskey, Franzsen, and Bahl 2017). Some MENA countries where laws prescribe detailed assessment criteria use valuation or assessment committees (for example, Egypt, Jordan, Morocco, and Yemen). In Lebanon, the Tax Office (a decentralized entity of the Ministry of Finance) is responsible for determining the rental value for the property tax. For recently sold property, the rental value is deemed 5 percent of the sale price, but for tenanted property, the rental value is based on the actual rent (for example, Jordan). The fairness of such a system is an issue, because rental values are determined ad hoc on the respective dates of occupancy rather than on a uniform valuation date for all properties—a practice that produces widely different assessed values for otherwise identical properties (World Bank 2016).[6] Valuation cycles are generally five years in countries where the law prescribes the cycles (Egypt, Jordan, Morocco).

Centrally determined country-wide tax rates are common across most MENA countries (Table 5.5), unlike OECD countries, where subnational governments set tax rates. Because the tax is levied and administered centrally, setting a uniform tax rate is understandable but could be problematic, given property value differences across cities, especially between large cities and small rural towns. Another problem is that tax rates remain static for the duration of valuation cycles or longer. For example, the tax rates applied uniformly to residential and commercial property throughout Lebanon have not been adjusted since 2004 (World Bank 2016). In Egypt, the uniform 10 percent tax rate has been in place since the real

[6] Besides the property tax levied centrally in Lebanon, municipalities levy a separate municipal rental value fee. The occupier pays the fee, not the owner, and it is also based on the estimated rental value. Municipalities have the legal authority to do their own rental value assessments, which they usually do through a committee. The committee will typically consider the rental value assessment by the Tax Office, but it is not mandated to do so, which results in duplication of valuation effort. Harmonization of valuation would provide for economies of scale and setting uniform valuation methods and standards (World Bank 2016).

TABLE 5.5.

Comparative Tax Rates in Selected MENA Countries

Country	Tax	Tax Base	Rate Structure	Tax Rate (percent)
Algeria	Property tax	Annual rental value	Uniform flat	3
Djibouti	Tax on built property	Annual rental value (80 percent)	Progressive	10, 18, 25
Egypt	Real estate tax	Annual rental value	Uniform flat	10
Jordan	Building and land tax	Annual rental value	Differential	2 (undeveloped), 10 (developed)
Lebanon	Property tax	Annual rental value	Progressive	4, 6, 8, 11, 14
Mauritania	Property tax	Annual rental value (80 percent)	Flat	3 to 10
Morocco	Residence tax	Annual rental value	Progressive	0, 10, 20, 30
Tunisia	Tax on built property	Annual rental value	Uniform flat	8, 10, 12, 14
United Arab Emirates	Municipality fee	Actual rental	Uniform flat	5 (Dubai)
Yemen	Real estate tax	Annual rental value	Uniform flat	8.33 (1/12)

Sources: IBFD (2022); and relevant country laws.
Note: MENA = Middle East and North Africa.

estate tax was introduced in 2014. Combined with property values that are often reassessed irregularly and infrequently, static tax rates result in real revenue losses, especially in an inflationary environment.

Tax rates in Tunisia are fixed based on the number of services provided by the relevant local authority (such as cleaning, streetlights, and pavements). For example, the rate for buildings benefiting from only one or two services is 8 percent, and the rate increases with the number of services used.

Progressive property tax rates are seldom used internationally but are encountered in Djibouti, Lebanon, and Morocco. In countries where the real estate tax is levied centrally, the benefit principle seems less important and elements of wealth taxation are more prominent, possibly explaining the use of progressive rates.[7]

Property tax relief can be provided through preferential valuations and valuation thresholds, exemptions, differential rates, rebates, and discounts for early payment, but relief is about more than just reducing tax burdens. If designed properly, it can improve equity and fairness, correct errors in the tax structure, and stimulate certain consumption and production activities. However, badly designed relief programs can erode the base and create complex administrative provisions (McCluskey, Franzsen, and Bahl 2017).

Globally and in many MENA countries, residential properties often benefit from one or more types of tax relief (McCluskey, Franzsen, and Bahl 2017). Some MENA countries give preferential treatment to owner-occupied residential property but not to tenanted property (Egypt, Jordan, Lebanon, Morocco, Tunisia). Owner-occupied dwellings are completely exempt in Tunisia, and in Egypt, a high value threshold applies (2 million Egyptian pounds [LE]). In Morocco, the

[7] Setting tax rates centrally also cancels tax competition that local rate setting could encourage.

taxable value of dwellings is limited to only 25 percent of the annual rental value, and new buildings and additions to buildings are exempted for five years after their completion.

In 2016, about 21 percent of properties in Beirut, Lebanon, were tax exempt, and exemptions applied to about 21.4 percent of all properties in the country (World Bank 2016). The owner of each housing unit is entitled to a deduction from their taxable base of 20 million Lebanese pounds per unit.[8] The deduction applies for a maximum of two units, but the taxpayer can choose the two units that have the highest rental value. Tenanted residential property and commercial property are not entitled to this deduction. Only occupied properties pay tax, and vacant buildings are exempt. Tax rate differentials and exemptions weaken the value of the recurrent property tax as a payment for local services, which is especially true where a nationally set tax rate policy applies. The resulting redistributive aspect of the differential treatment compromises efficiency and equity.

Land-Based Taxes

Vacant or underused urban land has a location value and benefits from public sector–financed infrastructure—for example, access to roads, electricity, and water services. An argument for levying property tax on undeveloped land with potential for development is that such a tax could generate revenue while guarding against landowners hoarding land for speculation purposes. The point holds particular importance for land located within urban areas or land zoned for development. Globally, policies on taxing vacant land differ significantly, reflecting both tax policy and land policy.[9] In the region, Jordan, Mauritania, and Saudi Arabia levy taxes on vacant land.

Throughout Lebanon, significant numbers of vacant properties are untaxed. In the mid-2010s in Beirut, 11.8 percent of residential properties and 16.2 percent of commercial properties were vacant, and the country average was 9.8 percent (World Bank 2016). Some properties might be vacant for reasons that warrant tax relief. Because Lebanon does not currently value and tax land, estimating the revenue potential of introducing a land tax is difficult. In 2016, 1.34 million land parcels were recorded in Lebanon's Land Registry, suggesting that taxing land holds significant revenue potential. However, valuation processes would have to change to accommodate any material extension of the tax base.

In 2016, Saudi Arabia introduced a 2.5 percent annual tax on the value of undeveloped plots (referred to as "white land") of more than 10,000 square

[8] The 2019 exchange rate crisis and ensuing inflation have had significant implications for the tax system, including property taxes.

[9] Some countries levy separate taxes on idle and vacant land, for example, the Philippines (Alvina 2022) and Taiwan (Lin and Wu 2022). A tax on unoccupied buildings and underused property is also a possibility (Bahl and Bird 2018; Bahl, McCluskey, and Franzsen 2022a; McCluskey, Franzsen, and Bahl 2017). Vancouver, Canada, imposes a 1 percent vacancy tax on the market value of unoccupied housing units to curb vacancy levels and speculation. Differentiated tax rates are also used elsewhere, such as Namibia, South Africa, and Vietnam, where significantly higher rates apply on vacant land.

meters in four major urban areas (Argaam 2018, 2020), extended to six cities since then (Deloitte 2022). In 2023, the Ministry of Housing announced plans to amend the relevant law. Article 3 of the draft law stipulates imposing an annual tax of at least 2.5 percent of the land's estimated value if that land is more than 5,000 square meters. According to Article 14 of the draft law, a tax rate of up to 10 percent can be levied based on specific criteria, which include the land's location and uses, available services, accessible utilities, population density, supply and demand, and economic and social considerations (Argaam 2023).[10]

Kuwait and Oman are apparently following suit, but Egypt abandoned an attempt to introduce such a tax after an adverse constitutional court judgement in 1993. Mauritania's 2022 Finance Law introduced a property tax on undeveloped land, though the tax rate still is not set.

Urban growth generates a demand for expanding infrastructure. Recurrent property taxes and land-based financing (LBF) instruments are receiving renewed global interest as a way to support infrastructure development and sustainable urbanization. Both would help recover from landowners or developers at least some of the public cost of developing or redeveloping land. LBF instruments include assessments applied to land value windfalls resulting from public investments (for example, land value increment taxes) and up-front cost-recovery charges for specific infrastructure or service improvements (for example, betterment levies and developer charges), among others.[11] Information on the use of LBF in MENA countries is scarce, but examples can be found in Egypt and Jordan. However, outdated laws in both countries are making it difficult for cities to apply such levies.

An analysis of Egypt's Betterment Levy Law (Law 222/1955) shows that the betterment levy is essentially a land value increment tax because the government is entitled to recover at least part of the land value increase that results from improved infrastructure and public services (UN-Habitat 2015). In practice, attempts to use this law to levy a fee on changes in land use include converting agricultural land to urban land, applying for a change of use (for example, residential to commercial), and approving applications for construction exceeding the stipulated building heights.

In Jordan, Greater Amman Municipality had to find new ways to raise revenue because of difficulties with interpreting provisions in the Planning Law (Law 79/1966) regarding development fees and betterment levies. The city implemented a compensation fee that must be paid when developers request and obtain increased building rights, when land is rezoned, and when land previously not zoned is zoned on request (Haas and Kriticos 2019).

[10] The Council of Ministers approved the draft law in April 2025.

[11] See UN-Habitat (2016) for more details on LBF instruments.

TAX ADMINISTRATION

Transfer taxes are attractive because they are easy to collect. The relevant collection agency must provide a tax receipt or exemption notice before the transfer is legally completed (Bahl and Bird 2018). Thus, the title or deed registration system functions like an audit mechanism to ensure compliance (Eyraud 2015). However, in some MENA countries, the property registration system is not comprehensive, and transfers often take place informally, making transfer tax evasion common. Undetected or unpunished evasion from undervaluing or under-declaring property prices would likely encourage evasion of other taxes, and significant under-declarations of value weaken the progressivity of the taxes (Wallace 2018).

Several MENA countries have streamlined the overall administration of property transfers (for example, Kuwait, Morocco, Oman, Qatar, and Saudi Arabia) and digitalized (for example, Saudi Arabia), reducing the overall costs of administration and compliance (World Bank 2020). However, some countries are still struggling with informality. Some countries (Egypt, Jordan, Morocco) allow self-declaration of property details, but whether the tax authorities have the capacity to perform audits to protect the integrity of property tax bases is unclear.

The recurrent property tax is a central government tax collected centrally in several MENA countries (though through regional offices of the national revenue authority, as in Egypt). In Morocco, some property taxes are collected centrally, but the revenue is remitted to municipalities.[12] The municipalities pay a 2 percent management fee (10 percent before 2021) to the national budget. In Egypt, at least 25 percent must be remitted to cities, but this does not happen in practice (see Annex 5.2).

Recurrent property tax administration processes are archaic and manual (with few exceptions), resulting in high administration and compliance costs. In Somalia, the migration to a financial management information system is expected to address some of the constraints experienced with tax administration by allowing, for example, automated billing, issuing prompt and accurate demand notices, and use of mobile money to pay tax (Fleck, Sheikh, and Said 2023).

In Lebanon, property owners have two months to make payment, after which a 2 percent per month penalty applies. After the two-month period, owners receive reminders and are granted an additional 14 days to make payment. Failure to pay results in a charge on the property (that is, a tax lien). Compliance rates within the two-month period are relatively low, and most taxpayers pay only after the period expires (World Bank 2016). Evidence suggests that the increased use of information and communication technology (ICT) to improve billing, collection, and enforcement can result in sustained revenue enhancement (see, for example, Okunogbe 2021), but it also increases taxpayers' trust and thus has a positive impact on voluntary compliance.

[12] This is also the situation in the West Bank. In Gaza, municipalities collect the property tax.

TABLE 5.6.

Urbanization in MENA Countries

Country	Urbanized	Urbanization Rate (2020–25)	Country	Urbanized	Urbanization Rate (2020–25)
Algeria	74.8	1.99	Morocco	64.6	1.88
Bahrain	89.7	1.99	Oman	87.8	2.32
Djibouti	78.4	1.56	Qatar	99.3	1.66
Egypt	43.0	1.90	Saudi Arabia	84.7	1.69
Iran	76.8	1.32	Somalia	47.3	4.20
Iraq	71.4	2.91	Sudan	36.0	3.43
Jordan	91.8	0.98	Syria	56.8	5.38
Kuwait	100.0	1.35	Tunisia	70.2	1.34
Mauritania	56.9	3.84	United Arab Emirates	87.5	1.50
Lebanon	89.3	–1.23	Yemen	39.2	3.71
Libya	81.3	1.45			

Source: CIA (2025).
Note: Urbanization describes the percentage of the total population living in urban areas; urbanization rate describes the projected average rate of change of the size of the urban population. MENA = Middle East and North Africa.

FUTURE PROSPECTS FOR MENA

Rapid urbanization is an issue in several MENA countries, with six countries experiencing more than 2.5 percent annual growth in the urban population over 2020–25 (Table 5.6). Such growth poses challenges to financing urban infrastructure and makes vacant land increasingly valuable. How might countries in the region respond to these challenges from a tax policy and land policy perspective?

With a growing international focus on domestic revenue mobilization to fund the Sustainable Development Goals and the climate transition (see, for example, Benitez and others 2023), the taxation of vacant land and unoccupied buildings must receive more attention. Taxing vacant or underused properties will expand the tax base and should result in increased revenues, which is especially important for rapidly urbanizing cities. Also, taxing vacant property should encourage owners to make productive use of their property by developing it or selling or renting it. The issue of vacant but serviced urban land and unoccupied buildings is especially relevant. Infrastructure and some services are available in such cases, and arguably owners should make a fair contribution.

In countries that use rental value as the tax base and tax the occupiers, vacant (temporarily) properties are often exempt. Taxing vacant properties should not be an issue, however, if the rental value tax is levied on the owner, as in many MENA countries. Exempting vacant properties or levying a negligible tax on them could lead to shifting more of the tax burden to other taxpayers. Many wealthy citizens in the region invest in real estate (and more specifically in residential property), which can result in fully serviced but unoccupied residential housing units (as in Egypt).

Most MENA countries align broadly with international trends in taxing real estate transactions, but they could benefit from a holistic reform strategy, which could involve following: (1) a review of the direct or indirect impact of real estate transfer taxes on the tax base assessment and administrative processes, such as titling and registration; (2) an audit of all real estate taxes and user fees related to acquiring property and registering real rights in a deed or title office; (3) consolidating different transfer taxes into a single, transparent tax; (4) a gradual decrease of the rate of the real estate transfer tax as revenue from the recurrent tax increases; and (5) eventually replacing the real estate transfer tax with a comprehensive capital gains tax. Points 4 and 5 should reduce tax inefficiencies on real property transactions and enhance the quality of the real property market.

Increasing the reliance on recurrent property taxes and reducing the use of property transfer taxes is a path for reform in the region to improve efficiency and revenue from property taxes. Concurrently, tax base coverage can be improved through the use of satellite imagery and drone technology, minimizing exemptions, using professional valuers, and applying appropriate mass valuation methods to value large numbers of properties, reducing preferential treatment given to owner-occupied residential property and eventually allowing local governments to determine their own tax rates.[13]

With a capital gains tax, the buyer has an interest in declaring the true market value, because under-declaring will increase the property's base cost when sold. This self-checking feature should lead to a more accurate self-declaration of sales prices and can therefore improve the database for the recurrent property tax. As Wallace (2018) points out, the administration of a capital gains tax is a drawback, especially establishing the base values, adjusting the base cost for allowable improvements to the property, and developing a method for indexing for inflation. Those challenges are not necessarily more difficult than the current requirement of establishing the market value for property transactions (Bahl, McCluskey, and Franzsen 2022b). A reform path that would result in replacing the real estate transfer tax with a capital gains tax merits more analysis, especially using the experiences of MENA countries that already have a capital gains tax (for example, Algeria, Lebanon, Libya, Morocco, and Tunisia). Analysis would also need to consider whether capital gains on the sale of an individual's principal residence should be taxed or exempt.

Property tax reform is often an integral part of a broader strategy of coordinating the taxing rights between central government and the subcentral levels. The recurrent property tax is generally a powerful fiscal tool for strengthening the social contract and deepening citizen engagement, especially when it is a local tax or the revenues are devolved or remitted to local government units. Fragile states generally lack a social contract and often struggle with tax compliance and governance issues, though recent projects to enhance land-based financing (supported

[13] See McCluskey and others (2013) for an explanation of mass evaluation methods.

by UN-Habitat) in Somalia's Puntland and Somaliland show an increase in property tax collections (Du Plessis 2022).

Although policy reforms can be difficult to achieve, the increased use of ICT and geographic information systems can achieve significant revenue enhancement from improved base coverage, simplified assessment, and better tax administration. Evidence of revenue enhancement in Somalia supports this concept (Fleck, Sheikh, and Said 2023; Haas 2017). However, ICT, automation, and digitalization must be supported with improved local governance and political backing for allowing local governments some flexibility in determining the tax rate and keeping most of the revenue for their own spending needs.

MENA countries should also review the use of LBF as another option to generate more revenue to meet the challenges of urbanization and service delivery. Ideally, planning laws should allow local governments to use developer charges to recover the infrastructure cost associated with urban growth.[14] In practice, informality in land use and zoning and weak local governance present challenges that must be addressed (UN-Habitat 2015).

ANNEX 5.1. LEGISLATION

Egypt
Betterment Levy Law, Law No. 222/1954
Constructed Real Estate Tax Law, Law No. 196/2008

Jordan
Building and Land Tax Law, Law No. 11/1954
Planning Law, Law No. 79/1966

Lebanon
Property Tax Law of 1962

Mauritania
Finance Law 2022

Morocco
Taxation of Local Authorities Law, Law No. 47/06 as modified by Law No. 07/20

[14] The costs of both internal and external infrastructure should ideally be recovered. Internal infrastructure refers to infrastructure on the property being developed. The developer is expected to install the infrastructure at its own expense or pay for the infrastructure elements provided by public authorities. Developers are also expected to contribute toward external infrastructure (for example, roads, water supply, and sanitation) required to accommodate the additional impact of a new development on engineering services (Peterson 2009). In practice, developer charges could, for example, require that private developers provide open public spaces, provide low-income housing, or pay compensation for increased congestion (Bahl and Bird 2018).

Somalia
Local Government Tax Harmonization Law of 2012 (Puntland)
Regional and Districts Self-Administration Law No. 23/2002 (Somaliland)

ANNEX 5.2. EGYPT AND MOROCCO COUNTRY CASES

Egypt

The recurrent real estate tax in Egypt (the buildings tax and the agricultural land tax) is a central tax. The revenue assignment to local administration units comprises shared revenue from central taxes, transfers, and local own-source revenues. Of those, central government transfers are by far the most important. The revenue contribution of the recurrent real estate is very weak, both in relation to total tax revenue (Annex Table 5.2.1) and to total property taxes (Annex Table 5.2.2).

Tax sharing is in decline and is negligible since FY18/19. Previously, the shared revenues included centrally levied taxes on agricultural land, buildings, entertainment and amusement, and motor vehicles and motor vehicle operators, along with surtaxes on some centrally collected taxes such as customs and profit taxes on commercial and industrial profits (World Bank 2022).

Transfer Fee

Egypt's transfer fee of 2.5 percent is not high compared with the tax rates levied internationally and elsewhere in the Middle East and North Africa (MENA) region. The transfer fee is a national tax and therefore not tied to local benefits.

Agricultural Land Tax

An agriculture land tax is levied annually and collected centrally on the estimated rental value of all lands used or that can be used for agricultural purposes. The base includes all rural areas within the jurisdiction of governorates (Amin, McCluskey, and Franzsen 2017). The tax rate is 14 percent of the rental value per feddan.[15] Rental values are determined by an assessment committee regarding land quality and soil fertility, and revaluations are supposed to take place every 10 years. Annex Table 5.2.2 shows that the revenue from the land tax is nominal.

Real Estate Tax

Egypt introduced a recurrent property tax on the rental value of buildings in 1842, and several laws have regulated the real estate tax over the years. However, in 2008, the Constructed Real Estate Tax Law 196/2008 replaced the Buildings Tax Law 56/1954, with the goal of modernizing the law, enlarging the tax base, and improving its overall administration (Amin, McCluskey, and Franzsen 2017).

[15] A feddan is approximately 1 acre or 4,200 square meters (that is, 0.42 hectare).

ANNEX TABLE 5.2.1.

Recurrent Taxes on Immovable Property, 2015–20
(Percent of total taxes)

Tax Type	Fiscal Year					
	FY15	FY16	FY17	FY18	FY19	FY20
Recurrent taxes on immovable property	**0.21**	**0.33**	**0.44**	**0.47**	**0.66**	**0.46**
Agricultural land tax	0.06	0.06	0.05	0.02	0.01	0.01
Buildings tax	0.15	0.27	0.40	0.45	0.65	0.45

Source: Egypt Ministry of Finance, 2021.

In 2010, as a first step toward implementing the new law, real estate owners were requested to declare their properties at local offices of the Real Estate Tax Authority. Because of socioeconomic and political challenges, Law 196/2008 was implemented only in 2014 after amendments were made to increase the exemption threshold and expand the list of exempt entities.

In principle, the real estate tax applies to all urban real estate in Egypt at a uniform rate of 10 percent of the annual rental value, subject to several forms of tax relief. Although the focus is on buildings, some land is included in the base. The taxpayer is the owner or usufructuary. A valuation committee is established in every governorate to determine assessed values every five years. The assessment committee considers three basic criteria: geographic location, type of building and construction material, and the utilities connected to the property or available to it. Whenever a new cycle begins, values are not permitted to increase to more than 30 percent for residential properties and 45 percent for nonresidential properties.

Extensive exemptions and other tax relief measures apply, including an exemption for residential property with a value of less than 2 million Egyptian pounds

ANNEX TABLE 5.2.2.

Recurrent and Non-recurrent Taxes on Immovable Property, 2015–20
(Percent of total property taxes)

Tax Type	Fiscal Year					
	FY15	FY16	FY17	FY18	FY19	FY20
Recurrent taxes on immovable property	3.0	4.2	5.6	5.8	8.2	5.7
Agricultural land tax	0.9	0.7	0.6	0.3	0.1	0.2
Buildings tax	2.1	3.5	5.0	5.5	8.1	5.5
Taxes on financial & capital transactions	83.5	86.0	87.6	87.4	82.1	84.6
Taxes and fees on cars	13.5	9.8	6.8	6.8	9.7	9.7
Total	**100**	**100**	**100**	**100**	**100**	**100**

Source: Egypt Ministry of Finance, 2021.
Note: Some items included in the public accounts as property taxes are outside of the standard classifications.

(LE; about US 40,000 dollars in December 2024). However, the value threshold applies to only one residential property owned by a taxpayer and not to multiple properties or the cumulative value of all residential property owned. The base erosion that results from this relief is likely substantial. More erosion occurs because of how the tax is calculated. Capital value is determined as 60 percent of the market value, then the annual rental value is determined as 3 percent of the capital value. Net annual value is then determined by deducting 30 percent from the annual rental value for residential property (and 32 percent for nonresidential property). An additional LE 24,000 is then deducted for primary residences to establish the taxable amount (see Annex Table 5.2.3). Notably, the effective tax rates are negligible.

Second (and additional) residential properties do not receive the LE 2 million exemption and LE 24,000 reduction. For a second home with a market value of LE 2 million, the tax is therefore LE 2,520. Although the effective tax rate of 0.126 percent is 21 times higher than on a primary residence worth LE 2 million, it is still low in an international context.

For nonresidential properties the net rental value is determined by deducting 32 percent from the annual rental value. An amount of LE 1,200 is deducted from the net rental value to determine the taxable amount. As Annex Table 5.2.4 shows, even for nonresidential properties, effective tax rates are low when compared with effective tax rates globally.

Real Estate Tax Authority offices located throughout the country's 27 governorates collect the real estate tax. The proceeds are paid to the Public Treasury only if 25 percent of the tax collected within each governorate is allocated to the old and new cities located in that governorate (which does not happen in practice).

Policy Issues and Administrative Challenges

Less than 10 percent of real properties in Egypt are registered formally, a level of informality that presents challenges to raising revenues from real property taxes. Informality in the construction industry and a lack of enforcing zoning regulations also create difficulties in using land-based financing mechanisms effectively, such as developer exactions and impact fees.

Although the real estate tax has significant revenue potential, several factors contribute to its limited revenues. The tax base is eroded significantly through legislated value reductions, potential value capping, numerous exemptions, and preferential treatment of primary residences. The use of survey and assessment committees following a rather prescriptive schedular approach to valuation of especially nonresidential property is practical but likely results in assessed values that are not related to the market, especially for luxury hotels, golf estates, and petrochemical plants. Also, the uniform tax rate of 10 percent across the entire country is problematic; a rate determined at the governorate or local authority units (within a range set centrally) would be more adequate, given wide disparities on values across regions and local units.

ANNEX TABLE 5.2.3.

Egypt: Calculation of Property Tax on Owner-Occupied Primary Residence						
Market Value (LE)	**Capital Value, 60 percent of MV (LE)**	**Annual Rental Value, 3 percent of CV (LE)**	**Net Rental Value, 70 percent of ARV (LE)**	**Taxable Value after Deducting LE 24,000 (LE)**	**Tax Liability, 10 Percent (LE)**	**Effective Tax Rate (percent)**
2,000,000	1,200,000	36,000	25,200	1,200	120	0.006
2,500,000	1,500,000	45,000	31,500	7,500	750	0.030
3,000,000	1,800,000	54,000	37,800	13,800	1,380	0.046
3,500,000	2,100,000	63,000	44,100	20,100	2,010	0.057
4,000,000	2,400,000	72,000	50,400	26,400	2,640	0.066

Source: Based on Egypt, Real Estate Tax Authority (2022).
Note: ARV = annual rental value; CV = capital value; LE = Egyptian pound; MV = market value.

ANNEX TABLE 5.2.4.

Egypt: Calculation of Property Tax on Nonresidential Property						
Market Value (LE)	**Capital Value, 60 percent of MV (LE)**	**Annual Rental Value, 3 percent of CV (LE)**	**Net Rental Value, 68 percent of ARV (LE)**	**Taxable Value after Deducting LE 1,200 (LE)**	**Tax Liability, 10 Percent (LE)**	**Effective Tax Rate (percent)**
2,000,000	1,200,000	36,000	24,480	23,280	2,328	0.116
3,000,000	1,800,000	54,000	36,720	35,520	3,552	0.118
4,000,000	2,400,000	72,000	48,960	47,760	4,776	0.119
5,000,000	3,000,000	90,000	61,200	60,000	6,000	0.120
15,000,000	9,000,000	270,000	183,600	182,400	18,240	0.122

Source: Based on Egypt, Real Estate Tax Authority (2022).
Note: ARV = annual rental value; CV = capital value; LE = Egyptian pound; MV = market value.

Good practice suggests regular or possibly annual adjustments to tax rates (especially if inflation is an issue). If tax rates remain static, indexation of values should be considered. If one of these two approaches is not used, and the tax base, taxable values, and tax rates remain static, revenue will also remain static. In an inflationary environment, revenues will decrease in real terms.

As a central tax, the ability of the real estate tax to strengthen the social contract by establishing a strong connection between property values and public services rendered to properties and their owners is limited.

Morocco

Morocco has a complex land tenure regime that is characterized by legal and administrative plurality and the lack of comprehensive land legislation. Tribes hold about 42 percent of land collectively (with the state as trustee), whereas state-owned land accounts for about 30 percent (Balgley 2015; Franzsen and Elkhdari 2017). Joint ownership by multiple, often multigenerational family members is also common.

In 2007, Morocco embarked on a significant reform of the subnational fiscal regime (Local Tax Guide 2008), aiming to simplify local taxes and improve their administration, adapt and align local taxation with the decentralization program by strengthening fiscal autonomy, and harmonize state and local taxation and amalgamate duplicate taxes.

Transfers Taxes

A registration duty becomes payable when real property is transacted. The tax rate depends on the type of transfer or the identities of the transacting parties, with the highest rate set at 6 percent and the lowest at 1.5 percent. When a building is acquired for residential, commercial, business, or administrative purposes, a registration fee is paid at the reduced rate of 4 percent. This reduced rate also applies to the land on which these buildings are constructed if the land area does not exceed the built area by more than five times. A lower rate of 3 percent is applied for first-time sales of any social housing or a unit in a low-value housing estate acquired from the developer by a natural or legal person who has concluded an agreement with the state as provided by the Tax Code. The reduced rate of 4 percent applies when vacant land or land with structures scheduled for demolition is acquired. The 4 percent rate also applies to land that will be subdivided and earmarked for the construction of residential, commercial, business, or administrative buildings within a maximum of seven years from when the land was acquired.

Listing the registered sales deed in the land registry is an additional formality separate from registration. The buyer applies to list the registered deed on the land registers and pays a fixed fee of 75 Moroccan dirhams (DH) and a stamp duty of 1 percent of the property value, with a minimum of DH 450.

Recurrent Taxes

Several recurrent property taxes are levied per Law No. 47/2006. The General Tax Administration collects the residence tax, municipal service tax, and the business tax centrally on behalf of local authorities. The two relevant taxes levied and collected locally are the tax on vacant urban land and the tax on building operations.

Residence Tax

The residence tax applies to buildings of any kind occupied wholly or partly by their owners as a principal or secondary residence, or occupied without consideration by the owner's spouse, ascendants, or descendants. The tax falls on properties within the jurisdiction of an urban commune and in its peripheral (peri-urban) areas and on properties identified as summer and winter resorts or spas. The owner or the usufructuary pays the tax, but it could be collected from the occupier if the owner is unknown. If land and a building on that land are owned by different persons, the owner of the building is liable for the tax (Local Government Guide 2008).

The tax base is the annual rental value of buildings, with a reduction of 75 percent for buildings with respect to the owner or usufructuary, or the owner's spouse, ascendants, or descendants; members of real estate companies; and Moroccan citizens living abroad if the building is a primary residence and occupied for free by their spouse, ascendants, or descendants. Some properties are exempt, including buildings belonging to the state, local authorities, charities, and public benefit organizations. A temporary five-year exemption is granted to new buildings and additions to buildings constructed as a principal residence, beginning on the date of their completion. These deductions and exemptions erode the tax base significantly (Franzsen and Elkhdari 2017).

The governor of a prefecture or province appoints a commission (members serve six-year terms) to conduct an annual census of all properties in each municipality. The commission must include a tax inspector proposed by the General Tax Administration, and a representative of the municipality's local tax services proposed by the municipal council president. The commission determines the annual rental value of buildings based on the average rents for similar properties in the same neighborhood. The rental values are increased by 2 percent every three years (previously every five years before 2021).

Tax rates are graduated according to estimated rental values, as shown in Annex Table 5.2.5. The tax is collected centrally, and the revenue is apportioned, with 87 percent transferred to the relevant commune's budget, 11 percent to professional chambers, and the remaining 2 percent retained in the general budget of the state as a management fee.

Business Tax

Natural or legal persons engaged in business or professional activities for profit pay an annual business tax. Activities are classified according to their nature in one of three classes as determined by law. The business tax is based on gross annual rental value, determined as follows (Local Tax Guide 2008):

ANNEX TABLE 5.2.5.

Graduated Tax Rates for the Residence Tax	
Annual Rental Value	**Tax Rate (percent)**
Less than DH 5,000	0
From DH 5,001 to DH 20,000	10
From DH 20,001 to DH 40,000	20
More than DH 40,000	30

Source: Morocco General Tax Code (Law No. 47/2006).

- Business and professional activities other than hotel establishments: based on actual lease contracts or rentals either by comparison or by direct reporting without using the correction procedure under the law. Either way, the rental value cannot be less than 3 percent of the overall cost of land, buildings, fixtures, equipment, and tools.
- Hotel establishments: by application, based on the cost of buildings, equipment, tools, fixtures, and fittings of each establishment; or fixed coefficients depending on the overall cost of tangible elements of the hotel establishment considered, that it is operated by the owner or by the tenant. The coefficients are defined by law and range from 1 percent to 2 percent of the cost.

The tax rates are 10 percent on class 3, 20 percent on class 2, and 30 percent on class 1. Minimum amounts are paid for each of the three classes and for urban and rural communes. The revenue is shared in the same way as the residence tax (Law No. 07.20 modifying Law No. 47/2006).

Municipal Services Tax

The municipal services tax benefits urban and rural municipalities (Local Tax Guide 2008) and is levied annually on the owner or usufructuary, or failing that, on the occupant. The tax applies to all existing buildings and constructions of any kind and to equipment, tools, and any other means of production covered specifically, regardless of their use. If a building is the owner's principal residence, the 75 percent reduction of the rental value (as the basis for calculating the residence tax) also applies to the municipal services tax.

The tax applies on the same basis as the residence tax and the business tax. In cases of exemptions from the taxes, the municipal tax applies to actual rent or presumptive rental value if the property is freely available to a third party.

The applicable tax rates are 10.5 percent of the rental value for buildings located within the municipal boundaries of urban municipalities, and for spas and summer and winter resorts; and 6.5 percent of the rental value of properties located in the peri-urban areas of urban municipalities. Taxpayers are subject to the same obligations as for the residence tax regarding completion of construction or a change of property ownership. The revenue is shared between the commune (95 percent) and the region (5 percent) (Local Tax Guide 2008).

Tax on Undeveloped Urban Land

An undeveloped urban land tax is levied and collected locally for the benefit of urban communes. The owner pays the tax on undeveloped land located within the boundaries of urban municipalities and delimited centers (with a town planning document), but undeveloped land already allocated for use of any kind is excluded. In joint ownership cases, owners can request to be charged in proportion to their relevant shares, but each joint owner remains liable to pay the entire tax (Local Tax Guide 2008).

The tax is an amount per square meter of the total land area, with any fraction of a square meter rounded up the next whole square meter. The rates range from DH 4 to DH 6 per square meter on the building area; and DH 2 to DH 4 per square meter on the villa area, individual housing area, or other areas.

The tax is due for the entire year based on the factual situation on January 1. The municipal taxation service conducts an annual census of all taxable properties.

Tax on Buildings Operations

The buildings operations tax is levied locally for the benefit of urban and rural communes. It is a one-off tax paid before a building permit is issued to the taxpayer for any new construction, reconstruction, or expansion of any kind. The tax is based on the total area (in square meters) to be covered by the construction, with any fraction of a square meter rounded up. A 100 percent surcharge is applied to any part of the construction protruding into any public area. The tax rates range from DH 10 to DH 20 per square meter on apartment buildings for private or business use, and DH 20 to DH 30 per square meter on single-unit housing (Law 47/2006).

Policy and Administrative Challenges

The Moroccan tax system is largely centralized. The General Tax Administration collects some of the local taxes through decentralized regional offices. Although property taxes constitute a significant percentage of GDP (the highest on the African continent), recurrent taxes on property are a relatively small proportion of them. The residence tax has a narrow base, and owner occupancy receives material preferential treatment. Raising recurrent property taxes (while protecting low-income property owners) would increase revenues and overall fairness because it would mainly affect wealthier property owners (Jewell and others 2015). Given that the overall tax-to-GDP ratio exceeds 20 percent (IMF 2024), the room to increase revenue from recurrent property taxes might be limited unless relief is granted elsewhere in the tax system.

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CHAPTER 6

Value-Added Taxes

Pierre-Pascal Gendron and Christophe Waerzeggers

INTRODUCTION

The purpose of exploring value-added taxes (VATs) in the Middle East and North Africa (MENA) region is to understand their revenue performance and the possible direction for reform to improve them. VAT dominates consumption taxes for many historical, political, and technical reasons (Bird and Gendron 2007). It has played a vital role in revenue mobilization in developing economies, raising on average 4.7 percent of GDP in low-income countries (LICs) and 6.4 percent of GDP in emerging market economies (EMEs) (Benitez and others 2023). In theory, a sound VAT exhibits several important features: a broad base that captures most household consumption, a uniform rate, few exemptions or non-export zero ratings, and a single, not too low, registration threshold. A sound VAT is also destination-based with border adjustments to exclude exports and include imports in the tax base. Including imports is typically one of VAT's most reliable tax handles.

Revenue goals are the primary motivation for using broad-based consumption taxes such as the VAT. Conversely, the VAT usually performs poorly in achieving nonrevenue objectives compared with alternatives (Gendron 2021). Importantly, the VAT generally replaced more distortionary taxes—that is, raised revenues with lower efficiency cost—thereby raising welfare by about 1 percent of GDP annually (de Mooij, Hebous, and Keen 2025).

Predictably, VAT performance diverges widely across regions and regional blocs. More surprisingly, VAT performance within regions also varies significantly, which Cnossen (2019) has shown in a comparative analysis of African countries. VAT performance is diverse in the MENA region: Some countries have operated VATs since the late 1980s to early 1990s, some implemented VATs in the early 21st century, and others have not yet implemented them. The reliance on hydrocarbon revenues in the Gulf Cooperation Council (GCC) countries is an important consideration,[1] because it positions VAT as part of a strategy for diversifying revenue sources.

This chapter assesses VATs and other consumption taxes in the MENA region and proposes options for reforms that consider the region's needs and institutional

[1] The GCC countries are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates.

constraints, starting with an anatomical snapshot of VATs along several performance indicators for the diverse groups of countries in the region. It then discusses their revenue yield and potential, examines the recent experience of VAT implementation in the GCC and the specific circumstances of sales taxes in fragile and conflict-affected states (FCSs), and then concludes with discussions of VATs and equity, a complicated issue. Two annex tables present detailed tables on the microstructure of VATs in the region. The chapter does not consider excise duties (see Chapter 7).

ANATOMY OF VATS IN THE MENA REGION

VAT designs, policies, and administrative practices in the MENA region reflect its diverse historical, economic, and social circumstances. The presence of oil and gas in many countries has had a negative impact on the development of non-oil tax systems, including VAT and sales taxes. Given the region's political and institutional fragility, a distinction between fragile and nonfragile states is warranted. VATs also reflect the policy ideas of their time of adoption.

Design and Operational Features

Table 6.1 compares several VAT policy parameters in the region by country and group, highlighting the region's heterogeneity. Three fragile hydrocarbon-importing states operate VATs, but no fragile hydrocarbon-exporting state does so. Six nonfragile hydrocarbon-exporting states operate a VAT, while five nonfragile hydrocarbon-importing states do so. The table reveals several interesting patterns. Average standard rates in hydrocarbon importing states exceed average standard rates in hydrocarbon exporting states, while average standard rates in nonfragile hydrocarbon importing states exceed those in fragile hydrocarbon importing states. Older VATs are more likely to feature additional rates beyond the zero rate (Algeria, Jordan, Mauritania, Morocco, Tunisia) or zero registration thresholds (Algeria, Morocco). Also, most countries feature exemptions or reduced positive rates on basic foodstuffs, but newer GCC country VATs do not (such as Bahrain, Oman, Saudi Arabia, and the United Arab Emirates). Hydrocarbon exporting states (Bahrain, Iran, Oman, United Arab Emirates) have the lowest rates in the region. Excluding those states, the average standard rate is 16.1 percent, about equal to the global average.

The concessional picture is far more complicated than Table 6.1 suggests. MENA countries with multiple VAT rates sometimes have highly detailed rate structures (for example, Egypt, Jordan, and Morocco). Exemptions beyond basic foodstuffs differ across countries and often cover sectors that are hard to tax (financial services, real estate), merit-good sectors such as health care and education, and prescription drugs (zero-rated in Oman). VATs in GCC countries (Bahrain, Oman, Saudi Arabia, United Arab Emirates) have few exemptions beyond those mentioned. The last column of the table refers to other atypical exemptions or zero rates. "Atypical" means anything other than supplies of

TABLE 6.1.

Key VAT Policy Parameters in MENA Region, 2024–25

	Country	Month and Year of Introduction	Standard Rate (Percent)	Other Rates (Percent)[1]	Registration Threshold (US dollars)[2]	Exemptions/ Reduced Rates on Foodstuffs	Other Atypical Exemptions (E) and/ or Zero Rates (Z)
Fragile Hydrocarbon Importers	Lebanon	Feb. 2002	11	0	55,750	Yes	E
	Sudan	Jan. 2001	17	30; 0	167	Yes	E
Nonfragile Hydrocarbon Exporters	Algeria	Apr. 1992	19	9	Nil	No	E
	Bahrain	Jan. 2019	10	0	99,547	No	E; Z
	Iran	Sep. 2008	9	ST	Nil	Yes	E
	Oman	Apr. 2021	5	0	100,001	Yes	E; Z
	Saudi Arabia	Jan. 2018	15	0	100,000	No	E; Z
	United Arab Emirates	Jan. 2018	5	0	102,110	No	E; Z
Nonfragile Hydrocarbon Importers	Djibouti	Sep. 2016	10	0	280,850	Yes	E
	Egypt	Sep. 2016	14	5; 0; ST	9,782	Yes	E
	Jordan	Jun. 1994	16	10; 5; 4; 2; 1; 0	105,783	Yes	E; Z
	Mauritania	Jan. 1995	16	18; 0	75,772	Yes	E
	Morocco	Jan. 1986	20	18; 15; 12; 10; 9; 0	Nil	Yes	E; Z
	Tunisia	Jun. 1988	19	13; 7	33,423	Yes	E

Sources: EY 2025; IBFD 2025; PwC 2023; and authors' calculations.
[1]Schedule taxes (ST) apply at rates higher than the standard rate to specified items. Some are akin to excise taxes (see Chapter 7).
[2]Current as of April 16, 2025.

margin-based financial services and supplies by governments. This definition is the perspective of a typical modern VAT with few exemptions but falls short of the comprehensive base of the New Zealand model, which does not exempt the government sector.

The variation in threshold levels is remarkable, ranging from zero (Algeria, Iran, Morocco) to a high of $280,850 (Djibouti). Interestingly, thresholds in several states center on the popular minimum benchmark of $100,000 (Bahrain, Jordan, Oman, Saudi Arabia, United Arab Emirates). Zero thresholds seem especially problematic for weak tax administrations (Algeria, Djibouti). The data in Table 6.1 conceal a more interesting fact: Some countries set multiple thresholds depending on the nature of the economic activity. Lebanon features a zero threshold for exporters and importers, while Jordan's thresholds range from zero to 75,000 local currency units depending on the type of supply. Tunisia sets a threshold of 100,000 Jordanian dinars (JD) for retailers but zero for other businesses. Only Bahrain allows voluntary registration in the region.

Annex Table 6.1.1 details the supplies subject to positive rates other than the standard rate for each country with a VAT. To highlight a few countries, Egypt, Jordan, Morocco, and Tunisia operate complex rate structures. Although the objectives for those structures figure in the long list of nonrevenue objectives presented in Gendron (2021), their complexity and micro detail raise questions about the tax administration's ability to operate them cost effectively and whether they achieve their objectives or can even be evaluated. Compliance costs must also be considered, including the costs of disputes and tax planning that inevitably come with such rate structures. Algeria imposes a reduced rate (about one-half of the standard rate) on a small number of goods and services. Some countries impose rates above the standard rate to function as excise duties on some goods and services,[2] and Morocco is engaged in reforms that aim to reduce the number of rates to three: 0 percent, 10 percent, and 20 percent (IMF 2024b discusses the reform package).

Annex Table 6.1.2 details exempt and zero-rated supplies in the region's VATs (other than the zero rate on exports of goods and services, which is common to all VATs in principle in the region). The VATs in some GCC countries (Bahrain, Oman, Saudi Arabia, United Arab Emirates) are simpler in their design than those in other countries in the region. They tend to rely much less on exemptions and more on zero-rating. Typical exemptions in the GCC include margin-based financial services and supplies of bare land, buildings, and real estate. The lengthy list of zero-rated supplies in GCC countries—94 items compared with 19 items in South Africa, for example—goes beyond the typical unconditional concessions on export, international transport, supply of international vessels, and others. Depending on the country, zero-rated supplies can include basic food items; medicines and medical equipment; oil, oil derivatives, and gas; investment-grade

[2] See Chapter 7 on excises, which describes how some countries in the region lack proper excise tax laws and use the VAT law as legal foundation for applying excises at higher rates than the standard VAT rate.

precious metals; first supply after extraction of gold, silver, and platinum; gemstones; and educational services. Basic foods are notable in the zero-rated list for Bahrain and Oman, where they include: meat and fish (33); vegetables and fruits (37); coffee, tea, and cardamom (8); legumes (4); dairy (4); water (2); sugar (1); prepared children's food (1); salt (1); olive oil (1); fresh eggs (1); and bread (1) (Grant Thornton Abdulaal 2018).

Non-GCC countries rely more heavily on exemptions than zero-rates, and many are typical of older VAT designs inspired by European Union (EU) countries. In addition to financial services, insurance and reinsurance, health care and medicines, education, real estate transactions, and international transport, exempt supplies include a wide range of goods and services, depending on the country: basic food and agricultural products and supplies, agricultural inputs, energy and fuels, newspapers and magazines, postal services and stamps, mobile phone recharge cards, and more. Lists of exempt supplies are especially long in Iran and Mauritania and are significant in Algeria, Lebanon, Morocco, Sudan, and Tunisia.

Despite their commitment to the 2016 GCC VAT framework, Kuwait and Qatar are still the only GCC countries that have not yet implemented a VAT. In Kuwait, opposition from the legislature driven mostly by regressivity concerns and high oil revenues continues to delay VAT implementation. The government's 2024–28 economic plan has ruled out introducing a VAT during this period, looking instead at excises on luxury goods, tobacco, and sweetened drinks. Although preparations for VAT introduction continue in Qatar, especially with upgrades in the tax administration's IT systems, the country has not set an implementation timeline. Draft legislation suggests a 5 percent tax rate, $100,000 registration threshold, and choices of exemptions and zero-rates similar to the other GCC countries with a VAT.

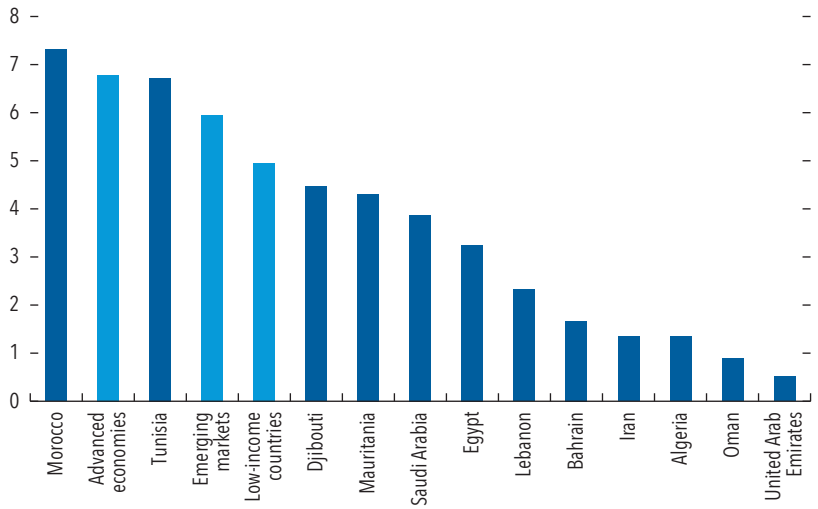
Revenue Role and Contribution

The primary role of VATs is to raise revenue as efficiently as possible. "Efficiently" can be interpreted in several ways: causing as little economic damage and distortions as possible, raising revenue at the lower marginal cost of public funds (Dahlby 2008), or minimizing collection costs, which are the sum of compliance and administrative costs. Governments often use VATs to pursue other objectives for which the tax is poorly suited (Gendron 2021)[3]—discussed later in this chapter.

The ratio of VAT revenue to GDP is the broadest revenue performance indicator and is used commonly as a basis for cross-country comparisons (Figure 6.1). The three comparator groups include LICs, EMEs, and advanced economies (AEs). Morocco stands out with the highest ratio (7.32 percent), which exceeds

[3] Those objectives include income redistribution and equity, formalization of the informal economy, investment promotion, price control or management (especially on imported goods), protection of domestic industry, and promotion of competitiveness.

Figure 6.1. VAT Revenue in the MENA Region and Comparators, 2021–22
(Percent of GDP)



Sources: IMF, World Revenue Longitudinal Database (November 20, 2024); and authors' calculations.

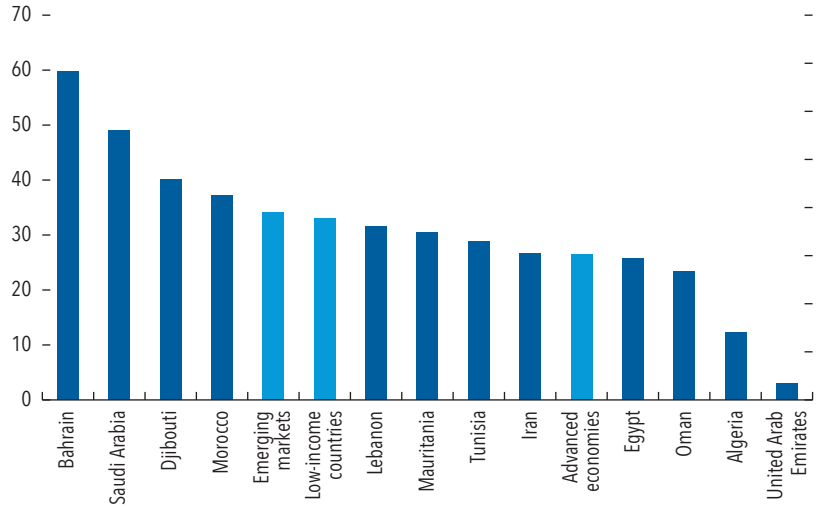
the average in AEs (6.78 percent). Tunisia is next with a ratio of 6.72 percent, positioned between the AEs average and the EMEs average of 5.95 percent. Ratios for the remaining countries range from a high of 4.46 percent (Djibouti) to a low of 0.52 percent (United Arab Emirates).

The discussion so far views the VAT contribution in isolation from other taxes, which is a potentially misleading snapshot because it makes little sense to consider a specific tax outside the context of the overall tax mix. The ratio of VAT revenue to (total) tax revenue (excluding hydrocarbon revenues) provides a direct measure of the importance of VAT in the tax mix (Figure 6.2).[4] VAT-to-tax-revenue ratios in Bahrain, Djibouti, Morocco, and Saudi Arabia are high and range from 59.81 percent (Bahrain) to 37.15 percent (Morocco), all of which exceed the averages in EMEs and LICs. Iran, Lebanon, Mauritania, and Tunisia are in the middle, ranging from 31.56 percent (Lebanon) to 26.66 percent (Iran). Iran's figure is slightly above the average for AEs. Algeria, Egypt, Oman, and the United Arab Emirates are at the lower end with ratios ranging from 25.72 percent (Egypt) to 2.98 percent (United Arab Emirates). Even without analyzing the entire tax system, the VAT revenue contribution indicates how much the country depends on it and the fiscal pressures the country could face if the revenue performance of its VAT deteriorates.

C-efficiency—the ratio of VAT revenues to the product of the standard rate and final consumption valued at VAT-exclusive prices—provides another view

[4] Chapter 2 notes that hydrocarbon revenues are classified as nontax revenues except for the corporate income tax, which is classified under income taxes.

Figure 6.2. VAT Revenue in the MENA Region and Comparators, 2021–22
(Percent of total tax revenue)



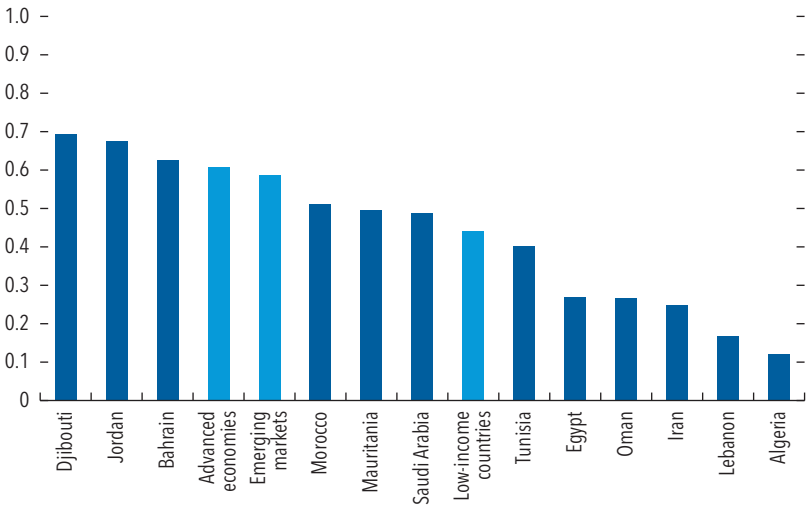
Sources: IMF, World Revenue Longitudinal Database (November 20, 2024); and authors' calculations.

into the relative revenue performance of the region's VATs (Keen 2013). The ratio compares the revenue a VAT raises with the ideal of a perfectly enforced VAT levied at a uniform rate (the standard rate) on all consumption without rate or base exceptions. C-efficiency falls between 0 and 1, by construction. Cross-country comparisons can be made under restrictive assumptions about changes in the composition of consumption (Figure 6.3).

C-efficiency ratios range from a maximum of 0.69 in Djibouti to 0.12 in Algeria. Ratios in Bahrain and Jordan exceed the averages in AEs (0.61) and EMEs (0.59). Mauritania, Morocco, and Saudi Arabia exceed the average in LICs (0.44). On the lower side, ratios range from 0.40 in Tunisia to 0.12 in Algeria. The rank ordering in Figure 6.3 resembles the ordering in Figure 6.2. Two limitations constrain the interpretation of the C-efficiency data. First, Figure 6.3 provides a snapshot at a point in time and thus cannot reveal trend directions and the impact of cyclical influences. Second, the ratios correlate positively with country income levels and will be affected adversely by effective base narrowing through reduced rates and zero rating of final domestic consumption. Poor administrative performance and low compliance will also have an adverse effect on the ratios (see Chapter 10 for a discussion of the administrative challenges in the region). Conversely, a higher C-efficiency ratio can also mask poor efficiency attributes, for example, when no refunds or partial refunds are paid out, in which case the VAT plays the role of a tax on intermediate consumption, underscoring the great care that should be taken when interpreting these ratios.

The heterogeneity of government consumption across the region is another area to consider. Sensitivity analyses were conducted to compare C-efficiency

Figure 6.3. C-efficiency of VATs in the MENA Region and Comparators, 2021-22



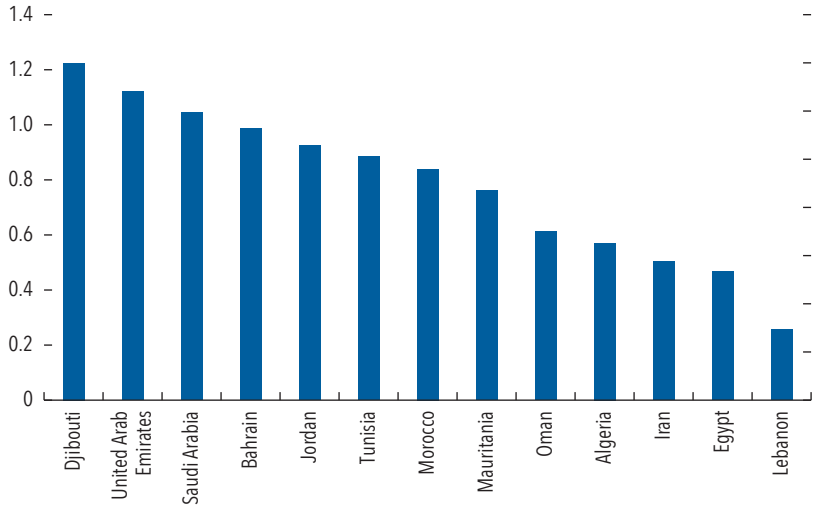
Sources: IMF, World Revenue Longitudinal Database (November 20, 2004); IMF Fiscal Affairs Department, Tax Rates Database; and authors' calculations.

calculated using total consumption (Figure 6.3) with C-efficiency calculated using private consumption only, thus excluding public consumption. The correlation coefficient between the two series equals 0.9915. The positive spread between C-efficiency calculated using private consumption and C-efficiency calculated using total consumption ranges from a low of 2.82 percent in Lebanon to a high of 16.83 percent in Tunisia. Because private consumption is smaller than total consumption, its use in C-efficiency calculations reduces the size of the denominator in the ratio. Figure 6.4 shows the C-efficiency figures calculated using private (instead of total) consumption in the denominator.

Table 6.2 summarizes VAT revenue to GDP, VAT revenue to tax revenue, and C-efficiency ratios over 2002–22 for three subgroups of countries and the MENA average. Hydrocarbon-importing states rely more on VAT revenues and exhibit higher C-efficiency than the MENA average, while the opposite is true for hydrocarbon-exporting states. Fragile states show below-average VAT-to-GDP and VAT-to-tax-revenue ratios but slightly above-average C-efficiency.

Figure 6.5 shows the evolution of C-efficiency ratios over 2002–22 for FCSs, hydrocarbon exporters and importers. Abstracting from the unusual COVID-19 years of 2020–21, average C-efficiency trended upward for hydrocarbon exporters. However, the measure deteriorated for FCSs and hydrocarbon importers. C-efficiency for FCSs peaked at 0.62 in 2008 and fell afterward, deteriorating markedly after 2018. C-efficiency for hydrocarbon importers peaked in 2010 and has trended down since then, with a short turnaround in 2018–19. The overall picture is unfavorable and points to several plausible causes related to VAT design

Figure 6.4. C-efficiency of VATs in the MENA Region, Private Consumption Only, 2019–21



Sources: IMF, World Revenue Longitudinal Database (2004); IMF Fiscal Affairs Department Tax Rates Database; and authors' calculations.

TABLE 6.2.

VAT Revenue Performance Indicators by Group in the MENA Region
(Average 2020–22)

	VAT to GDP (Percent)	VAT to Tax Revenue	C-efficiency
Fragile states	3.41	0.26	0.46
Hydrocarbon exporters	1.16	0.16	0.24
Hydrocarbon importers	5.14	0.33	0.51
MENA average	4.05	0.28	0.43

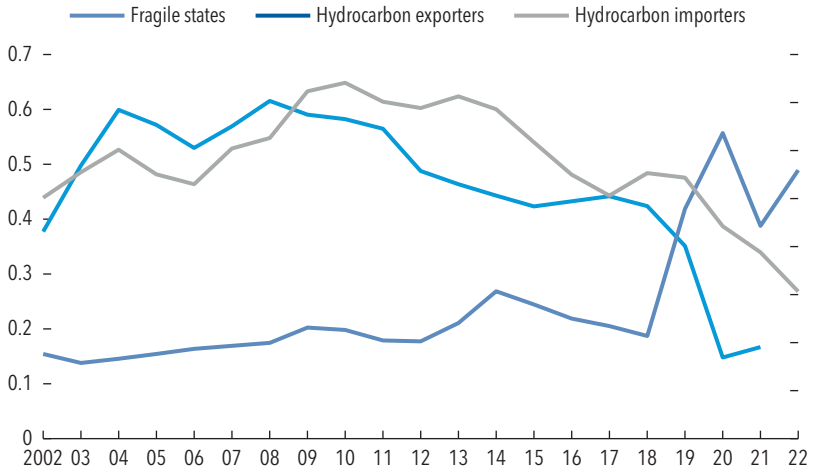
Sources: IMF, World Revenue Longitudinal Database (November 20, 2024); and authors' calculations.

and collection. Design issues include base narrowing, a restricted base definition ignoring elements of a modern VAT's base that should include real estate (immovable property), fee-based financial services, property and casualty insurance, gambling and lotteries, public broadcasting, and postal services (Cnossen 2022). Collection issues could include weakening tax administrations and deteriorating compliance.

A more extensive analysis is needed to fully explain the plausible causes of the evolution shown in Figure 6.5, but such analysis is beyond this chapter's scope. Gendron (2021) recommends that in addition to a deeper analysis of C-efficiency, such an analysis should include the following:

- More granular analysis of VAT revenue by sector and firm size.

Figure 6.5. C-efficiency by Country Group in the MENA Region
(Average 2002–22)



Sources: IMF, World Revenue Longitudinal Database (November 20, 2024); and authors' calculations.

- Macroeconomic analysis, such as buoyancy, which is the ratio of change in revenues to the change in GDP (Gendron 2021, p. 34).
- Micro analysis of the VAT law and its administration.

A second line of analysis follows Keen (2013) in decomposing departures from C-efficiency into a policy gap and a compliance gap. The former represents "a normalized measure of tax expenditures under the VAT, measured relative to a single rate VAT applied to final consumption, calculated under the assumption of full compliance" (Keen 2013, p. 436). The compliance gap represents "the difference between the amount of VAT that is payable in principle and that [which is] actually received by the government, expressed as a proportion of the former" (Keen 2013, p. 438). Compliance gap analysis for the region's VATs is likely to show relatively more important gaps for FCSs, for example, and in countries where informality is high.[5,6]

[5] The IMF's Revenue Administration–Gap Analysis Program methodology can provide VAT compliance gap estimates on a sector-by-sector basis (Hutton 2017).

[6] Informality levels are generally higher in hydrocarbon-importing countries than in hydrocarbon-exporting countries in the region. The size of the informal sector is estimated to average 30 percent to 40 percent in Egypt, Morocco, and Tunisia compared with 10 percent to 20 percent in Qatar and the United Arab Emirates (Medina and Schneider 2018).

VATs AND OTHER CONSUMPTION TAXES IN THE GCC AND FCSs

Recent Experience with VATs in GCC Countries

In 2016, all six GCC countries agreed to harmonize VAT implementation through adoption of the Unified Agreement for Value-Added Tax (VAT) of the Cooperation Council for the Arab States of the Gulf, a major development in VAT policy in the MENA region. Since then, four countries have implemented a VAT in their domestic legislation, but Kuwait and Qatar have not yet done so (Table 6.1).[7]

The agreement aimed to diversify revenue sources and reduce dependence on hydrocarbon revenue, and promote fiscal sustainability in the region. It establishes a standardized approach to VAT implementation in the GCC while allowing member states some flexibility to adapt to local economic and administrative conditions.

The agreement has the following key features:

- Member countries apply a single standard VAT rate of 5 percent and can deviate from it with approval from the GCC Financial and Economic Cooperation Committee. Saudi Arabia raised its VAT rate to 15 percent in 2020 and Bahrain to 10 percent in 2022 (Table 6.1).
- The scope is broad and generally includes all supplies and imports of goods and services in the GCC unless exempted or zero-rated, with specific rules for intra-GCC trade.
- Zero-rated supplies include exports, international transport, investment in precious metals, and less commonly, first supplies of residential property (subsequent sales could be exempt).
- Exempt supplies include financial and insurance services (except for fee-based financial and payment services and general insurance services, which are taxable); health care; education; basic foods; and government-provided public services.
- Intra-GCC transactions between VAT-registered persons in two GCC states are subject to reverse charging to ensure destination-based taxation,[8] supported by electronic reporting and data exchange.
- A mandatory VAT registration threshold is set at approximately $100,000 and allows voluntary registration below that threshold.

[7] Only Saudi Arabia and the United Arab Emirates met the agreement's January 1, 2018, target date for implementation. Bahrain and Oman followed in 2019 and 2021, respectively (Table 6.1).

[8] Under a reverse charge mechanism, the VAT liability is shifted from the seller to the purchaser, which can typically satisfy that liability by recording it as VAT payable (output tax) in its VAT return for the period in which the purchase was made. If the purchase relates to making taxable supplies (including zero-rated supplies), the purchaser is normally entitled to a corresponding credit or deduction (input tax) in the same VAT return, thus eliminating any VAT cash flow burden related to the transaction.

- Input tax recovery is generally available for registered businesses for VAT paid other than for making exempt supplies or for nonbusiness expenses.

The intra-GCC trade arrangement distinguishes the agreement from other regional VAT harmonization efforts outside the EU, such as those of the Central African Economic and Monetary Community and the West African Economic and Monetary Union. The trade arrangement aims to integrate trade between member countries, avoid double taxation, and ensure taxation at destination, thus treating trade between GCC VAT-implementing countries differently from trade with non-GCC countries (and more favorably). VAT on intra-GCC supplies is reverse charged between VAT registered businesses, which effectively relieves intra-GCC trade from VAT (including any associated financing costs) when the purchaser is entitled to a corresponding full and immediate input credit. It also preserves the destination principle, because any subsequent supply by the purchaser will ordinarily be taxed in the destination country. Intra-GCC supplies to end consumers (and other unregistered persons) in another GCC VAT-implementing country are taxed either at origin or at destination, depending on the total volume of the supplier's sales to the destination country. If the total volume exceeds the VAT registration threshold in the destination country, the destination country VAT applies. If the volume does not exceed the threshold, the supplier's home country VAT applies. Conversely, trade with the rest of the world is treated as imports and exports, which, for goods especially, typically involves stricter customer procedure requirements to ensure that VAT is paid at import (even if it might later be credited and refunded) and to verify that the goods actually leave the territory at export.

The arrangements are similar to those used in the EU since the creation of the EU internal market in 1993.[9] However, they have also enabled VAT "carousel" fraud (or missing trader intracommunity fraud, one of the most pervasive forms of VAT fraud) in the EU.[10] The scheme exploits the nontaxation of business-to-business intra-EU trade by generating refunds in one member state for commodities on-sold by an accomplice in another member state, without paying tax there (the missing trader). To avoid detection and increase profits, the scheme typically involves complex circular transaction chains among a ring of complicit traders in different countries (the carousel) to obtain as many refunds as possible before discovery. To address this risk, the GCC agreement makes full implementation of the intra-GCC arrangements contingent on establishing an electronic service system to facilitate seamless data exchange among GCC countries, track cross-border transactions, verify zero-rating eligibility, and combat fraud. Progress has been made in developing national digital systems to support VAT administration (such as Saudi Arabia's Fatoora e-invoicing platform and the United Arab Emirates' in-progress e-invoicing portal [see Chapter 10]), but the integrated

[9] See Waerzeggers (2010) for a brief history and drivers of EU VAT harmonization.

[10] The European Commission has estimated the revenue loss from missing trader intracommunity fraud at €12.5 billion to €32.8 billion annually from 2010 to 2023, averaging 1.2 percent to 3.1 percent of actual VAT revenue (EC 2024).

GCC-level system for real-time data sharing and transaction monitoring remains incomplete. Therefore, fraud vulnerability remains a concern (Ainsworth and Alwohaibi 2016).

Several challenges to GCC VAT harmonization remain, beyond implementation by the two nonimplementing countries (Kuwait and Qatar). The GCC VAT agreement leaves many VAT policy choices to member states, including whether to tax, exempt, or zero-rate key sectors such as health, education, real estate, extractives, financial services, and second-hand goods. These base variations, along with growing VAT rate variation among implementing countries, could increase GCC internal market distortions and associated revenue losses. Mitigating these dynamics—without setting stricter base and rate rules in the agreement—requires stronger rules to ensure taxation at destination, building on existing e-commerce rules introduced by several members (consistent with OECD 2017), and more robust coordination mechanisms for implementing those rules. The GCC Financial and Economic Cooperation Committee, composed of finance ministers, or their representatives, from each member state, plays a pivotal role in this respect. However, experience elsewhere shows that the GCC still lacks other features of a robust regional VAT integration model. Specifically, no binding GCC-level judicial dispute resolution mechanism exists to ensure coherent interpretation and implementation of the agreement, such as a hypothetical "court of justice of the GCC."[11]

Countries without a VAT

The non-GCC MENA countries without a VAT—Iraq, Libya, and Yemen, all FCSs—tax consumption through selected sales taxes on specific sectors or activities (such as restaurants and other retail activities) in addition to traditional excises and customs duties. Compared with a broad-based VAT, their sales taxes have the following features in common:

- Narrow base, typically targeting only selected activities or sectors.
- Relatively low rates.
- Turnover tax base instead of value-added or final consumption.
- Low compliance levels.
- Inconsistent or poor enforcement.
- Low revenue yields.

Besides showing the common characteristics of tax systems in FCSs, the features also illustrate the revenue potential of sales tax reform. In all three countries, the sales tax contribution to non-oil revenue is minimal (0.2–0.7 percent; Table 6.3), a clear example of the low use of consumption taxes usually observed

[11] For example, a 2024 decision of the United Arab Emirates federal supreme court ruled on the application of the agreement to a specific transaction between Saudi Arabia and the United Arab Emirates. Although the decision is authoritative (and the issue was relatively straightforward), it is not binding on other GCC countries.

TABLE 6.3.

Sales Tax Features of MENA Fragile and Conflict-Affected States

Country	Nonhydrocarbon Revenue (Percent of GDP, 2019–23)	Sales Tax Rates	Sales Tax Revenue (Percent of Nonhydrocarbon GDP)	Informality (Percent of GDP)
Iraq	2.9	10–15 (mostly hotels and restaurants)	0.3–0.5	30–40
Libya	2–4 (estimate)	5–10 (telecom; retail sales in some areas)	0.3–0.6	30–35
Yemen	3.1	2–10 (telecom; retail sales in urban areas)	0.4–0.7	35–40 (post conflict estimate is likely higher)

Sources: Estimates of informality from Medina and Schneider 2018.
Note: Informality refers to all economic activities that are hidden from official authorities for monetary (including tax), regulatory, and institutional reasons (Medina and Schneider 2018).

in FCSs (Mansour and Schneider 2019). The low use reflects the narrow bases of current sales tax systems, high levels of informality (likely increasing in Yemen), and institutional fragmentation worsened by conflict.

In addition, and consistent with the first point, these countries have significant revenue potential from gradually broadening the consumption tax base, which would contribute substantially to domestic revenue mobilization and bring them closer to the higher tax-to-GDP ratios typical of countries that have exited fragility. However, VAT might not yet be appropriate because of capacity constraints and institutional fragility (see Chapter 10). In FCSs, the priority should be consolidating and strengthening institutional capacity in controlled areas, simplifying existing sales taxes, and establishing separate excises on a few items (see Chapter 7). Iraq, with relative stability, is best positioned to adopt a broader low-rate turnover-based sales tax system with limited exemptions, along with separate excises, as a stepping stone toward a VAT in the medium term.[12]

VAT AND EQUITY CONSIDERATIONS

Given the VAT's primary role of raising revenue as efficiently as possible, incorporating equity considerations into the VAT analysis raises broad and difficult issues that are politically sensitive because the VAT is often described as regressive without context or evidence. This section discusses the key issues and proposed solutions, focusing on tax preferences in favor of households while acknowledging that the VAT is also used to confer preferences to businesses—a much less defensible approach given how the VAT was designed to work. Business

[12] A 5 percent VAT with limited exemptions could raise 3.7 percent of nonhydrocabon GDP in Iraq (IMF 2024a), more than doubling its current tax-to-GDP ratio.

incentives through VAT warrant a separate discussion (see PCT 2025 to explore the issue).

The Issues

Many VATs have been launched with significant tax preferences, such as exemptions or reduced rates (including zero rates) on basic foodstuffs and other necessities. The term "necessities" is somewhat elastic and could include prescription drugs, household fuels, a portion of electricity consumption, and similar items. History shows that once introduced, such preferences are extremely difficult to reverse, often more challenging than raising the standard rate later. Their presence at the outset can create pressures for more preferences, famously known as "exemption creep." Again, an elastic reformulation can include zero rating creep.

VAT mechanics lack simple mechanisms to target benefits to deserving households (meaning low-income households in many cases). Preferences are broad-based and blunt instruments, and thus benefits will also accrue to unintended beneficiaries such as middle- and high-income households. Many distributional impact analyses of actual VAT preferences show that although low-income households benefit in relative terms, the absolute (monetary) benefits that accrue to higher-income households are larger because they consume more. That is, relative benefits are typically distributed progressively while moving up household expenditure deciles, but absolute benefits are typically distributed regressively.

Focusing on VAT to deliver benefits is another issue. Doing so often overlooks alternative methods such as income tax expenditures or direct expenditures in cash or in kind, which can target deserving households much better than the VAT. Such methods are worth considering when available, but their absence creates dilemmas (see below).

Delivering social benefits through the VAT is costly in foregone revenue, and the resulting tax expenditures should be costed as part of a fuller tax expenditure analysis involving benchmark definition, inventory and description of tax expenditures, costing, and reporting (Heady and Mansour 2019). The separate but related tax expenditure evaluation framework is also available to answer deeper questions in a cost-benefit analysis, such as whether the preferences produce the intended impacts and whether the benefits are worth the cost in foregone revenue, for example, Beer and others (2022).

Experience in a Difficult Context

The most difficult context regarding equity is a highly unequal income distribution and the inability of instruments other than the VAT to reliably reach households at or near the low end of the income distribution. South Africa illustrates this case because of the following:

- The country's income distribution is highly unequal (Gini index coefficient forecast of 63.0 in 2025).[13]
- VAT policy provides significant relief to households through 19 zero-rated basic foodstuffs, a few household fuels, and farming inputs.
- The South African National Treasury costs tax expenditures (National Treasury South Africa 2024).
- Independent South African commissions have studied the issues in comprehensive detail.

Two commissions have issued reports: the Davis Tax Committee in March 2018, followed by the Independent Panel of Experts on the Review of Zero Rating in South Africa. In August of 2018, the Independent Panel recommended to the Minister of Finance, among other things, that the list of zero-rated items be extended with additional food items and sanitary products, school uniforms, and diapers. The executive summary's concluding paragraph succinctly captures the relevant policy dilemmas:

> "The Panel is of the view that expenditure programmes have a role to play in mitigating the impact of the VAT increase on poor households. In theory, it would be cheaper to return the cost of the VAT increase to the poorest households than to extend zero rating. The challenge is to ensure that expenditure actually increases above the baseline, and that it reaches the bulk of low-income households. In addition, as noted above, experience internationally indicates that in the long run, improving income distribution requires a strongly overall progressive incidence for taxation (although each individual tax instrument need not be progressive), irrespective of the progressivity of government expenditure" (Independent Panel 2018, p. 8).

Keen (2009) is more optimistic about the role of expenditures but still qualifies that view, stating:

> "Potentially adverse equity implications of VAT design should not be dismissed with vague references to dealing with them on the spending side: precision is needed as to exactly how, if at all, that can be done, and this has often been lacking" (Keen 2009, p. 167).

Experience in the MENA Region

The income inequality situation in the MENA region is less extreme than in countries such as South Africa. Based on incomplete data from 2012 to 2022, Gini index coefficients ranged from a low of 26.4 in the United Arab Emirates in 2018 to a high of 45.1 in Djibouti in 2012. The average of available observations for the region over the same period is 34.6. Table 6.4 shows the Gini index values for countries in the region based on the latest year of data. Average Gini indices

[13] Data are from World Bank Group, "Poverty and Inequality Platform, Gini Index." (https://data.worldbank.org/indicator/SI.POV.GINI/).

TABLE 6.4.

Gini Index in MENA Region

Countries and Country Groups	Gini Index	Latest Year
Fragile Hydrocarbon-Importing States		
Djibouti	41.6	2017
Lebanon	31.8	2011
Nonfragile Hydrocarbon-Exporting States		
Algeria	27.6	2011
Iran	34.8	2022
United Arab Emirates	26.4	2018
Nonfragile Hydrocarbon-Importing States		
Egypt	31.9	2019
Jordan	33.7	2010
Morocco	29.5	2013
Tunisia	33.7	2021

Source: World Bank Group, Poverty and Inequality Platform, Gini Index.

are lowest in nonfragile hydrocarbon exporting states and highest in fragile hydrocarbon importing states. The average in nonfragile hydrocarbon importing states falls between the other two groups.

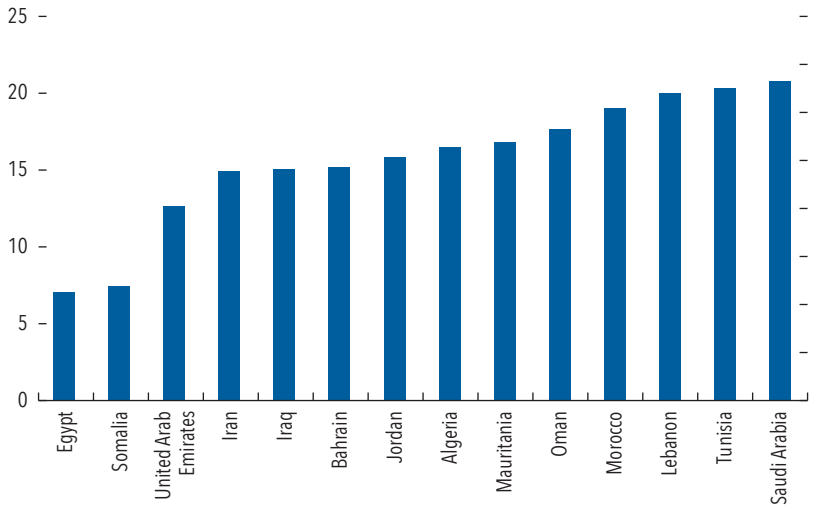
Morocco stands out in the region for publishing tax expenditure reports, which the Ministry of Economy and Finance has been doing for about 20 years. The most recent edition provides valuable information on the VAT system benchmark, costing methods, cost estimates by tax and other dimensions, and an inventory of individual measures (MEF 2024). However, it cannot help determine whether VAT exemptions and reduced rates are effective instruments for pursuing equity objectives because the analysis does not include a tax expenditure evaluation of the measures or their distributional analysis, which should be part of a separate tax expenditure evaluation.[14] Despite a few methodological reservations (for example, reduced rates appear to be part of the benchmark VAT system), the Moroccan tax expenditure report is a good example for MENA region countries to follow.

Dilemmas and Possible Solutions

Countries that rely heavily on VAT to achieve equity objectives face several dilemmas, such as how to transition to instruments that target benefits better and more cost effectively without the political fallout. Complex VATs with many tax preferences have higher collection costs and undermine tax administration effectiveness. Another issue is how to improve tax administration performance when the overall governance and institutions are weak.

[14] In Canada, for example, annual tax expenditure reports include economic evaluations of one to three individual tax expenditures on a rotating basis (see Department of Finance Canada 2025, Part 4 for two examples).

Figure 6.6. Government Expenditure in the MENA Region
(Percent of GDP)



Sources: IMF, International Financial Statistics Database; and authors' calculations.

Improved targeting and cost-effectiveness depend on the availability of alternative instruments to deliver benefits while improving equity, which must consider the personal income tax (see Chapter 3) and the mix between direct expenditures and other tax expenditures (for example, income tax expenditures). Country data on tax expenditures can be scarce, but direct expenditures are readily available from budgets. All else equal, countries that spend a larger share of GDP should have the administrative capacity to use direct expenditures to deliver benefits progressively. Figure 6.6 shows the ratio of government expenditure to GDP for MENA countries. Of the VAT country subsample, Bahrain, Jordan, Algeria, Mauritania, Oman, Morocco, and Lebanon spend between 15 and 20 percent of GDP. Only Saudi Arabia and Tunisia spend more at almost 21 percent.

Balancing revenue and equity is harder when personal income taxes are weak. It places pressure on direct expenditures because the VAT is unsuitable to deliver targeted benefits. Reporting tax expenditures is a good start because costly tax expenditure items draw attention and become good candidates for economic evaluation through impact, cost-effectiveness, or cost-benefit analyses (Beer and others 2022). Reporting and evaluation provide insurance against VAT stasis or deterioration and are a prerequisite for a medium-term approach to VAT reform. By contrast, piecemeal reforms (often driven by short-term objectives) that make minor adjustments to the VAT are rarely effective in improving VAT revenues sustainably. Such reforms typically focus on the VAT's legal design and fail to recognize its links with the rest of the tax system and the broader economic context.

CONCLUSION

The implementation of VAT in MENA countries is a policy achievement that should not be taken for granted, given the region's institutional and economic challenges. VATs in the region are diverse, reflecting the countries' history, macroeconomic structures and composition of GDP, and regional coordination in the GCC. The coordinated VAT implementation in four of the six GCC countries is one of the most important tax policy developments in the region—a key to reducing those countries' reliance on hydrocarbon revenues and an enabler of future development of their domestic tax systems.

However, VAT revenue performance in the region has been trending in the wrong direction since 2008–10 (at least for FCSs and hydrocarbon importers). VAT design features that narrow the base or make VAT revenues less buoyant with economic activity partly explain the trend, along with the effectiveness of tax administration in operating and enforcing VAT (Chapter 10). Tax administrations must operate within the constraints they are given, but poor policy choices make their jobs even harder. All else equal, multiple rates and exemptions, multiple non-export zero ratings, and low and dual registration thresholds undermine the effectiveness of all administrative functions and waste scarce resources on activities that generate minimal revenue and achieve only a few of the stated policy objectives (based on experience with tax expenditure evaluation).

Ideas for VAT reform are plenty, but implementing reforms is much harder and requires discipline and persistence. The piecemeal approach (described in Cnossen 2019) has been tried many times and proved far less likely to produce meaningful results because of its many hidden problems that are difficult to measure. However, a disciplined and persistent approach based on large numbers (costing tax expenditures associated with important tax preferences) offers greater visibility and is much more likely to succeed, given the well-established processes on which it relies and the success of such projects around the world, which can be encouraging.

Deeper analysis is required to better understand the drivers of the declining C-efficiency trend in hydrocarbon importers and FCSs, but it points to structural weakness—likely in VAT policy design and administration—that if addressed can unlock additional revenues for these countries while improving the overall efficiency of their VATs. Given the small contribution of personal income taxes in the region (see Chapter 3), pressure on the VAT to generate more revenue is high, and the need to plan for reforms is pressing.

Priorities for the GCC countries are to complete VAT implementation in Kuwait and Qatar, deepen regional coordination, and strengthen the internal market. Experiences elsewhere, including in the EU, will continue to provide useful lessons in this regard.

The priority for the remaining MENA countries without a VAT—all of which are FCSs—is to consolidate and strengthen their institutional capacity and streamline existing sales tax systems, including unbundling them from customs and excise duties, as a stepping stone to VAT over the medium term.

ANNEX 6.1. VALUE-ADDED TAX RATES AND EXEMPTIONS IN THE MENA REGION

ANNEX TABLE 6.1.1.

Value-Added Non-Zero Tax Rates in the MENA Region

	Country	Positive Rates Other than the Standard Rate
Fragile Hydrocarbon Importers	Lebanon	None.
	Sudan	30 percent applies to sales of telecommunication companies and cigarettes.
Non-Fragile Hydrocarbon Exporting States	Algeria	9 percent applies to social allocations of electricity and gas; sales of heavy fuel oil, butane, propane and liquefied propane gas; pawnbroking with households; cinema tickets; operations in air and maritime construction sites; services related to tourism activities; and recyclable waste.
	Bahrain	None.
	Iran	Yes, but the rates are unknown and higher than the standard rate.
	Oman	None.
	Saudi Arabia	None.
	United Arab Emirates	None.
Non-Fragile Hydrocarbon Importing States	Djibouti	None.
	Egypt	5 percent applies to machinery and equipment used in manufacturing and in the service sector. Schedule tax applies at a rate of 5 percent on a long list of goods, 22 percent or 24 percent on excisable goods, and 22 percent on televisions and air conditioning units. Schedule tax applies with special ceiling rules for input value-added tax deduction.
	Jordan	10 percent applies to live animals and cheese; 5 percent to corn; 4 percent to oil and ghee, supplies used by the handicapped, and veterinary medicines; 2 percent to food salt and pencils; and 1 percent to hygiene, disinfectants, and gloves.
	Mauritania	18 percent applies to telecommunications.
	Morocco	The main reduced rate is 10 percent. 18 percent, 15 percent, 12 percent, and 9 percent are transitional rates to be phased out over 2025–26. Transitional rates will be as follows: sales of electricity from renewable sources, 10 percent starting in 2025; services provided by insurance companies, marketers, and brokers, 10 percent starting in 2025; urban and road passenger and freight transportation, 12 percent in 2025 and 10 percent in 2026; refined or agglomerated sugar, 9 percent rate in 2025, 10 percent rate in 2026; rental of electricity meters, 15 percent in 2025, 20 percent rate in 2026; electric power, 18 percent in 2025, 20 percent in 2026; passenger and freight transport, non-urban, nonroad, 18 percent in 2025, 20 percent in 2026.
	Tunisia	13 percent applies to sales of electricity for household consumption and electricity for water pumping equipment used in agriculture, and sales of buildings constructed by real estate developers for the exclusive use of housing. 7 percent applies to transport of goods, activities by doctors and laboratories, materials and supplies for pharmaceutical products, tourism activities, charging equipment for electric motor vehicles and motor vehicles and motorcycles equipped only with electric motors for propulsion.

Sources: EY (2025); IBFD (2025); PwC (2023).

ANNEX TABLE 6.1.2.

Value-Added Tax Exemptions and Zero Rates in the MENA Region

	Country	Exempt Supplies	Zero-Rated Supplies
Fragile Hydrocarbon Importers	Lebanon	Postal services and stamps; education; insurance; financial services; transfers of real estate; medical services and equipment; precious metals and precious and semiprecious stones; betting and gaming; collective transport of persons; agricultural activities and products, including inputs; books, newspapers, and magazines; basic foodstuffs and baby foods; and diesel fuel.	None.
	Sudan	Agricultural products supplied in raw condition; cattle, meat, poultry, fish, dairy products; agricultural inputs; medicines for human and veterinary use; locally produced flour and bread; imports pursuant to diplomatic or government agreements; financial services and insurance services; educational services; medical services; sale or rent of real estate to be used for private personal occupancy; and goods and services exempted by an order of the Minister of Finance.	None.
Non-Fragile Hydrocarbon Exporting States	Algeria	Transactions conducted by a startup; construction and services related to prospecting, research, exploitation, and liquefaction or pipeline transport of liquid and gaseous hydrocarbons; acquisitions by banks in the context of leasing activities; sales operations related to pharmaceutical products; export of goods and services; internet access royalties (until December 31, 2026); and fixed assets acquired and used exclusively in activities related to electricity and gas.	None.
	Bahrain	Supply of financial services except for those remunerated by fees; supply of bare land and buildings; and import of goods exempt from value-added tax.	Local transport; oil, oil derivatives, and gas sector; supply or import of investment-grade precious metals; first supply after extraction of gold, platinum, and silver; supply or import of pearls or precious gemstones; supply or import of medicines and equipment; supply of educational services (all levels) and related goods; supply of food items listed in the Gulf Cooperation Council list of basic food items (94 items); and construction of new buildings.

ANNEX TABLE 6.1.2 *(continued)*

Value-Added Tax Exemptions and Zero Rates in the MENA Region

Country	Exempt Supplies	Zero-Rated Supplies
Iran	Supply or importation of livestock and live poultry, aquatic products, and insects; agricultural inputs; flour, bread, meat, sugar, rice, cereals, soya, milk, cheese, vegetable oil, and baby food; paper and electronic books, newspapers, magazines, and publications of all types; products donated free of charge to governments; personal use items accompanying travelers to Iran; immovable property; medicines and medical products and services; employment services taxed under other taxes; banking and credit; public intercity and intracity transportation, all modes; handmade carpets and handicrafts made in Iran; research and educational services; domestic animal food products; radars and aeronautical navigation equipment; items used for defense and security; and export of commodities and services.	None.
Oman	Margin-based financial services and life insurance; health care services and related goods and services, education services and related goods and services, supply of bare land, resale of residential real estate, local passenger transportation, and rental of real estate for residential purposes.	Basic food items; approved medicines and medical equipment; investment-grade gold, silver, and platinum; supply of oil, gas, and oil derivatives; supply of rescue aircraft and ships.
Saudi Arabia	Certain financial services except for those remunerated by fees, and real estate.	Direct exports to nonresidents outside the Gulf Cooperation Council countries, exports of services, international transport, medicines and medical goods, investment metals, and supply of military supplies to military forces in Saudi Arabia.
United Arab Emirates	Financial services and their arrangements; supply of residential buildings, unless zero-rated; supply of bare land; and supply of local passenger transportation services.	Direct or indirect export of goods outside United Arab Emirates; export of services; intra-GCC transport that begins or ends in United Arab Emirates; supply and import of sea or land transportation services, including related services; supply or import of investment-grade precious metals; first supply of residential buildings.

ANNEX TABLE 6.1.2 *(continued)*

Value-Added Tax Exemptions and Zero Rates in the MENA Region			
	Country	**Exempt Supplies**	**Zero-Rated Supplies**
Non-Fragile Hydrocarbon Importing States	Djibouti	Banking and insurance transactions; sales of immovable property or intangible assets; newspapers; cultural, medical, and educational services; provision of noncommercial services by state and public bodies; and imports of sanitary napkins.	None.
	Egypt	Tea, sugar, and coffee; banking services; medicines and active substances; health care services; production, transfer, or sale of electricity; education.	None.
	Jordan	Wheat, bread, electrical energy, firefighting vehicles, education and training, and medical services.	Printing, and raw materials for the production of medicine.
	Mauritania	Sale of petroleum oils or bituminous minerals, petroleum gas, and other gaseous hydrocarbons; medical acts, hospital costs, and hemodialysis materials and inputs; sales and services provided by the state and its collectivities; goods and services delivered to airlines or sea or international river shipping; revenues from composition and printing of newspapers and periodicals; transactions involving the transfer of business ownerships; transport operation conducted by a public transporter of passengers or goods; international air transport and ticketing operations by travel agencies; operations conducted by banking, financial, and credit organizations; teaching activity; purchase of goods and services related to mining operations; and sale of foods, plants, seeds, and ice.	None.
	Morocco	Sale of fish products, other than for consumption on the spot; sales of recovered metals and used water pumps that use solar or renewable energy, used in the agricultural sector; insurance and reinsurance services; royalties and license fees included in the taxable amount for import value-added tax; and school supplies and the products and materials used in their composition.	Fertilizers; machinery for agricultural use; investment goods recorded as fixed assets for 36 months, excluding vehicles at rental agencies; pharmaceutical products; sales and deliveries of water for domestic use, sanitation services, and water meter rental.

ANNEX TABLE 6.1.2 *(continued)*

Value-Added Tax Exemptions and Zero Rates in the MENA Region

Country	Exempt Supplies	Zero-Rated Supplies
Tunisia	Banking interest; maritime air transport; milk and flour; commission on electronic payments via terminal, internet, or mobile phone; margins made by distributors of electronic top-up phones and airtime recharge cards; and interest on loans intended for financing through crowdfunding platforms.	None.

Sources: EY (2025); IBFD (2025); PwC (2023).
Note: The zero rates exclude exports of goods and services, which are zero-rated in principle in all countries.

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CHAPTER 7

Excise Taxes

Anne-Marie Geourjon and Patrick Petit

INTRODUCTION

Modern tax systems fund government expenditures through a few broad-based taxes on income and consumption. The value-added tax (VAT) is the favored policy instrument globally to tax consumption because of its revenue potential and production neutrality properties (see Chapter 6). Unlike most other taxes (including the VAT), excise taxes target a few items with relatively high rates to influence consumption and production behavior. A principal goal of excises is to counterbalance market inefficiencies that lead to overconsumption, especially when it leads to health or environmental problems. Such problems include negative externalities (for example, the impact of cigarette smoke on others) and internalities (for example, self-damage from addiction to alcohol).

Excise taxes are generally covered by legal and administrative frameworks distinct from those of general sales taxes, and they apply to a limited set of products with significant externalities or internalities; an easy-to-control supply chain; a clear, unambiguous, and inclusive definition; and low price- and substitution-elasticities (Crawford, Keen, and Smith 2010). Typical excise taxes include so-called "sin taxes" on tobacco and alcohol (Mansour, Petit, and Sawadogo 2023; Petit and Nagy 2016), and those on fuel and motor vehicles because of their environmental externalities (Cnossen 2005).[1] Other nontraditional goods can be excisable despite low revenue potential, such as sugar-sweetened beverages, which are linked to obesity (Petit, Mansour, and Wingender 2021); or skin lighteners, which can have negative health side effects. Also, without better policy solutions, excise taxes can be used to tax mobile communication, given its reliance on limited electromagnetic spectrums.[2]

This chapter assesses excise systems in the Middle East and North Africa (MENA) region and proposes options for reforms that match the region's diverse needs and institutional constraints. It presents a typology of excise tax systems that groups countries in the region according to their legal frameworks and how intensely they use excises. It then discusses the revenue performance of excises and

[1] The use of excises (such as a carbon tax) to meet broader environmental objectives is covered in Chapter 9.

[2] Entry into the industry requires paid licenses because of limited spectrum space. Excise taxes can complement the licenses or be an imperfect fallback option if license payments are too low (Matheson and Petit 2017).

their potential, using primarily international benchmarking. The chapter concludes with suggestions for reforms to improve the design and transparency of excise regimes and their revenue performance.

A TYPOLOGY OF EXCISE SYSTEMS

The diverse historical, economic, and social circumstances in the MENA region have led to excise systems with a wide variety of policies and practices. In many countries, the presence of hydrocarbons has had a negative impact on the development of nonhydrocarbon tax systems, which includes the excise system. Taxing fuel (often the main excise revenue source) has also been challenging politically because citizens in hydrocarbon-rich countries expect cheap fuel. Religious practices have created a natural inclination to tax alcohol, and production or consumption (or both) are banned in several countries, which limits its revenue potential. Unlike alcohol, tobacco consumption is generally allowed in all countries in the region, though production is sometimes restricted.[3]

A cursory review of excise tax regimes in the MENA region suggests that grouping countries into the following categories can help tailor reform options. The categories can be compared with the legal and administrative procedures in Box 7.1, which are generally considered good practices. Differences across the three groups are a result of several factors, including the presence of hydrocarbons or fragility; and legal and administrative practices inherited from French and English colonialism, earlier political regimes, and geography.

- Group 1: Countries without a legally defined excise tax system.
- Group 2: Countries with a legally defined but basic excise tax system.
- Group 3: Countries with well-established excise tax systems.

Countries without a Legally Defined Excise Tax System

Group 1 countries include Djibouti, Egypt, Iran, and Kuwait; and fragile and conflict states (FCSs) such as Iraq, Libya, Somalia, Sudan, and Yemen.[4] Most of these countries have added excise-like features to their sales taxes (which by design and administrative feasibility are poorly suited to rate differentiation) or to their customs duties (which do not apply to local production). This lack of proper excise legislation and a clear difference between excise taxes and other types of indirect taxation on consumption and production prevents effective pursuit of the standard policy objectives of correcting for externalities and internalities. They also make it difficult to benchmark such systems against others.

[3] Since the purpose of an excise is to curtail consumption, banning consumption is arguably equivalent to setting the excise at a rate that makes consumption equal to zero, assuming full compliance. This chapter does not explore this issue further.

[4] Syria is excluded from the analysis because of a lack of current data.

Box 7.1. Key Aspects of Legal Frameworks and Administrative Procedures for Excises

Excise taxes are a potential source of significant revenue but can pose compliance challenges. To implement controls of the entire supply chain from early stages of production or import to distribution, excise tax administration requires a clear legal framework and dedicated services or functions of the revenue administration, including to fight illicit trade.

The legal framework needs to include clear definitions of the taxed product that are easy to apply (designating them using the Harmonized Commodity Description and Coding System codes is one way to do so) yet broad enough in scope to prevent excessive substitution of untaxed products. The tax base must also be defined in value or volume metrics, and the rates and tax liability calculation methods must also be specified. The framework should also include statutory responsibility for payment; the point in the supply chain at which the product is taxed and revenue collected (such as production, imports, ex-factory sales, and retail sales); and the payment frequency and mode. In principle, excises apply to imports and domestic production and in certain cases even if domestic production is not consumed locally but generates externalities, such as tree harvesting for wood exports. Typically, all participants in the production and distribution chains will be licensed to ensure the technical, financial, and administrative quality and reliability of the participants. Guarantees, safeguards, and other assurances can be required as part of a broad compliance strategy, and noncompliance should be penalized severely—in some cases, independent players in the supply chain can be held jointly liable for noncompliance. Licensees must maintain records, notably on inputs, production, inventories, and flow of materials, and the law must define the content and format of such records. The legal framework must also impose restrictions on internet sales and duty-free sales (which would typically be at the exit of airports or ports for outbound passengers) and limit duty-free personal imports to short-term personal consumption. The framework should also provide the basis for tax administration organization and responsibilities and define administrative controls and fines and penalties. Given the importance of border control, a clear breakdown of responsibilities between customs and the tax department and the coordination mechanisms between them is crucial.

To implement the framework, customs and revenue administrations need to enforce strong controls, which can be physical (such as in-place at production facilities or escorting shipments in transit), electronic (satellite-connected devices on sealed containers, for example), or through audits (such as conformity of production, sales, and inventories; or correspondence in records between purchasers and buyers). Control can extend to

track-and-trace systems—that is, labeling every product along the supply chain with date, time and place of production, origin, intermediaries, intended destination, taxation status, and other details. All of this requires significant investments in physical and human capital. Illicit trade is a key issue related to excise taxes, with smuggling the most important form by far. Fighting illicit trade demands strong border protection and significant security investments (such as X-ray scanners, mobile surveillance units, and infiltration operations) and effective regional-international cooperation.

Source: Authors.

For example, the sales tax in Iraq applies to only a few products (excluding fuel), with highly differentiated rates (see Annex 7.1).[5] Sudan applies stamp taxes (on telecommunication and motor vehicles), and other product-specific levies, in addition to its VAT. Libya also uses stamps, but they are applied mainly to documents and authorizations. In Yemen, a higher sales tax applies to tobacco and khat,[6] weapons and ammunition, and luxury goods. Somalia has a road tax, which could be considered an excise tax.

Djibouti, Egypt, Iran, and Kuwait are in this group but are not FCSs. Iran's system relies on a higher VAT rate on tobacco.[7] Djibouti's and Kuwait's systems are closer to an excise regime in rates and coverage of consumption items. Kuwait imposes a standard 5 percent tariff on customs, insurance, and freight value for all merchandise but raises the rate to 100 percent for tobacco (and only for tobacco), with a minimum specific amount.[8] Kuwait is currently considering shifting to a separate excise system after its 2015–16 commitment to the Gulf Cooperation Council (GCC) framework on VAT and excises. Djibouti applies a domestic consumption tax to all imports destined for local consumption, which varies from 0 to 26 percent of customs, insurance, and freight value, with higher rates applying to final consumption goods, including the usually excisable goods. Djibouti also applies a surtax (as part of its Customs Code) on a range of excisable goods (see Annex 7.1), which in effect is an excise on imports and local production. Excise taxes in Egypt are legislated in the VAT law as schedule taxes and sometimes apply in addition to the VAT and sometimes without it.

[5] Customs rates are also imposed on these products, for example, 30 percent for alcohol and tobacco.

[6] Khat is an evergreen shrub that is chewed like tobacco leaves and is known for its stimulant effect.

[7] The rates in 2024 were 50 percent on domestically produced international cigarette brands and 75 percent on imported cigarettes. Rates are set to increase to 70 percent and 95 percent, respectively, by 2028. The tax rate applicable to domestic brands is 25 percent.

[8] For cigarettes, the minimum was 8 Kuwaiti dinars ($26) per 1,000 cigarettes in 2024.

Countries with a Legally Defined But Basic Excise Tax System

Countries in group 2 are GCC countries and thus all hydrocarbon exporters. They have initiated revenue diversification reforms to mitigate their dependence on hydrocarbon revenues. Only three categories of products are subject to excise taxes: tobacco, sugar-sweetened beverages, and alcohol. Excise systems were introduced in Bahrain, Saudi Arabia, and the United Arab Emirates in 2017, and in Qatar and Oman in 2019, along with VATs in 2018. Qatar does not have a VAT, and Kuwait does not have a VAT or excises.[9] Unlike countries in group 1, these countries have independent excise systems that complement their sales tax or customs duties, but their design is rudimentary in that they are new and part of a gradual reform process, including building the tax administration's capacity to implement excises. As in many hydrocarbon-exporting countries, petroleum products are not taxed (at least not explicitly because retail prices can be closely regulated), similar to Iran, Iraq, and Yemen in group 1.

A key challenge for GCC countries in separating excise taxes from customs duties has been adapting the administration systems to a broader tax base than just imports. This expansion of the tax base has been feasible because of the small number of taxed products and limitations on domestic alcohol and tobacco production. For instance, countries have been able to implement basic excise requirements such as registration and licensing, and to expand control on imports to the entire supply chain. Implementing such controls is a necessary condition for future rate increases and broadening the excise tax regime, for example, to environmental taxes.

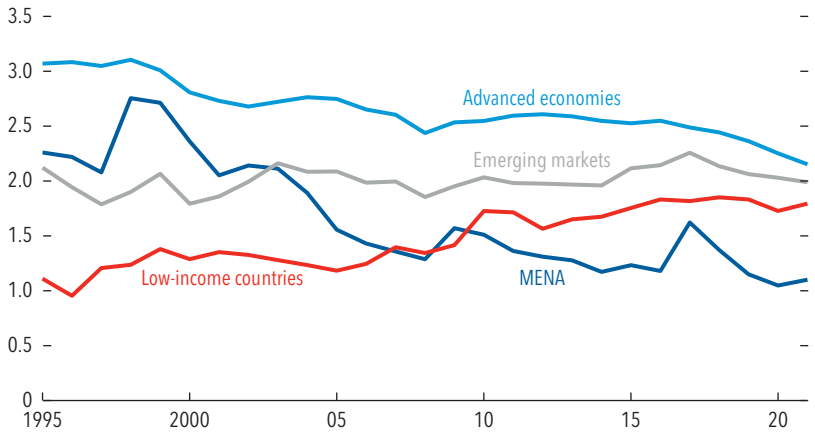
Countries with Well-Established Excise Tax Systems

In group 3, excise tax systems are defined better legally and are separate from sales taxes and customs duties. These systems also have larger coverage of taxed products, relatively high rates (consistent with the objective of targeting externalities and internalities), and well-developed and dedicated administrative procedures and services. Algeria, Jordan, Lebanon, Mauritania, Morocco, and Tunisia are in this category. All are hydrocarbon-importing countries except for Algeria, and all have had these regimes in place since at least the 1990s. However, these systems still have shortcomings, such as design complexity and expansive coverage in some cases.

Most of these countries apply taxes to the core group of excisable products (tobacco, alcohol, motor vehicles, fuels, and telecommunication), including Algeria, which has an explicit excise on fuel products. Also, sugary products are taxed in the three North African countries, with detailed provisions depending on the product and sugar content. However, some systems tend to expand beyond the usual scope of excises. For example, Mauritania has an excise on meat and

[9] See Chapter 6 for more detail on VAT.

Figure 7.1. Comparative Evolution of Excises Revenue in the MENA
(Percent of GDP)



Source: IMF, World Revenue Longitudinal Database (November 20, 2024).
Note: MENA = Middle East and North Africa.

milk;[10] Algeria on certain fresh fruits; Morocco on televisions and motor vehicle batteries; and Tunisia on playing cards, marble and limestone, glass objects for table service, and wristwatches. Excise legislation can sometimes stipulate that the tax applies only to imported goods, which is the case for mineral water in Mauritania (Annex 7.1).

THE REVENUE ROLE OF EXCISE TAXES

The revenue performance of excise taxes in the region has declined since the late 1990s by about 1 percentage point of GDP (Figure 7.1), in sharp contrast to low-income countries, where excise tax revenue increased by almost 1 percentage point of GDP over the same period, and to emerging market economies, where performance has been relatively stable.

This evolution masks differences across MENA countries (Table 7.1). Some countries do not have an excise or excise-like tax system and thus report no revenue from these sources (FCSs from group 1 and Kuwait).[11] Other countries from group 1 report revenue, but it is from taxes that do not meet the strict definition of excise taxes (Djibouti, Iran, and Iraq).[12] Also, hydrocarbon exporters from group 2 introduced excise tax systems only recently and for now have low revenue as a share of GDP, which pulls the average down for these years (Bahrain, Oman,

[10] Djibouti also taxes milk.

[11] Yemen reports revenues from higher sales taxes as sales tax revenue.

[12] Djibouti reports excise tax data, but it is in fact a surtax on a domestic tax that has the features of a customs duty, not an excise.

TABLE 7.1.

Evolution of Excises Revenue in MENA Countries

	Share of GDP (percent)				
Countries by Group	**1995**	**2005**	**2015**	**2020**	**2022**
Group I (average)	–	1.16	1.11	0.86	1.53
Djibouti	–	2.08	1.32	1.44	1.23
Egypt	–	1.06	1.60	1.63	1.84
Iran	–	0.33	0.41	0.36	–
Iraq	–	–	–	0.03	–
Kuwait	–	–	–	–	–
Libya	–	–	–	–	–
Somalia	–	–	–	–	–
Sudan	–	–	–	–	–
Yemen	–	–	–	–	–
Group II (average)	–	–	–	0.36	0.33
Bahrain	–	–	–	0.42	0.47
Oman	–	–	–	0.25	–
Qatar	–	–	–	–	–
Saudi Arabia	–	–	–	0.61	0.42
United Arab Emirates	–	–	–	0.14	0.09
Group III (average)	2.28	1.80	1.31	1.66	1.02
Algeria	0.99	0.90	0.34	1.37	–
Jordan	1.10	–	0.60	1.69	–
Lebanon	–	2.43	1.79	1.01	–
Mauritania	–	0.33	0.81	1.11	1.02
Morocco	3.95	2.60	2.35	2.38	–
Tunisia	3.06	2.76	1.97	2.42	–
MENA average	**2.28**	**1.56**	**1.24**	**1.06**	**0.84**

Source: IMF, World Revenue Longitudinal Database (November 20, 2024).
Note: Data are scarce from 2022 and are reported primarily to show recent adopters of excise taxes in group 2. – = not available or negligible; MENA = Middle East and North Africa.

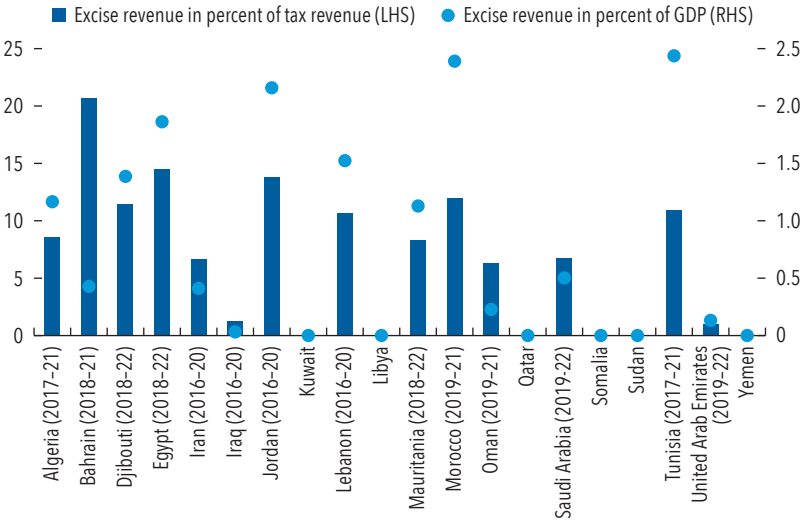
Qatar, Saudi Arabia, and the United Arab Emirates). Countries in group 3 (plus Egypt) have accounted for most of the excise revenue since 1995, and thus the revenue decline (most of which occurred between 1995 and 2005) has largely related to this group. Several factors have contributed to the decline, including excise policy design and compliance.

The share of excise revenue in tax revenue also varies across countries (Figure 7.2). In Djibouti, Egypt, Jordan, Lebanon, Morocco, and Tunisia, excise revenue is more than 10 percent of tax revenue. In Djibouti, Egypt, and Lebanon, it also accounts for 1.5 percent to 2.0 percent of GDP, and in Jordan, Morocco, and Tunisia, it accounts for more than 2.0 percent of GDP. Algeria, Iran, and Mauritania also have significant revenue from excises. In Bahrain, Oman, and Saudi Arabia, the high share of excise tax revenue in total tax revenue is due to the relatively low revenue from nonhydrocarbon taxes.

Differences in revenue performances can be analyzed by examining the retail prices of two excised goods: tobacco and gasoline (Figure 7.3 and 7.4). Retail prices vary across countries in general and within country groups. For example,

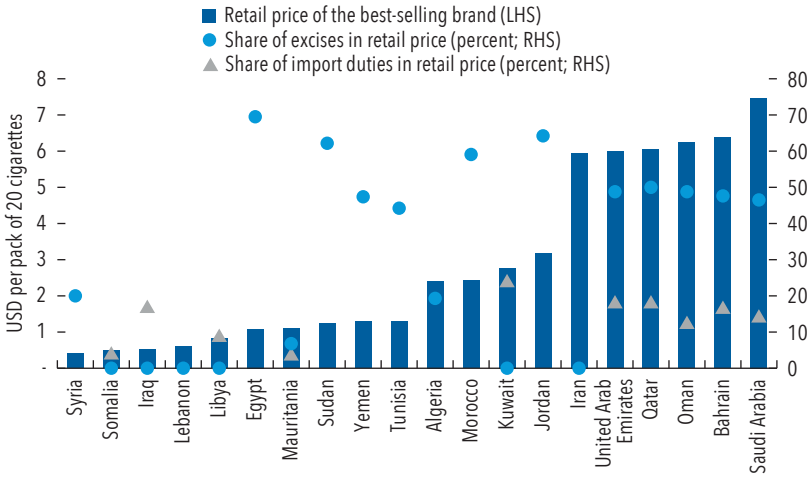
Figure 7.2. Excises Revenue as a Share of GDP and Tax Revenue in MENA Countries

(Averages)



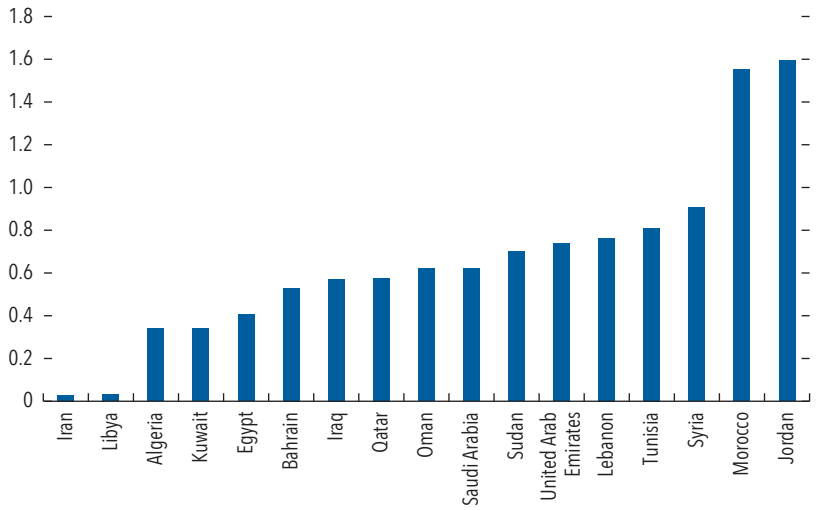
Source: IMF, World Revenue Longitudinal Database (November 20, 2024).
Note: Unweighted averages are for up to five years depending on data availability. Countries with a share of 0 do not have excise taxes or proper reporting of excise or excise-like tax revenue. The share in GDP for Bahrain is the average over 2018–23. LHS = left-hand scale; MENA = Middle East and North Africa; RHS = right-hand scale.

Figure 7.3. Cigarette Prices and Excises Revenue in MENA Countries (2022)



Source: WHO 2023.
Note: For Bahrain, Iraq, Kuwait, Libya, Mauritania, Oman, Qatar, Saudi Arabia, Somalia, and the United Arab Emirates, the import duty is also reported following the World Health Organization methodology. For Yemen, the excise is the sales tax applied at a rate higher than the standard rate. Data for Syria and Somalia are for 2020. LHS = left-hand scale; MENA = Middle East and North Africa; RHS = right-hand scale.

Figure 7.4. Gasoline Prices in MENA Countries
(US dollars per liter)



Source: GlobalPetrolPrices.com.
Note: Data are as of January 22, 2024. MENA = Middle East and North Africa.

in GCC countries, which belong to the hydrocarbon-exporters group, tobacco excises are set at relatively high rates but gasoline retail prices (and therefore excise rates on gasoline) remain relatively low in most of them. However, gasoline prices in the GCC are higher than those in Algeria, Iran, or Libya—all three hydrocarbon exporters. Algeria and Egypt—two large, populous countries—stand out for their low prices for gasoline and, to a lesser extent, cigarettes, which are lower than those in neighboring (hydrocarbon-importing) countries: Egypt, Jordan and Morocco. This indicates an untapped revenue and potential health benefits from higher excise rates.

Differences in the size of the tax base could explain some of the differences in revenue yields across countries, but this does not seem to be the case for tobacco or gasoline (Table 7.2). For example, tobacco and gasoline consumption per capita are similar in Algeria, Egypt, and Morocco, but the related revenue yields differ significantly across the three countries. Similarly, gasoline consumption in Iran and Iraq is much higher than in Morocco, but the revenue yields are mere fractions of Morocco's. Gasoline consumption in GCC countries also highlights a significant tax base to tap. With only a few exceptions, the tax base also seems to evolve over time in a lower range than that of revenue, again reflecting policy differences across countries and the revenue potential of reforms. Many countries in the region could reasonably aim for a gain of 1 to 2 percentage points of GDP in excise tax revenue.

TABLE 7.2.

Assessing the Excises Tax Bases on Cigarettes and Gasoline in MENA Countries

	Excise Revenue (percent of GDP)	Adult Smoking Prevalence (percent)		Gasoline Consumption Per Capita (tons)	
Country	**Last available year**	**2006**	**2021**	**1995**	**2023**
Algeria	1.31	14	14	0.30	0.43
Bahrain	0.50	6	12	–	–
Egypt	1.84	14	22	0.40	0.33
Iran	0.36	14	8	0.99	0.93
Iraq[1]	0.03	11	17	0.90	0.97
Jordan	1.69	36	30	–	–
Lebanon	1.01	17	22	–	–
Mauritania	1.02	18	7	–	–
Morocco	2.41	15	11	0.26	0.36
Oman	0.31	4	6	1.18	2.07
Saudi Arabia	0.42	7	10	3.77	5.25
Tunisia	2.45	32	18	–	–
United Arab Emirates	0.09	8	8	8.56	4.74

Sources: IMF, World Revenue Longitudinal Database (November 20, 2024); World Health Organization; Energy Institute Statistical Review of World Energy 2024 (https://www.energyinst.org/statistical-review/home).
Note: – = not available; MENA = Middle East and North Africa.
[1]Oil consumption data for Iraq start in 2003.

REFORM OPTIONS

The review of excise tax regimes in the MENA region suggests three reform strategies broadly aligned to the three country groups:

- Group 1: Adoption of simple and separate legal frameworks for excise taxes (and for general sales taxes and custom duties) so the interaction and delineation of these three components of indirect tax systems is made as clear as possible in law.
- Group 2: Expansion of excise taxes, mainly to fuel products.
- Group 3: Scaling back the coverage of excises and aligning their design with policy objectives; for example, the mix between specific and ad valorem excises.

Greater legal and policy clarity, along with better alignment of design with objectives, will help improve revenue administration efficiency to support domestic revenue mobilization (Mansour 2015; Burkhardt and Tosun 2020).

Despite the differences in reform strategies by country group, four factors tend to be important for excise tax design and administration—all of which are consequences of the need to set tax rates at a relatively high level. First, a broad-based sales tax is typically ad valorem (a percentage of the value of consumption), but excise taxes can be ad valorem or specific (an amount per physical unit), which

has implications for innovation and for market structures, such as quality and variety (see Annex 7.2 for a brief analysis). Second, even if revenue is not the primary objective of excise taxes, they have traditionally been convenient and highly reactive sources of revenue. The implication is that policymakers are often tempted to expand the use of excises, which can weaken general sales taxes—for example, by expanding the use of exemptions and low rates—and dilute revenue administration resources. Third, high rates influence compliance behavior, because taxpayers at the margin modify the taxed products to escape taxation, thus the need for clear product definition, unlike for general sales taxes. Fourth, high rates increase prices significantly and may create incentives for illegal trade, such as bootlegging (buying a product legally in low-tax jurisdictions and then selling it illegally in high-tax jurisdictions), or smuggling (diverting untaxed products directly to the market). Those activities require additional and specialized administrative support.

Adopting Legal Frameworks in Group 1 Countries

Several MENA countries, especially FCSs, face institutional capacity constraints, and thus their legal frameworks must therefore be simple, clear, and focused on a few core taxes, including excises. The role and objectives of the three main indirect taxes in a modern tax system—general sales tax, excises, and customs duty—need to be distinguished in national laws to ensure that each can achieve its core objective.[13]

Custom tariffs are primarily a trade policy tool but also an easy tax collection point. Customs codes should contain all provisions and procedures relevant to the valuation of imported goods and services and application of duties, exclusive of any sales tax and excises. Excise tax provisions, unlike general sales taxes such as VATs, generally have their own law and procedures, but general sales taxes apply to consumption broadly. National legislation in both advanced and developing countries often includes cross-references between these laws—for example, rules for the valuation of imported goods are usually reflected in custom codes and can in principle also apply to assess the base of VATs and ad valorem excises, both of which are levied on customs, insurance, and freight values at the point of import. However, such cross-references are not always necessary or even possible. In a customs union, for example, import tariffs do not apply to trade among members, and VATs can rely on valuation at origin instead of at destination.

By these counts, the magnitude of reforms in group 1 appears significant. They involve an overall review of the customs codes and tariffs and of the VAT and its administrative procedures (where a VAT applies) to create a legally solid and administrable excise regime. Excise taxes can be managed and collected by

[13] Clarifying those taxes in national laws is also international best practice. However, in FCSs, the need for simple, narrow legislation targeting a few excisable items is especially acute, given the revenue potential and limited policy alternatives. Mansour and Schneider (2019) argue that FCSs in general do not exploit their excise revenue potential as much as they could.

either the customs department or the domestic tax administration can manage and collect excise taxes, but close coordination between them is required because excises are domestic taxes.[14] A detailed reporting mechanism on sales and revenue (at least) separate from the customs and VAT revenue also needs to be established. Ideally, statistics for excises should be available by product to better monitor their impact.

Countries are often aware of these challenges and in some cases have attempted reforms in those directions. For example, some GCC countries have implemented these reforms since 2018. They focused first on simple VAT and excise taxes that target a few products and introduced basic administrative functions of an excise system, thus preparing the ground for additional reforms. Introducing specific excise taxes targeting goods such as tobacco, alcohol, khat, and soft drinks can provide a positive policy rationale and mobilize support from the public and the health sector. Replacing customs duties with excise taxes where appropriate is also a useful step toward international trade commitments, because excise taxes are domestic taxes while trade taxes apply only to international trade in goods and are often subject to bilateral and international trade agreements, which take precedence over domestic laws.

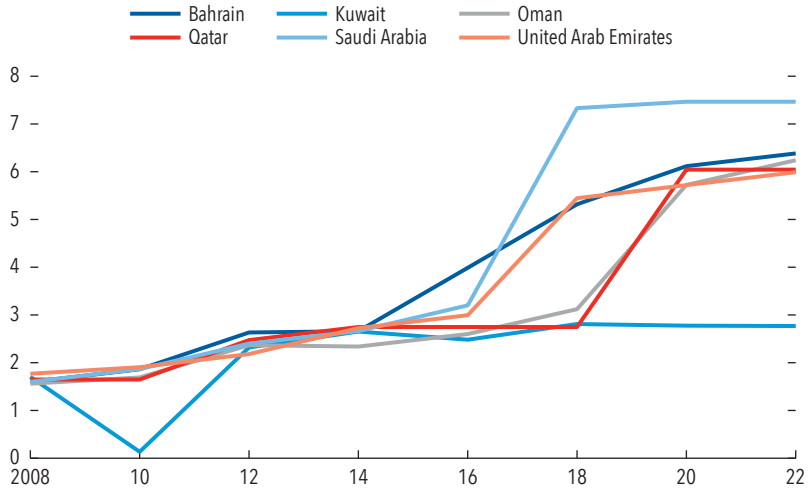
In that context, proceeding gradually to minimize disruption to tax administrations is crucial. A first step would be to purge the indirect tax system from nuisance (excise-like) and low-yield fees while compensating for the revenue by adjusting the rates of the few excises or the sales tax. A second step would be to ensure that general sales taxes are distinct from customs duties and apply uniformly to imports and domestic production. The absence of general sales taxes in some FCSs, where such taxes can be too complex, should make these legal reforms simple. A third step would eventually be to transition from sales taxes to VAT-like taxes, given their neutrality and revenue appeals, which many countries have done as part of a broader fiscal transition agenda from distortive trade taxes to more neutral and broader domestic taxes. For example, Yemen was preparing reforms in this direction before it was interrupted by war in 2014.

Expanding the Use of Excises in Group 2 Countries

The strength of a proper excise system is the effectiveness of its control over the supply chain, which allows for much sharper rate differentiation and thus extra revenue mobilization. This issue is relevant mostly in GCC countries, which began implementing excises in 2018, with impressive results. The evolution of cigarette prices in GCC countries illustrates this clearly (Figure 7.5). Implementation of new excise systems was concurrent with a sharp increase in taxes and prices, except for Kuwait, which did not implement these reforms. However, the pool of taxed products could be expanded to a wider list of items and thus the prospects of higher revenue. Although the potential for taxing

[14] Customs and domestic tax administrations are sometimes housed under a single entity. This is rarely the case in MENA countries (see Chapter 10).

Figure 7.5. Cigarette Prices in Gulf Cooperation Council Countries
(US dollars per pack of most popular cigarettes)



Source: WHO (2023).

alcohol remains low among GCC countries and to a lesser extent in the rest of the region,[15] motor vehicles and fuel are possible candidates for those countries.[16]

The case for higher cigarette excises is also strong in other MENA countries. According to WHO (2023) estimates, the adult daily smoking prevalence in the region ranged from less than 10 percent in Iran, Oman, Qatar, and the United Arab Emirates to 30 percent in Jordan (Figure 7.6).[17] Egypt, Iraq, Jordan, Lebanon, and Tunisia also show a large gap between prevalence and price levels (Figure 7.6), which are well below those of the GCC, indicating room for higher excise taxes. Water pipe tobacco is also widely undertaxed.

Excises on motor vehicles could play a small role in increasing the tax burden on the rich while contributing to environmental objectives.[18] Besides the GCC countries, Djibouti, Iran, Mauritania, Sudan, and Yemen do not have such

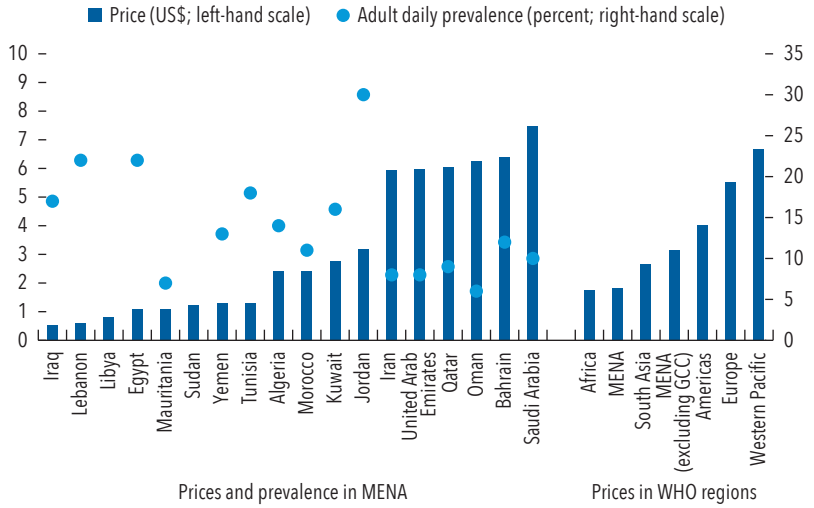
[15] Alcohol consumption is low in the region—1.3 liters of pure alcohol in 2018 (male ages 15 and older) compared with more than 16 liters in Europe (World Health Organization). Also, the disease burden attributable to alcohol consumption has decreased over the last three decades (Safiri and others 2022).

[16] Regarding telecommunications, fees and payments can be collected through licenses for use of the electromagnetic spectrum.

[17] The prevalence of tobacco smoking is lower among women, ranging from 0.3 percent in Oman to 28.2 percent in Lebanon and 12.9 percent in Jordan (Abu-Rmeileh and others 2022).

[18] Excises on motor vehicles are inferior to fuel excises, which target the use of motor vehicles. Also, considering environmental objectives, some policy differentiation between combustion engines and electric vehicles is perhaps warranted.

Figure 7.6. Cigarette Prices and Smoking Prevalence in MENA Countries and Selected Regions (2022)



Source: WHO (2023).
Note: Price and prevalence data are not available for Djibouti, Somalia, and Syria, and prevalence data are not available for Libya and Sudan. Regions as defined by the World Health Organization were adjusted to correspond to MENA countries by including Algeria and Mauritania. GCC = Gulf Cooperation Council; MENA = Middle East and North Africa; WHO = World Health Organization.

excises, and Egypt and Iraq could increase theirs. Tunisia's rates on motor vehicles appear to be high but are effectively low, because of widespread preferential rates. Excise taxes on sugary drinks can also be expanded across the GCC. Rates could be revised upward, given that sweetened drinks could affect the rates of diabetes, where prevalence rates are among the highest in the world.[19] Finally, fuel products represent the largest unexploited source of revenue in GCC and MENA (see Chapter 8). As of January 2024, 14 of the 26, and 5 of the 7 countries with the lowest fuel prices in the world belonged to the MENA region.

A Focus on Core Excises in Group 3 Countries

The role of excise taxes has gone beyond revenue and externality objectives in several countries in group 3. In some, certain excises apply only to imports and

[19] Age-adjusted comparative prevalence rates of diabetes reach 24.9 percent in Kuwait, 19.5 percent in Qatar, 18.7 percent in Saudi Arabia, 16.4 percent in the United Arab Emirates, 13.8 percent in Oman, and 11.3 percent in Bahrain. The prevalence rates are also high in Egypt (20.9 percent) and Jordan (15.4 percent), but relatively lower in Tunisia (9.6 percent), Morocco (9.1 percent), Djibouti (7.4 percent) and Algeria (7.1 percent), where they are closer to rates in advanced economies such as United States (10.7 percent), France (5.3 percent) and Japan (6.6 percent) (IDF 2021).

thus act as a trade tariff and favor local production,[20] and domestic producers can benefit from favorable treatment under certain conditions. Some countries use excises widely to finance earmarked funds, with no apparent externalities or even revenue objectives to meet. These practices have increased the complexity of indirect tax systems, without any clear added benefit.

Streamlining excise regimes by improving their design and legal texts and returning to the basics of excise taxation should be a priority for this country group. Doing so could also lead to other reforms, for example, to state-owned enterprises that provide excised goods, such as monopolies, which are prevalent in the region. For such monopolies, price regulation is directly linked to tax policy because prices can be set to reflect the externalities that excise taxes usually target. In this respect, reforming excise policy might be more difficult than it appears and could also involve carefully assessing the overall impact of excises and other price regulations on the competitive environment of domestic producers and the policy objectives pursued.

A first step is to prepare an exhaustive list of excise taxes and excise-like levies, along with their intended policy objectives, revenue yield, and whether they are earmarked (and to which line ministry or agency, if so). Depending on revenue performance and other considerations, the objective of a streamlining exercise can be to reduce the number of excises and excise-like levies significantly and compensate line ministries for lost earmarked revenue in their annual budgets. The streamlining exercise can be performed on a revenue-neutral basis at the consolidated budget level.

CONCLUSION

The differences in the level of development of excise tax systems in the MENA region, and their evolution in design and revenue performance within countries' broader tax systems, suggest that reform involves policies tailored to each country's situation: setting up the basics, such as in FCSs; expanding nascent systems, such as in GCC countries; and simplifying mature systems, such as in North Africa and the Eastern Mediterranean. A gradual approach that coordinates excise systems with other core indirect taxes—customs duties and general consumption taxes—and other price regulation policies seems required, given the distinct objectives each instrument is intended to achieve. This approach should benefit the overall indirect tax system, not only excises.

The region itself probably provides the most useful lessons on excise reforms. Examples include the successful implementation of indirect taxation in the GCC and the long, well-established experience of North African and Eastern Mediterranean countries. These lessons also point to opportunities for

[20] For example, the excise tax on mineral water in Mauritania applies to imports only, tobacco excises in Tunisia tend to favor cheaper local cigarettes, and cigarette excises in Iran apply differently to local and imported brands. Lebanon's wine excises favor local producers by applying the tax unequally to domestic producers and importers.

cooperation, which is necessary to address challenges such as excise tax competition and illicit trade in excisable items. This chapter did not discuss tax cooperation in excise taxes, but options include hard law measures, such as setting minimum prices, and soft law measures, such as promoting good practices and collaboration across tax administrations in information sharing and joint enforcement to fight illicit trade in excisable items. Such collaboration needs networks and institutions, which countries in the region largely lack except in the GCC customs union.

ANNEX 7.1. A BRIEF DESCRIPTION OF EXCISE TAXES IN THE MENA REGION

ANNEX TABLE 7.1.1.

A Brief Description of Excise Taxes in the MENA Region

Country	Group Classification	Summary of Main Excises and Rates
Algeria	Group 3, hydrocarbon exporter	The excise tax system covers tobacco (mix of ad valorem and specific), alcohol (specific), sugar and glucose preparations for drinks (specific), vehicles (ad valorem), fuel (specific), and telecommunications (ad valorem). Multiple rates apply in each case except for vehicles, which are subject to a single 60 percent rate. A range of other fees and levies cover radios, televisions, and luxury items such as salmon, caviar, ice cream, bananas, pineapple, kiwis, and coffee.
Bahrain	Group 2, hydrocarbon exporter	The excise tax system covers tobacco (100 percent), carbonated drinks (50 percent) and energy drinks (100 percent).
Djibouti	Group 1, hydrocarbon importer	Djibouti does not have an excise tax system. Surtaxes apply on top of the domestic consumption tax. Products include tobacco (75 percent), alcohol (150 percent), perfumes (specific), mineral water and juices (specific per liter), fuel (specific per liter), and other products such as rebar, imported milk, imported yogurt, khat, and plastic bags.
Egypt	Group 1, hydrocarbon importer	Egypt does not have an excise tax system. Schedule taxes apply exclusive of VAT (such as on tobacco and e-cigarettes, gas, kerosene, cooking oil, fertilizer, and consultancy fees) or inclusive of VAT (such as on alcohol, soft drinks, vehicles, telecommunications, perfume, air conditioners, and televisions).
Iran	Group 1, hydrocarbon exporter	Iran does not have an excise tax system. Sales tax rates on tobacco products are higher. The rate depends on the type of brand (local or imported) and place of production (locally produced international brands are taxed at a lower rate than imports of international brands).
Iraq	Group 1, FCS, hydrocarbon exporter	Iraq does not have an excise tax system. High taxes apply on a few products, including tobacco, alcohol, and motor vehicles (15 percent), usually at customs. For tobacco and alcohol, the standard customs duty rates were 30 percent as of early 2023, to which a local product protection is added at 100 percent for tobacco and 200 percent for alcohol.
Jordan	Group 3, hydrocarbon importer	The excise tax system covers tobacco (specific), alcohol (180 percent to 200 percent), soft drinks, motor vehicles, and fuel (ad valorem).
Kuwait	Group 1, hydrocarbon exporter	Kuwait does not have an excise tax system. Differentiated customs duties could apply on selected products, including tobacco and alcohol.

ANNEX TABLE 7.1.1. *(continued)*

A Brief Description of Excise Taxes in the MENA Region		
Country	**Group Classification**	**Summary of Main Excises and Rates**
Kuwait	Oil-producing country No proper excise system	There is no excise tax system. Differentiated customs duties may apply.
Lebanon	Group 3, FCS, hydrocarbon importer	The excise tax system covers tobacco (ad valorem at various rates), alcohol (specific), vehicles (ad valorem), and fuel (specific).
Libya	Group 1, FCS, hydrocarbon exporter	Libya does not have an excise tax system. Differentiated customs duties apply. Tax stamps are collected, but they mainly apply to documents and authorizations.
Mauritania	Group 3, hydrocarbon importer	The excise tax system covers tobacco, alcohol, and imported mineral water (all ad valorem); and fuel (specific), telecommunications (recharge cards and cell phones), and other products (meat, sugar, imported milk, imported yogurt, cement, and rebar).
Morocco	Group 3, hydrocarbon importer	The wide-ranging excise system covers, among others, tobacco, alcohol, a vast range of sweet products and sweetened drinks, vehicles, fuel, televisions, computer screens, electronic pads, and smartphones. Most products attract specific rates except for tobacco, to which a mix of specific and ad valorem taxes apply.
Oman	Group 2, hydrocarbon exporter	The excise tax system covers tobacco (100 percent), alcohol (100 percent), carbonated (except for carbonater water) or sweetened drinks (50 percent), energy drinks (100 percent), and pork products (100 percent).
Qatar	Group 2, hydrocarbon exporter	The excise tax system covers tobacco (100 percent), carbonated drinks except for nonflavored aerated water (50 percent), and energy drinks (100 percent).
Saudi Arabia	Group 2, hydrocarbon exporter	The excise tax system covers tobacco, e-cigarettes, and liquid recharge (100 percent); soft drinks and sweetened drinks (50 percent); and energy drinks (100 percent).
Somalia	Group 1, FCS, hydrocarbon importer	Somalia does not have an excise tax system except for a road tax.
Sudan	Group 1, FCS, hydrocarbon importer	Sudan does not have an excise tax system. Stamps apply to a range of documents and products. Cigarettes are taxed at 230 percent.
Tunisia	Group 3, hydrocarbon importer	The wide-ranging excise system covers tobacco (ad valorem), alcohol (specific and ad valorem), sweets, sweetened juices, and other food preparations; and vehicles (ad valorem), fuel (specific), telecommunications (stamp tax), marble, ceramic, perfume, playing cards, and wristwatches.
United Arab Emirates	Group 2, hydrocarbon exporting	The excise tax system covers tobacco, e-cigarettes, and liquid recharge (100 percent); soft drinks and sweetened drinks (50 percent); and energy drinks (100 percent). Sale of alcohol is restricted.
Yemen	Group 1, FCS, hydrocarbon exporter	Yemen does not have an excise tax system. The sales tax applies at rates higher than the standard rate to tobacco (90 percent), khat (20 percent), weapons and ammunition (90 percent), and mobile telephone services (10 percent). Reduced rates apply to precious metals. Luxury goods attract higher customs duties.

Sources: Authors' compilations from various sources, including IMF country reports, World Health Organization, World Customs Organization, World Trade Organization, and country authorities.
Note: The group refers to the typology identified in the section "A Typology of Excise Systems."

ANNEX 7.2. THE CHOICE BETWEEN AD VALOREM AND SPECIFIC EXCISES

Excise taxes can be applied as a proportion of the value of the taxed products (ad valorem excise) or as a specific amount per quantity (specific or ad quantum excise). The ad valorem excise rate will be a percentage of a defined value base, for example, ex-factory price, or import price. The specific excise rate is a fixed monetary amount per volume, for example, count or weight. Some systems combine the two types of excises. The choice between ad valorem and specific has consequences on industry structure, prices, product quality and diversity, and on tax revenue (Keen 1998).

A key feature of ad valorem taxes is its multiplier effect. The ad valorem tax will magnify any increase or decrease in the base of the product, therefore penalizing cost increases (for example, to improve quality or increase variety) and rewarding cost decreases (Annex Table 7.2.1). The result will be to exert downward pressure on costs, decreasing product quality and diversity while favoring producers with the lowest fixed costs, leading to a highly concentrated industry.

ANNEX TABLE 7.2.1.

The Impact of Production Cost Changes under an Ad Valorem Tax

Scenarios	Ex-factory Price	Ad Valorem Tax (40%)	Retail Price	Price Change
I: initial situation	1.00	0.40	1.40	n.a.
II: cost increase = 0.20	1.20	0.48	1.68	0.28
III: cost decrease = –0.20	0.80	0.32	1.12	–0.28

Source: Petit and Nagy (2016).
Note: All units are monetary values, unless otherwise specified. n.a. = not applicable.

Conversely, specific excises will increase all prices by the same amount, regardless of product quality or diversity. A given quality-related price difference will therefore become relatively smaller with a specific tax, thus facilitating switching to higher quality products (Annex Table 7.2.2). As a result, there is a greater variety of products and a larger number of smaller producers. The overall impact on tax revenue compared with an ad valorem system depends on price elasticity.

ANNEX TABLE 7.2.2.

Decrease in the Relative Price of Quality under a Specific Excise Tax

	Specific Tax = 0		Specific Tax = 0.50	
Price Level and Excise Rate	Low-Quality	High-Quality	Low-Quality	High-Quality
Pretax price	1.00	1.25	1.00	1.25
Specific excise	0.00	0.00	0.50	0.50
Final price	1.00	1.25	1.50	1.75
Percentage price difference	(1.25–1.00)/1.00 = 25%		(1.75–1.50)/1.50 = 16.7%	

Source: Petit and Nagy (2016).
Note: All units are monetary values, unless otherwise specified.

Other policy factors affect the choice between ad valorem and specific excises. If excise taxes are used to correct for externalities, which are related to the quantity consumed, specific excises are more effective. Specific excises are also generally easier to administer because assessing quantities is easier than assessing values. However, ad valorem excises have a built-in indexing to inflation because they are proportional to value. Combining ad valorem and specific excise taxes can help achieve balanced policy objectives.

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CHAPTER 8

Taxation of Upstream Oil and Gas and Implications of Carbon Levies

Carole Nakhle and Thomas Benninger

INTRODUCTION

The Middle East and North Africa (MENA) region plays a prominent role in oil and gas markets. The region is endowed with the world's largest proven oil and gas reserves (nearly 52 percent and 43 percent, respectively) and produces 36 percent and 22 percent of global oil and gas, respectively (Figure 8.1). Most reserves lie near the surface and are mainly onshore or in shallow water if offshore, giving the region a cost advantage over producers from outside the region, especially those with deepwater production such as Norway, the United Kingdom, and the United States. The scale, ease of access, and low extraction and production costs give some of the region's producers—especially those in the Middle East—some of the highest government takes in the world.[1]

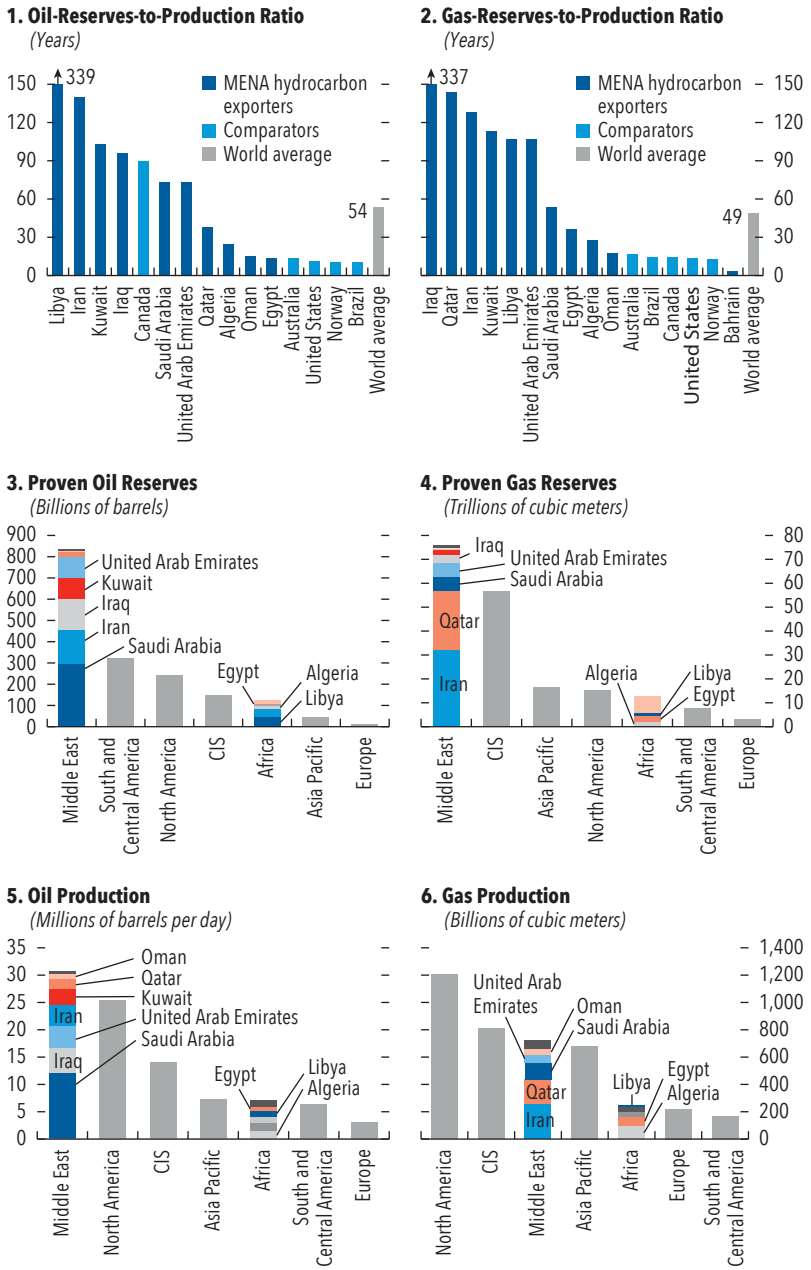
Oil and gas wealth has brought notable benefits. Half of MENA countries are net oil and gas exporters, but hydrocarbon wealth has boosted income status in only half of those countries. Before the oil and gas era, the Gulf region was among the poorest areas in the world.[2] Today, the Gulf Cooperation Council (GCC) countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates), which include the region's largest oil and gas producers, are classified as high-income countries—the only Arab countries in that classification. Only 2 of the region's 11 net hydrocarbon exporters (Libya, Iraq) are classified as suffering from institutional and social fragility or conflict. All the region's low-income economies (Somalia, Sudan, Syria, Yemen) are fragile and conflict-affected states (FCSs) and net importers of oil or gas or both (Table 8.1).

However, the performance of the upstream hydrocarbon sector has resulted in high dependency and substantive macroeconomic challenges. Some countries rely

[1] "Government take" is the average effective tax rate (AETR), calculated as total government revenues divided by a project's pretax cash flows over its life (from exploration to abandonment). The AETR can be expressed in discounted or undiscounted terms.

[2] The region's economy was based mainly on pearl diving, subsistence agriculture in the coastal areas, international trade in the coastal cities, and a traditional nomadic economy in the interior areas (Winckler 2012).

Figure 8.1. MENA Region Oil and Gas Reserves and Production



Source: EI (2023).
Note: Data for reserves-to-production ratios and reserves are for 2020, and data for production are for 2022. CIS = Commonwealth of Independent States; MENA = Middle East and North Africa.

TABLE 8.1.

MENA Countries Classification by Income and Oil and Gas Trade

Country	Income Level	Status*	Upstream Greenhouse Gas Intensity (kg CO_2eq/boe)	Fragility Classification
Net hydrocarbon exporters				
Algeria	Lower middle income	Net oil and gas exporter	124.1	
Bahrain	High income	Net oil exporter	30.9	
Egypt	Lower middle income	Net gas exporter	64.6	
Iran	Lower middle income	Net oil and gas exporter	104.4	
Iraq	Upper middle income	Net oil exporter	86.2	Conflict-affected country
Kuwait	High income	Net oil exporter	42.3	
Libya	Upper middle income	Net oil and gas exporter	67.3	Institutional and social fragility
Oman	High income	Net oil and gas exporter	71.4	
Qatar	High income	Net oil and gas exporter	39.7	
Saudi Arabia	High income	Net oil exporter	28.4	
United Arab Emirates	High income	Net oil exporter	43.7	
Net hydrocarbon importers				
Djibouti	Lower middle income	Net oil and gas importer	–	
Jordan	Lower middle income	Net oil and gas importer	38.8	
Lebanon	Lower middle income	Net oil and gas importer	–	Institutional and social fragility
Mauritania	Lower middle income	Net oil and gas importer	90.5	
Morocco	Lower middle income	Net oil and gas importer	57.2	
Somalia	Low income	Net oil and gas importer	–	Conflict-affected country
Sudan	Low income	Net oil and gas importer	90.9	Institutional and social fragility
Syria	Low income	Net oil and gas importer	182.2	Conflict-affected country
Tunisia	Lower middle income	Net oil and gas importer	94.2	Institutional and social fragility
West Bank and Gaza	Upper middle income	Net oil and gas importer	–	Institutional and social fragility
Yemen	Low income	Net oil and gas importer	164.7	Conflict-affected country

Sources: EI (2023); IMF; Masnadi and others (2018); World Bank.
Note: Net oil exporters produce oil in excess of their domestic consumption but are either self-sufficient in gas or import it. Net gas exporters produce gas in excess of their domestic consumption but do not export oil. Net oil and gas exporters produce both oil and gas in excess of their domestic consumption, leading to the export of both commodities. Fragility classification follows the IMF's list (see Chapter 2) except for Djibouti, which was declassified from the list starting in 2023. – = not available; kg CO_2eq/boe = kilograms of carbon dioxide equivalent per barrel of oil equivalent; MENA = Middle East and North Africa.

heavily on the oil and gas sector to accumulate net foreign assets and finance their budgets (see Annex 8.1). Iraq is one of the most oil dependent countries in the world, with oil revenues accounting for more than 99 percent of exports, 85 percent of government revenue, and 42 percent of GDP over the last decade (World Bank 2022). Therefore, such economies are highly exposed to developments in global oil and gas markets and to price volatility, and they experience large swings in their fiscal revenues. The literature documents the problems of limited economic diversification and reliance on rent from natural resource extraction, and governments across the region have acknowledged the problems and announced and pursued several economic reforms (though progressing at different speeds). *Saudi Vision 2030*,[3] published in 2016, is Saudi Arabia's and the region's most ambitious plan. Despite attempts to diversify, oil and gas are still the backbone of the region's economy. Non-oil GDP has increased in many countries across the region, but its performance still reflects changes in oil prices.

Furthermore, oil and gas revenues are financing ambitious green energy projects (which governments have championed), and thus the region's energy transition also depends on the hydrocarbon sector's health.

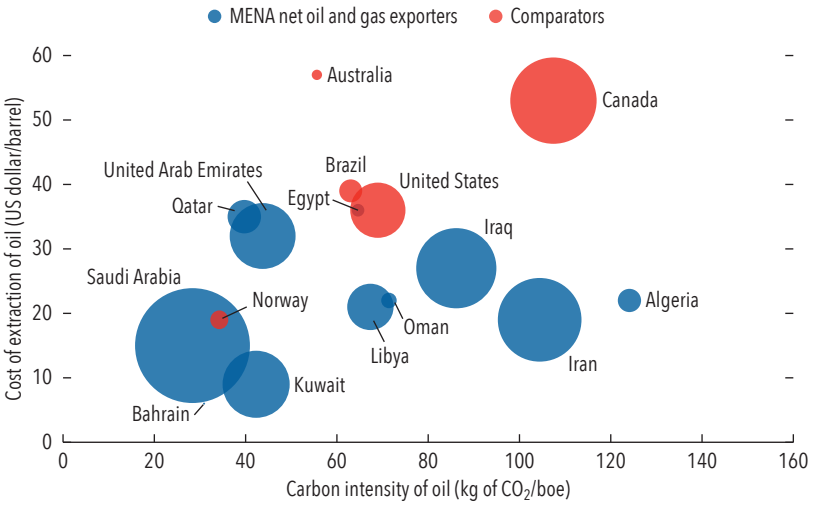
Globally, the ongoing shift from fossil fuels—oil, natural gas, and coal—to low-carbon sources will eventually reduce demand for conventional fuels. In a greener world, the region's oil and gas producers will gradually face a shrinking market and declining revenues, bringing unfavorable consequences for their economies.

A more comprehensive assessment of the energy transition's impact on each country in the region must include an additional and important dimension along with the reserves size and unit production cost: carbon intensity, which is the amount of CO_2 equivalent emissions per unit of energy produced from oil and gas (Figure 8.2). Countries with low production costs and low carbon intensity are less likely to be left with stranded assets as a shrinking market begins pushing out some producers with higher costs and higher carbon intensity.

This chapter examines upstream oil and gas taxation in the MENA region and assesses the impact of carbon taxation on the existing systems in the context of the ongoing energy transition. It provides an overview of the region's hydrocarbon sector, highlighting shared features and differences within the region. It then analyzes the region's petroleum fiscal regimes and discusses the advantages and disadvantages of introducing carbon taxation into the oil and gas sector. The quantitative analysis compares these regimes with those of Australia, Brazil, Canada, Norway, and the United States.

[3] The full text of the *Saudi Vision 2030* can be read at https://www.vision2030.gov.sa/media/rc0b5oy1/saudi_vision203.pdf.

Figure 8.2. Cost, Proven Reserves, and Upstream Greenhouse Gas Intensity of Crude Oil



Sources: EI (2023); Masnadi and others (2018); and Rystad Energy (www.rystadenergy.com).
Note: The size of the circle represents the size of proven oil reserves. The cost of oil is the posttax breakeven oil price after the investment decision was made. kg of CO_2eq/boe = kilograms of carbon dioxide equivalent per barrel of oil equivalent; MENA = Middle East and North Africa.

A REGION WITH A DIFFERENCE

The analysis focuses on some of the distinctive features of the region's oil and gas producers—primarily the net exporters—and discusses the differences among them, which affects their exposure to climate change and related policies and how vulnerable they are to a shrinking market.

Diverging Fortunes

The MENA region accounts for 38 percent of world oil exports and 20 percent of gas exports (see Annex 8.2). Asia has been the main market for the Middle East, while North Africa has traditionally supplied the European market because of its proximity. However, the aggregate figures mask significant differences in export share within the region, where a few producers dominate. More than one-third of the region's crude oil exports come from Saudi Arabia, and Qatar accounts for nearly 71 percent of its liquid natural gas exports.

Several factors explain this heterogeneity. Oil and gas reserves are distributed unevenly across the region. The Middle East holds 48 percent of the world's proven oil reserves and 40 percent of proven gas reserves (Figure 8.1, panels 1 and 2), along with 34 percent and 17 percent of global oil and gas production, respectively. Five countries hold 90 percent of the total proven oil reserves: Saudi Arabia (33 percent), Iran (18 percent), Iraq (16 percent), Kuwait (11 percent) and the

United Arab Emirates (11 percent). By contrast, Algeria, Bahrain, Egypt, and Oman hold modest volumes, together accounting for less than 2 percent of the region's net exporters' proven oil reserves.

Saudi Arabia's Ghawar field, discovered in 1948 and brought on-stream in 1951, is still the world's largest conventional oil field, with proven reserves of about 58 billion cubic meters, nearly equivalent to Europe's entire proven reserves. The Ghawar field has accounted for more than half of Saudi Arabia's total cumulative crude oil production. For natural gas, Iran and Qatar hold about 70 percent of the region's proven gas reserves (40 percent and 30 percent, respectively). The South Pars/North Dome gas field, co-owned by Iran and Qatar, is the world's largest gas field.[4] Discovered in 1971, the field started production in 1989 and today represents approximately 13.6 percent of the world's proven gas reserves.[5] By contrast, Bahrain, Libya, and Oman together hold less than 3 percent of the region's total proven gas reserves.[6]

Political instability, wars, unrest, and sanctions in some countries also contribute to differences among net exporters, limiting investment in the sector and restricting production and exports. Iraq's oil production peaked in 1979 at 3.5 million barrels per day (mb/d) but took more than 35 years to return to that level because of war and sanctions. Iran's oil production peaked at 6.1 mb/d in 1974 and in 2022 was half that amount. Libya's oil production peaked at 3.1 mb/d in 1970 and fell to about half that level in 2022 (Figure 8.3). These countries stand to lose the most when the climate-related transition to green alternatives leaves their reserves undeveloped.

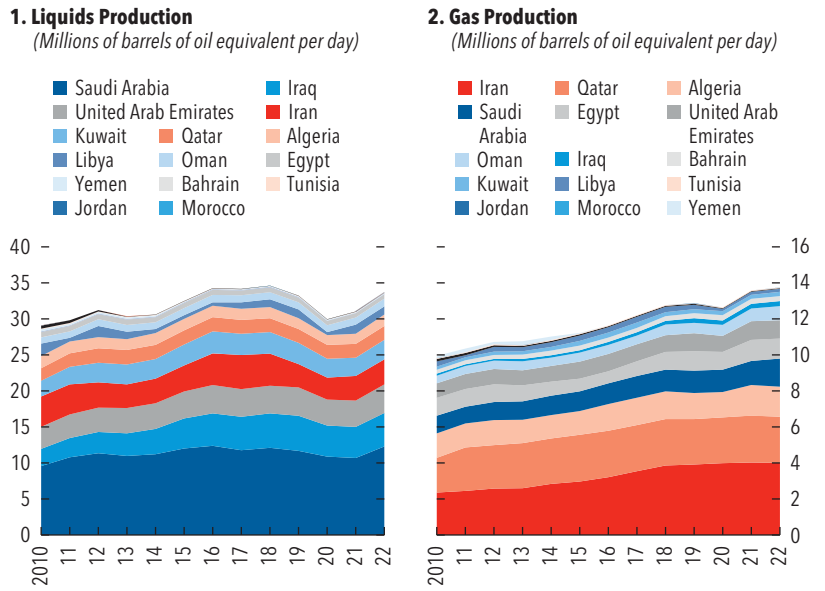
Several factors have affected the pace at which natural gas reserves are monetized, including the reserves size and production cost, infrastructure availability, oil policy, and domestic demand. In the Middle East, only Oman and Qatar are net exporters, and only Qatar is significant on a global scale. Without Qatar, the region is a net gas importer. Despite holding larger reserves than Qatar, Iran consumes or flares most of its production domestically. Also, most net gas importers in the Middle East are Organization of the Petroleum Exporting Countries (OPEC) members, and their gas production is mostly associated with oil and affected by OPEC's output decisions. Many net gas importers in the region aspire to become net exporters. Saudi Arabia, for example, is currently self-sufficient in gas and plans to double production (including from local shale resources) and become a gas exporter by 2030.

[4] South Pars is the Iranian section of the gas field, covering about 3,626 square kilometers in Iran's territorial waters. North Field (also called North Dome) is 5,957 square kilometers in Qatari territorial waters (Sawe 2018).

[5] Qatar Energy (2024).

[6] The region also holds significant unconventional oil and gas resources. A 2013 study by the US Energy Information Administration found that Libya has the fifth largest technically recoverable shale oil resources after Russia, the United States, China, and Argentina, while Algeria has the third largest technically recoverable shale gas resources after China and Argentina (EIA 2013).

Figure 8.3. MENA Liquids and Gas Production



Source: Rystad Energy (www.rystadenergy.com).
Note: MENA = Middle East and North Africa.

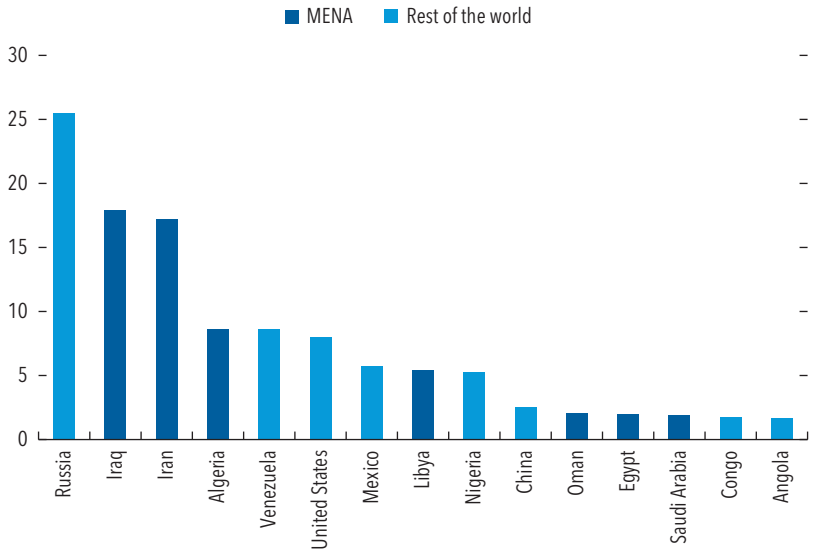
The region also faces a major flaring problem. According to the World Bank, this practice stems from a lack of political will to create suitable structures and markets to capture and use the gas, not from a lack of technology. Gas flaring limits export potential and increases both carbon footprint and carbon intensity (more on this below). Algeria, Iran, Iraq, and Libya are among the top 10 gas-flaring nations in the world (Figure 8.4). Iraq alone accounts for about 13 percent of all gas flaring worldwide—an amount equal to 95 percent of its natural gas consumption in 2022.

Gas trade by pipeline is much more developed in North Africa than in the Middle East, where only one significant intraregional pipeline (the Dolphin Project) connects Oman, Qatar, and the United Arab Emirates. Several pipeline proposals have been discussed but never materialized.

Algeria and Egypt are Africa's largest gas producers and exporters, together accounting for 65 percent of Africa's gas production and 60 percent of its exports.[7] However, rapid growth in domestic demand, supported by generous subsidies, has constrained North Africa's export potential (see Chapter 9). Egypt

[7] Across the region, Algeria and Egypt rank 6th and 7th in terms of proven gas reserves after Iran, Qatar, Saudi Arabia, the United Arab Emirates, and Iraq, and 4th and 5th in gas production after Iran, Qatar, and Saudi Arabia.

Figure 8.4. Top 15 Gas-Flaring Nations in the World (2022)
(Billions of cubic meters)



Source: World Bank, Global Flaring and Methane Reduction Partnership (https://www.worldbank.org/en/programs/gasflaringreduction/global-flaring-data).
Note: MENA = Middle East and North Africa.

is Africa's largest gas market, with domestic consumption accounting for 37 percent of regional consumption, followed by Algeria with 27 percent (EI 2023).

The Rising Importance of Carbon Intensity

Pressure to reduce emissions and transition to cleaner forms of energy is expected to increase as climate change intensifies, bringing both benefits and drawbacks to the region. Gas is widely regarded as a transition fuel because its carbon content is lower than that of oil and coal, which in principle should benefit the region's gas producers in the short and medium terms.

The MENA region is the fourth largest emitter of CO_2 in the world after Asia and the Pacific, North America, and Europe.[8] Although the region's emissions are a fraction of those of Asia and the Pacific, its growth rate between 2012 and 2022 was 1.88 percent per year—similar to Asia and the Pacific's 1.67 percent, which is the highest in the world over that period (compared with a world average of 0.65 percent). The region's share of global emissions has increased steadily over the past 30 years (EI 2023).

[8] CO_2 emissions are the sum of emissions from energy use, flaring, CO_2 equivalent of methane emissions, and industrial processes (EI 2023).

The region has significant potential to reduce its carbon footprint, including by reducing flaring and increasing the share of renewable energy, especially in power generation, which is dominated by hydrocarbons. However, production expansion plans for oil, gas, and petrochemicals in some MENA countries largely offset those efforts unless greener technologies such as carbon capture and storage (CCS) are widely adopted, which raises exploitation costs.[9]

Higher carbon intensity associated with the production and use of a particular hydrocarbon makes it less attractive from a climate perspective and potentially subject to a higher carbon tax burden. Carbon intensity can also be used as a standard to compare the climate performance of different oil and gas products.

Carbon emissions might also have fiscal implications. A carbon tax could be imposed in either a producing country or an importing country. Even if producers resist the introduction of carbon taxes, adopting them in importing countries with carbon border adjustments to equalize the tax burden between domestic producers and importers can shift some of the oil and gas rent from exporters to importers and favor imports from low-carbon producers (Box 8.1).

Several key players in the MENA region increasingly highlight the climate advantage of their hydrocarbons. Aramco claims that "decades of 'best-in-class' operational practices has" the company's "carbon intensity ranked among the world's least carbon intense sources of crude oil" (Pinheiro 2020). A 2023 *S&P Global* article quoted an executive of the Abu Dhabi National Oil Company stating that the company was on target to reduce its carbon intensity by 25 percent by 2030, relative to 2019, despite expected increase in production.[10]

Data on carbon intensity in oil and gas production are limited and face significant measurement issues. Masnadi and others (2018) analyze the carbon intensity of oil fields from 90 countries that together account for 98 percent of global crude production, using well-to-refinery methods—equivalent to the well-to-tank method.[11] They estimate a global volume-weighted-average upstream carbon intensity of 63 kilograms of carbon dioxide equivalent per barrel of oil equivalent (kg CO_2eq/boe), with country-level intensities ranging from 20.2 kg CO_2eq/boe in Denmark to 124.2 kg CO_2eq/boe in Algeria (Figure 8.6).

[9] The most notable oil production expansion plans include those by the United Arab Emirates (5 mb/d by 2027, up from 4.2 mb/d in 2022); Iran (5.7 mb/d by 2030, up from 3.8 mb/d in 2022); and Kuwait (4.75 mb/d by 2040, up from 2.83 mb/d in 2022). In natural gas, Qatar plans to expand its liquid natural gas export capacity from 105 billion cubic meters per year (bcm/year) to 150 bcm/year by 2027. Iran aims to produce 548 billion cubic meters of gas by 2030—nearly double its 2021 output—and Algeria's target is 140 billion cubic meters in 2023, a 20 percent increase from its 2021 gas output.

[10] https://www.spglobal.com/commodity-insights/en/news-research/latest-news/crude-oil/081723-interview-adnoc-to-reduce-carbon-intensity-by-2030-despite-oil-capacity-boost (accessed on November 5, 2025).

[11] The well-to-tank method estimates the greenhouse gas emissions of oil from production up to its storage at the refinery. The method is a subset of the well-to-wheels method, which estimates the greenhouse gas emissions of the fuel's entire life cycle from production to combustion at the car.

Box 8.1. EU Carbon Border Adjustment Mechanism

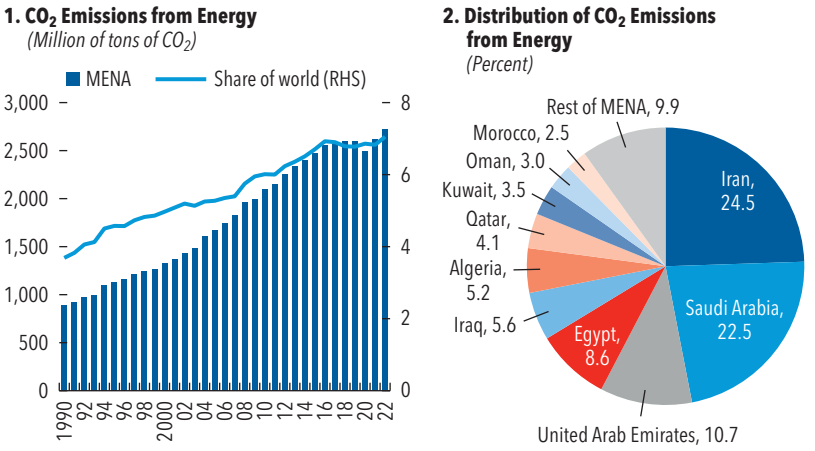
Countries with trade-exposed industries are introducing more ambitious climate mitigation policies and considering measures to protect competitiveness and reduce emissions leakage. Competitiveness and leakage concerns arise from unilateral domestic policies that raise costs for energy-intensive, trade-exposed (EITE) firms significantly through carbon pricing or regulations (such as requirements to install costly clean technology). Higher domestic costs for such firms can cause them to lose market share to foreign producers that do not face these policy-driven costs. The loss in market share reduces domestic economic activity and weakens the emissions reductions achieved by the policy because production of EITE products shifts (or leaks) abroad.

The EU Carbon Border Adjustment Mechanism (CBAM) is the most prominent example of a policy designed to reduce leakage and protect competitiveness. Starting in 2026, the CBAM imposes a levy on the carbon content of imports. In October 2023, importers began collecting the information needed to impose the CBAM levy (for example, emissions incurred before importation). The CBAM initially applies to imports of iron and steel, cement, fertilizers, aluminum, electricity and hydrogen, and some precursors and downstream products such as screws and bolts, and then will expand in 2030 to all sectors covered by the EU Emission Trading System (ETS; all industrial and power sector activities). The levy base includes direct and indirect emissions of CO_2 (such as those emitted from producing electricity used in industrial operations) and nitrous oxide and perfluorocarbons for specific products. Taxes paid on emissions before importation will be credited. The carbon price is expected to match the ETS price at the time of import, adjusted for the portion of free ETS allowances. Default values will likely be used if actual emissions cannot be determined.

Source: Authors' compilation.

Masnadi and others (2018) find that crude oil from GCC countries (except for Oman) has lower carbon intensity than that of regional peers and global comparators, which would give these producers a competitive edge if carbon taxes are applied globally. At the other end of the spectrum, crude from Algeria, Iran, and Iraq has the highest carbon intensities in the region, largely because of their gas-flaring footprint, which is not entirely exogenous (Figures 8.5 and 8.6). Assuming a carbon tax of \$86.53/ton CO_2 (the 2022 EU Emission Trading System average), Algerian crude oil would cost about \$8.30 per barrel more than Saudi Arabian crude, with all else constant. Egypt, Libya, and Oman are in the middle of the spectrum. The analysis in the next section uses carbon intensity data to show how a carbon tax affects upstream oil and gas taxation.

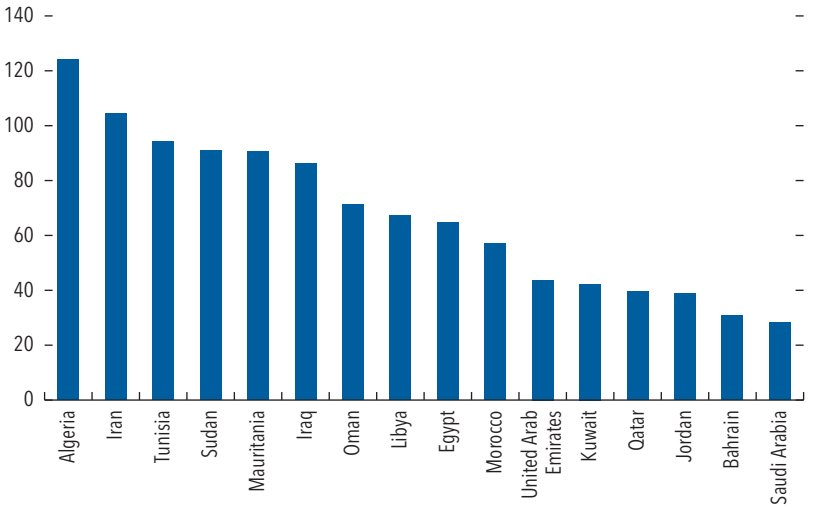
Figure 8.5. Carbon Emissions from Energy in the MENA Region



Source: EI (2023).
Note: MENA = Middle East and North Africa. RHS = right-hand scale.

Figure 8.6. Upstream Greenhouse Gas Intensity of Crude Oil in the MENA Region

(Kilograms of CO_2 equivalent per barrel of oil equivalent)



Source: Masnadi and others (2018).
Note: Syria and Yemen are not included because of limited production. MENA = Middle East and North Africa.

UPSTREAM PETROLEUM FISCAL REGIMES

Policy and political choices shape the oil and gas industry structure in the region and the fiscal terms that apply. This analysis examines the main features of the region's fiscal regimes.

Policy Choices

In most countries in the region, governments and state authorities are the legal owners of mineral and hydrocarbon resources and therefore are entitled to collect revenue from them. They can extract the resources themselves through national oil companies (NOCs)—for example, Kuwait, Saudi Arabia, Abu Dhabi—or allow a role for private enterprise, as in the United Kingdom and the United States. In practice, regardless of this choice, international oil companies play prominent roles in many stages and activities of extraction, often in cooperation with host country NOCs and within a framework of national control. A government's policy for developing its hydrocarbon resources has significant implications for the choice of fiscal regime and investment incentives.

After World War II, Western oil companies dominated the region's sector and enjoyed lenient fiscal terms and limited host government involvement, but powerful NOCs and tougher terms soon replaced that model. In 1960, OPEC was founded in Baghdad, and five of the six founding members—Iran, Iraq, Kuwait, and Saudi Arabia—were from the region, with Venezuela as the other member. At about the same time, governments began nationalizing international companies' assets. Where private companies continued to operate, new contractual arrangements replaced previous concessions.

Most of the region's oil and gas producers welcome international investment, yet in most of those countries, the NOC is the majority equity holder, which has a major impact on sector taxation because transfers from NOCs to the government make up a significant share of government revenues. This feature contrasts with the rest of the world, where private sector companies are major investors and operators. Where states participate, they usually hold only a minority stake. Oman does not have an NOC. The country's small, technically challenging oil and gas reserves are a main reason for this policy choice. Iraq established an NOC in 1966 and broke it up in 1987. Since then, regional national entities such as the Northern Oil Company, Basrah Oil Company, and Missan Oil Company have managed oil and gas developments in their respective areas. A 2018 law was passed to establish a new NOC, independent of the Ministry of Oil and owning the regionally fragmented NOCs. Its operations began in 2022.

Bahrain, Kuwait, and Saudi Arabia are among the few countries that remain closed to private equity participation in their upstream oil sector (Table 8.2), but Bahrain is considering opening its sector to international firms (OBG 2024). Exceptions exist in countries where the NOC does not fully own the licenses, such as the Neutral Zone between Kuwait and Saudi Arabia, where Chevron holds the operating license. The only assets in Saudi Arabia not operated by Saudi

TABLE 8.2.

National Oil Companies of MENA Region Net Oil and/or Gas Producers

		Crude Oil Production in 2021 (Millions of Barrels per Day)		
Country	**National Oil Company**	**Country**	**NOC**	**Share of NOC (Percent)**
Algeria	Sonatrach	0.9	0.8	86.8
Bahrain	BAPCO, Tatweer	0.2	0.2	100.0
Egypt	Egyptian General Petroleum Corporation	0.6	n.a.	n.a.
Iran	National Iranian Oil Company	2.5	2.5	100.0
Iraq	Iraq National Oil Company	4.0	4.0	100.0
Kuwait	Kuwait Petroleum Corporation	2.4	2.43	100.0
Libya	National Oil Corporation	1.2	n.a.	n.a.
Oman	Petroleum Development Oman	1.0	0.635	65.5
Qatar	Qatar Energy	0.6	0.3	53.9
Saudi Arabia	Aramco	9.2	9.2	100.0
United Arab Emirates	Abu Dhabi National Oil Company	2.7	n.a.	n.a.

Sources: EI (2023); and various national oil company annual reports.
Note: n.a. = not available; NOC = national oil company.

Aramco are the gas exploration contracts in the Rub' al-Khali region, held by Eni, Lukoil, Repsol YPF, Shell, and Sinopec. The government granted this concession after the 1998 Strategic Gas Initiative, when Saudi Arabia turned to foreign investment to explore its gas potential—the first involvement of foreign investment in the country's upstream sector since industry nationalization in 1976.

In general, the Middle East has admitted only a few large oil companies, while North Africa has a more diverse corporate landscape with international oil and gas investors. North Africa has smaller reserves and discoveries and higher production costs than the Middle East, which partly explains this difference. These factors have also influenced those countries' tax and nontax policy choices for their oil and gas sectors.

Fiscal Systems

A fiscal regime is the set of tax and nontax instruments that determine how host governments and investors share the risks and rewards from oil and gas projects. When an NOC fully owns and operates a sector, all free cash flows ultimately go to the state, so fiscal policy instruments hold little relevance. However, if the NOC is subject to tax, the choice of tax instrument affects the timing and size of flows between the NOC and the government—for example, the revenue patterns of a classic corporate income tax (CIT) would be different from those of a pure rent tax.

Tax policymaking principles for the hydrocarbon sector are the same as for general taxation but with some differences because of sector-specific characteristics, including complex ownership and production structures, long project horizons, large up-front exploration and development costs, price volatility, the potential for large economic rents, and the exhaustibility of the resource. These

Box 8.2. Principles of An Ideal Fiscal Regime for the Hydrocarbon Sector

Neutrality: An ideal tax should not distort investment and production decisions.
Simplicity: The tax system should be easy to understand, administer, and enforce.
Taxing rent: The fiscal regime should tax profits above the required rate of return to investors at higher rates than those applied to the required rate of return.
Stability: Taxes should provide some level of predictability, which is especially important given the sector's long horizon nature and large up-front exploration and development costs.
Competitiveness: An internationally competitive tax regime recognizes and adapts to the special characteristics of the local hydrocarbon basin or country.

Source: Authors.

characteristics require special attention to the mix of tax and nontax instruments to ensure that governments receive a fair share of revenue while providing adequate investment incentives and keeping the fiscal regime internationally competitive. Box 8.2 highlights the key principles for tax design, adapted to the specifics of the oil and gas sector.

Two main types of fiscal regimes have developed worldwide: the concessionary system and the contractual agreement. The concessionary system began in the mid-1800s at the start of the petroleum industry and still predominates in OECD countries such as Australia, Canada, Norway, and the United States. The contractual system emerged about a century later in the mid-1950s and has generally been favored by developing countries. The two regimes differ legally regarding production ownership. Economically, both types can be designed to generate similar fiscal outcomes.

A concession grants an oil company the exclusive right to explore, develop, produce, and export oil. It also gives the company title to the oil produced and requires it to pay taxes. Because modern concessions combine elements such as royalties, income tax, and resource rent tax, they are also called Royalty and Tax Systems. State participation in an oil and gas concessionary venture or participation through its NOC has become common. The basic features of oil and gas concessions are similar, but the fiscal terms vary widely and evolve as fields and basins mature.

Under a contractual system, the government contracts an oil company (typically an international oil company) to operate in a specific license area. The state retains title to the hydrocarbons, and all production belongs to the state unless

TABLE 8.3.

Prevailing Fiscal Regimes in the MENA Region

	Net Exporters of Oil and/or Gas	Oil and Gas Prospective Countries
Service agreement	Egypt, Iran, Oman, Iraq	None
Production sharing contract	Algeria, Bahrain, Egypt, Iraq, Libya, Oman, Qatar	Jordan, Lebanon, Mauritania, Sudan, Syria, Tunisia, Yemen
Royalty and tax regime	Algeria, Egypt, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates	Jordan, Morocco, Tunisia

Source: Rystad Energy (www.rystadenergy.com).
Note: MENA = Middle East and North Africa.

shared explicitly. The international oil company operates at its own risk and expense, providing the necessary financing and technology required and agreeing to meet the exploration and development costs. In return, it receives a share of production or a cash fee for service if production succeeds. If the company receives a share of production (after deduction of the government's share), the system is called production sharing agreement (PSA). The company is rewarded in physical barrels and takes title to that share of petroleum extracted at the delivery point (the export point from the contract area).

Under service contracts, the host government hires an international oil company for a fee (often taxed), without sharing in the production. A distinction is sometimes made between service contracts and risk service contracts, in which the contractor can be paid additional fees for taking specified risks.

MENA countries use a mix of contractual and concessional regimes, unlike international comparators that rely mainly on concessional regimes (Table 8.3). PSAs prevail in the region, especially in most prospecting countries or emerging producers such as Lebanon, Mauritania, and Yemen. Among the net exporters, a few countries—such as Saudi Arabia (for gas and the Neutral Zone) and the United Arab Emirates—apply the concessionary regime, while Iran and Iraq largely use the service contract model. Some countries have both concessions and contracts in parallel, such as Algeria and Libya. Several fiscal structures can exist within the same country: In Federal Iraq, four contractual forms are in use, while PSAs dominate in the Kurdish region.

The mix of fiscal instruments also varies across countries. Algeria, Morocco and Tunisia use classical concessions with royalty and CIT; Algeria adds a profit tax; and Tunisia applies a variable CIT rate using the R-factor.[12] Algeria, Egypt, Iraq, Jordan, Lebanon, Mauritania, and Yemen use PSAs with or without royalties. Many countries in the region rely on the daily rate of production to share profit oil, while only Lebanon and Mauritania use the R-factor. Iraq, Mauritania,

[12] The R-factor can be broadly defined as the ratio of cumulative net earnings to cumulative total expenditures (some countries use gross revenues instead of net earnings). The R-factor is calculated in each accounting period and once a threshold is reached, a new sharing rate will apply in the next accounting period (Nakhle 2010).

Morocco, and Yemen have minority state participation, while Algeria and Tunisia have state participation above 50 percent.

Algeria, Egypt, Iraq, Jordan, and Yemen rely more on revenue-based instruments than on profit-based instruments. Revenue-based instruments typically lead to more regressive fiscal regimes, with government take rising or declining as project profitability declines or rises. Such a fiscal regime also raises investor risk by increasing the required breakeven price.

Some of the instruments commonly used in the region are discussed next, while Annex 8.3 provides a brief description of each instrument.

State Participation

Besides the full state ownership applicable in Bahrain, Kuwait, and Saudi Arabia, the region has two other main forms of state participation:

1. State majority equity holding (Algeria, Iran, Qatar, United Arab Emirates). Under this approach, the state holds a working interest, which means the state pays its share of exploration and development costs when exploration succeeds. For example, Algeria's Law No. 19-13 governing hydrocarbon activities sets the participation rate of the NOC at a minimum of 51 percent for PSCs.[13] Under Abu Dhabi's Law No. 4 of 1976 (Gas Ownership Law), Abu Dhabi National Oil Company has the right to exploit and use all gas either solely or through joint agreements or projects with third parties, provided that the company's participation is at least 51 percent working interest. For oil, the United Arab Emirates (also through the Abu Dhabi National Oil Company) can participate in a concession between 60 percent and 100 percent (McPherson 2008). Similarly, under the Iranian Petroleum Contract, the foreign investor must partner with an Iranian entity (that owns at least 51 percent interest in the joint venture) approved in advance by the National Iranian Oil Company. In Qatar, the NOC (Qatar Energy) either fully owns and operates assets or forms a joint venture with international partners. The state's two main liquid natural gas ventures have individual ownership structures, with Qatar Energy holding at least 65 percent in each.
2. Carried state participation through development. This occurs in Iraq's Kurdish region and in Mauritania, Tunisia, and Yemen,[14] while in Morocco, the state is carried only through exploration.

In Egypt, the PSA does not stipulate minimum state participation. In Oman, the government does not take a participating interest when granting an exploration and production sharing agreement. However, in several such agreements, a wholly-owned government exploration and production company holds a stake (Figgins, Taqi, and Al-Busaidi 2021). In Lebanon, where no discoveries have been

[13] https://www.joradp.dz/FTP/JO-FRANCAIS/2019/F2019079.pdf.

[14] "Carried" means that the private investors cover, or carry, the state's proportional share of capital investments. Repayments (usually with interest) are then made after production starts, using some or all of the cash flows from the state's share of production.

made to date, the state maintains the right to acquire a given interest after a commercial discovery is declared, though the rate and form have not been determined.

Higher state participation in the form of working interest typically occurs where the NOC or the government is financially strong and able to share the risk with private investors. State participation offers advantages and disadvantages regarding the state's role in the sector and often brings significant governance challenges. Positive cash flows are often not transferred back to the treasury automatically but can be retained to finance future investments. This delays transfers from the NOC to the state and can lead to misallocation of public resources. Decision making often lacks transparency, and information on the operation of NOCs is not always accessible.

Bonuses

Bonuses in the region typically occur in countries with contractual arrangements, including Egypt, Libya, Mauritania, Morocco, Oman, Qatar, the United Arab Emirates, Yemen, and in the Kurdish region in Iraq. Bonuses may be paid at contract signature, discovery, and production, unlike comparator countries where only signature bonuses are common.

Royalties

Royalties are widespread in the region, with notable variation in rates and application (Figure 8.7), though they do not apply in Jordan, Mauritania, and Oman. Saudi Arabia's royalty rate is the highest and is linked to oil prices, although the government can choose not to collect royalties on natural gas and condensates for a predetermined period. For example, the Saudi Ministry of Energy, aiming to increase gas production to free up more oil exports, decided not to collect royalties from Aramco on condensate production for five years beginning January 1, 2018. Then in September 2019, the government extended this decision for an additional 10 years, with the option for further extension.

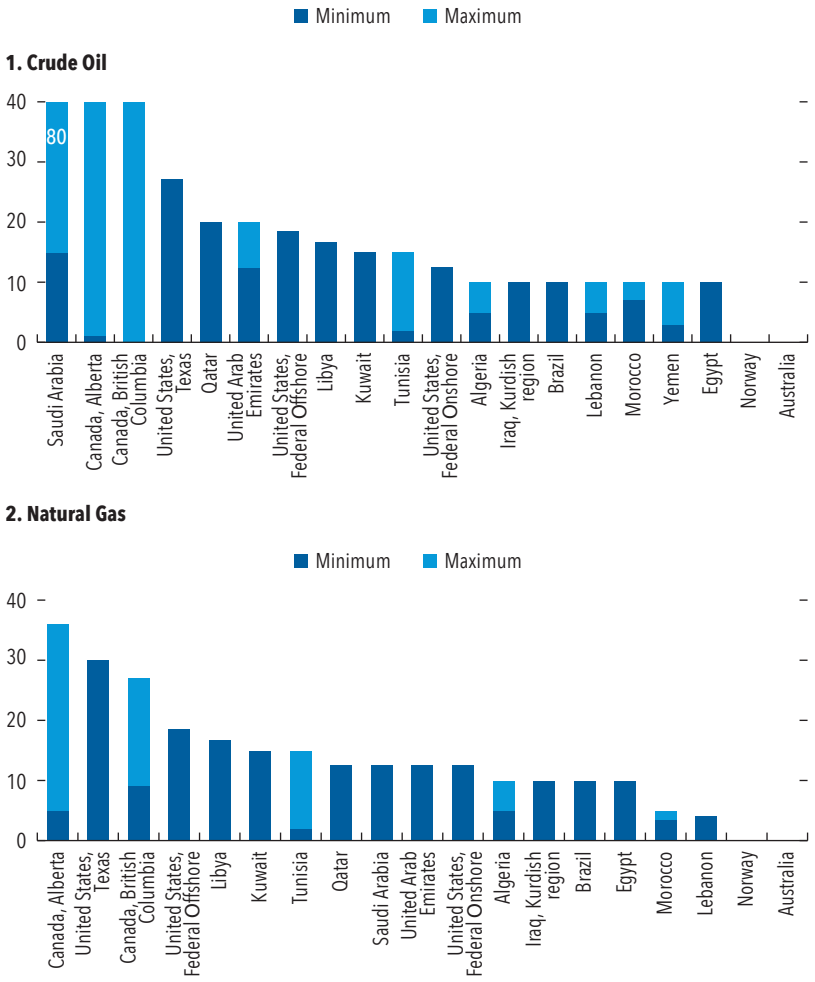
Two forms of royalties are imposed in the region. Flat-rate royalties, the most common form, range from 5 percent in Algeria to 20 percent in Qatar for crude oil and 3.5 percent in Morocco to 16.67 percent in Libya for natural gas (Figure 8.7). Variable-rate royalties link rates to prices within a defined band, as in Saudi Arabia (Figure 8.8); the daily rate of production, as in Lebanon and Yemen; or the R-factor, as in Tunisia.

Profit Petroleum

Regimes in Egypt, Iraq, and Yemen limit the cost recovery ceiling to 50 percent or less of revenue, a low level that contributes to making these regimes more regressive. These countries, along with Jordan, also share profit petroleum based on the daily rate of production. In Egypt, the oil price is an additional variable for determining the profit share (Resource Contracts 2021). However,

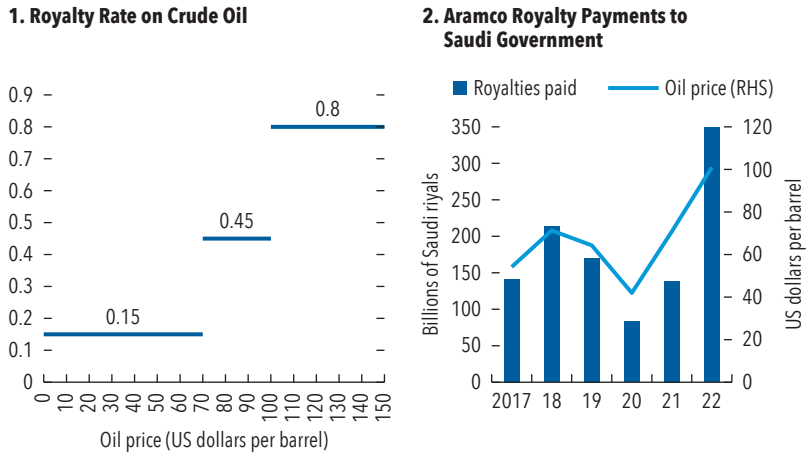
Figure 8.7. Royalty Rates for Selected Countries and Provinces

(Percent)



Sources: Various industry and country reports.

Figure 8.8. Prevailing Royalty in Saudi Arabia



Source: Saudi Aramco 2024.
Note: MENA = Middle East and North Africa. RHS = right-hand scale.

production and oil prices are poor proxies for profitability. In Iraq, Lebanon, and Mauritania, profit petroleum is based on the R-factor, which is more progressive than using the daily rate of production.

Corporate Income Tax

The region's net oil and gas exporters have some of the highest CIT rates on crude oil, relative to a global average of CIT at 20 percent to 30 percent (Figure 8.9).

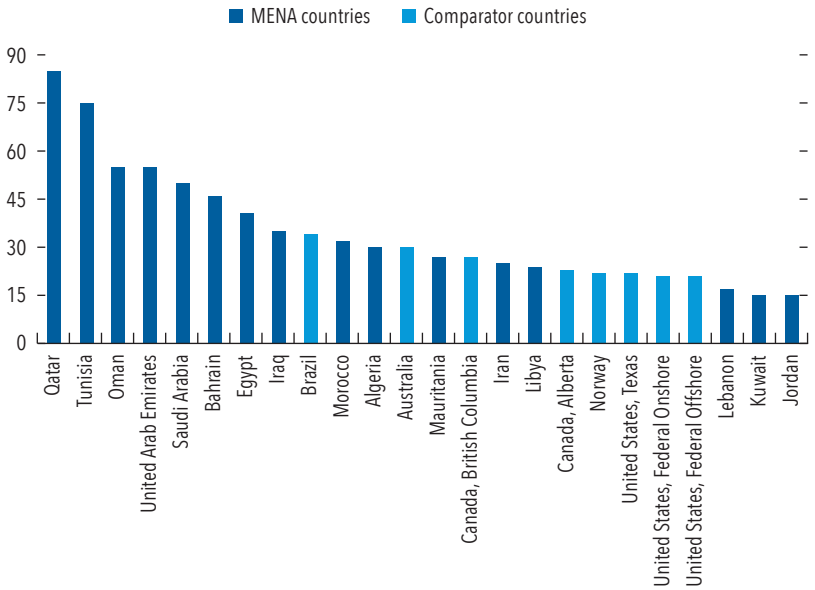
In most cases, the CIT is paid on behalf, meaning that it is included in the government's share of profit petroleum. Tunisia applies a variable CIT based on the R-factor when the state does not participate. Where state participation reaches or exceeds 40 percent, the CIT is fixed at 50 percent. Morocco grants 10-year CIT holidays (the only country that does so), after which the standard CIT applies. In the other countries surveyed for this analysis, CIT rates range from 21 percent (the US federal rate) to 34 percent (Brazil), and the CIT is not paid on behalf.

Resource Rent Taxes

Among the surveyed countries, only Algeria levies an additional profits tax: the hydrocarbon revenue tax, which is based on the R-factor.[15] Outside the region, some form of resource rent tax is common in concessionary regimes (except for Canada and the United States).

[15] For R ≤ 1, HRT = 10%; for R ≥ 3, HRT = 50%; for 1 < R < 3, HRT = 20% x (R)–10% (see *Law No. 79 of 2019*, Algeria. https://www.joradp.dz/FTP/JO-FRANCAIS/2019/F2019079.pdf).

Figure 8.9. Income Tax Rate on Crude Oil Activities
(Percent)



Sources: Various industry and country reports.
Note: MENA = Middle East and North Africa.

Carbon Tax

Algeria is the only country in the region that imposes a carbon tax on gas flaring, at a rate of 12,000 Algerian dinars per 1,000 cubic meters (equivalent to $84 per 1,000 cubic meters or $0.0442 per ton of CO_2).[16] Among comparator countries, only two impose carbon taxes. Norway in 2023 charged a CO_2 tax on burned petroleum of 2.03 Norwegian krones per liter of oil or condensate (equivalent to $81 per tonne of CO_2), on natural gas of 1.78 Norwegian krones per standard cubic meters of gas (equivalent to $72.30 per tonne of CO_2), and on natural gas discharged to air (Norwegian Petroleum 2023).[17] Canada has applied, since April 1, 2019, a carbon tax of Can$30 per tonne of CO_2 equivalent ($23.06), which is expected to reach Can$170 per tonne of CO_2 equivalent by 2030 ($130.70).[18]

[16] The Canadian dollar equivalent is based on the 2022 average exchange rate.

[17] Rates are for 2023.

[18] The consumer part of the carbon tax, a direct fuel charge on consumers and small businesses, was removed effective April 1, 2025. The newly elected government announced that the carbon tax will be refocused on large industrial emitters, starting at Can$80 per ton in 2025 and reaching Can$170 in 2030.

ANALYSIS OF FISCAL REGIMES

The analysis in this section uses the IMF's Fiscal Analysis of Resource Industries model to evaluate fiscal regimes in the region where terms are publicly available and the government does not hold the main ownership stake.[19,20] The analysis uses two representative projects: a medium-size onshore oil field and a large offshore gas field. A second step illustrates the effect of a carbon tax. Annex 8.4 provides the project data and fiscal terms for the selected countries.

Assessment of Current Fiscal Regimes

The government take in the region, estimated using the average effective tax rate (AETR),[21] is relatively high, reflecting a mature industry in several countries (Figure 8.10). Established producers such as Algeria, Egypt, Iraq, and Tunisia aim for a government take of about 75 percent. Iraq's PSC has an AETR exceeding 90 percent. Prospecting countries and emerging producers such as Jordan, Lebanon, and Mauritania aim for lower takes between 60 percent and 70 percent. Morocco is an outlier with an AETR below 50 percent, closer to international comparators such as Australia, Brazil, Canada, and the United States. Norway's take is about 85 percent, and it relies almost entirely on profit-based instruments and the carbon tax described above (Norwegian Petroleum 2024).

In FCSs (Yemen and Iraq), high AETRs could hinder foreign investment. These countries could reconsider the structure of their fiscal regimes for the sector and the overall level of the AETR to ensure that the risk-reward for foreign investors is competitive.

For most MENA countries, the AETR stabilizes when a project reaches a pretax rate of return between 20 and 30 percent for onshore projects and 15 and 20 percent for offshore projects (Figure 8.11). Tunisia's concession stands out as being progressive over some range of price and internal rate of return. The regressivity of regimes is due to the use of royalties, cost recovery limits, and bonuses, and the quasi-absence of progressive and profit-sensitive instruments—such as rent taxes.

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[19] In countries where the state has full ownership of operations through an NOC, the fiscal regime effectively equals a 100 percent tax on profits after expenses and payments to contractors, which are subject to the CIT on their own profits. These cases are not modeled.

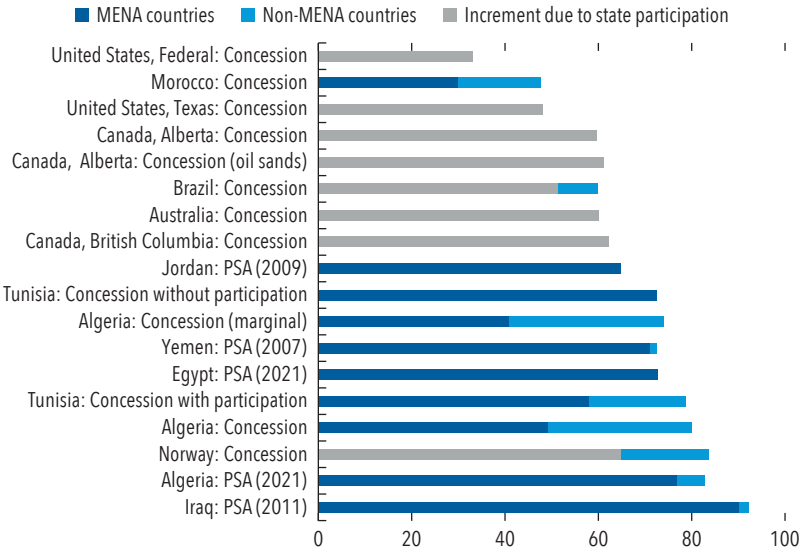
[20] The Fiscal Analysis of Resource Industries methodology uses a discounted cash flow model to analyze fiscal regimes in the extractive sectors and assess how different policy instruments interact. The methodology aligns closely with extractive industry practice, which uses discounted cash flow modeling to guide investment decisions. Unlike the industry application, the methodology focuses on key fiscal issues, including the government's share of the free cash flows a project generates through the fiscal regime (for more details, see the IMF's explanation of the methodology https://www.imf.org/en/Topics/fiscal-policies/fiscal-analysis-of-resource-industries).

[21] The AETR used in this chapter is the ratio of undiscounted flows of taxes to undiscounted project net cashflows over the estimated life of the project. The AETR can also be measured by discounting flows at a certain rate. Differences between the undiscounted and discounted method reflect primarily the timing of tax liabilities and the choice of the discount rate.

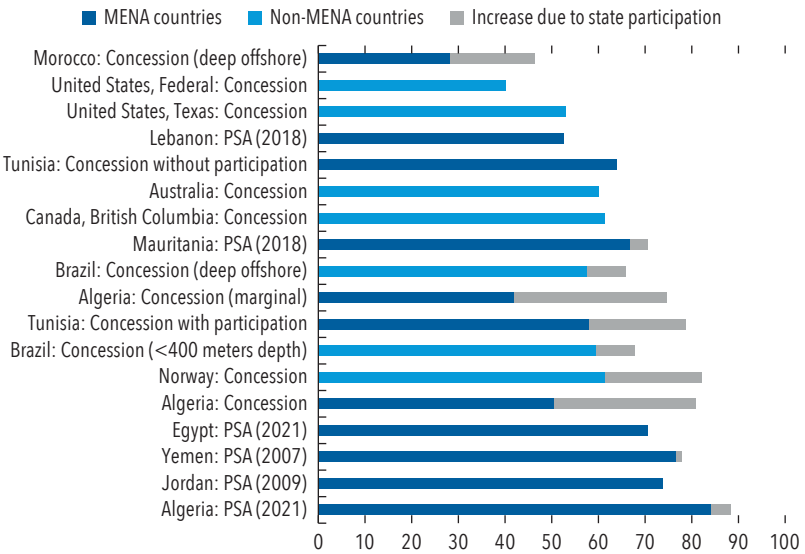
Figure 8.10. Average Effective Tax Rates for Selected Regimes

(Percent)

1. Onshore Oil Field



2. Offshore Gas Field

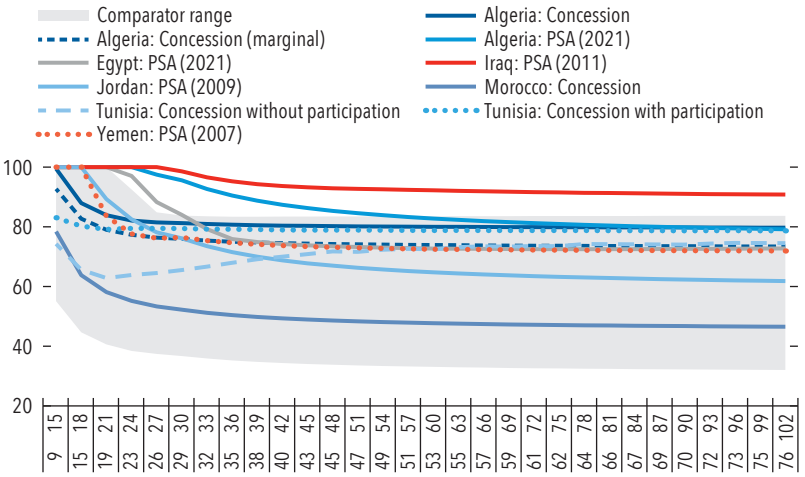


Source: Authors calculation using the IMF's Fiscal Analysis of Resource Industries model.
Note: 2023 fiscal regimes unless specified. In panel 1, production: 373 million barrels. Unit cost: $11.8 per barrel; oil price: $60.0 per barrel (both in 2023 $). In panel 2, production: 25 million barrels of oil; 12,314 billion SCF gas. Unit cost: $9.4 per barrel of oil equivalent; oil price: $60 per barrel; gas price: $6 per million Btu(all in 2023 $). Btu = British thermal unit; MENA = Middle East and North Africa; PSA = production sharing agreement; SCF = standard cubic foot.

Figure 8.11. Average Effective Tax Rate Sensitivity Analysis for Selected Regimes

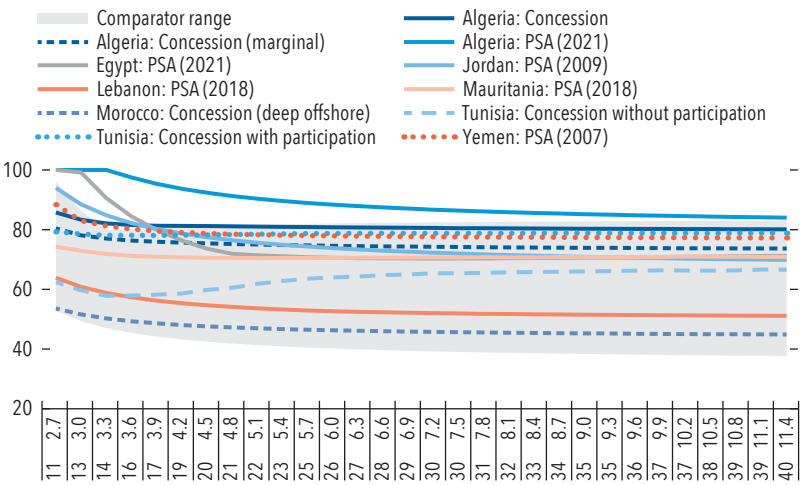
(Percent)

1. Onshore Oil Field



Oil price (US dollar per barrel; upper values) and pre tax internal rate of return (percent; lower values)

2. Offshore Gas Field



Gas price (US dollars per million Btu; upper values) and pre tax internal rate of return (percent; lower values)

Source: Authors' calculations using the IMF's Fiscal Analysis of Resource Industries model.
Note: 2023 fiscal regimes unless specified. In panel 1, AETR by varying project profitability and oil price. Production: 373 million barrels. Unit cost: $11.8 per barrel (2023 $). In panel 2, AETR by varying project profitability and gas price. Production: 25 million barrels of oil; 12,314 billion SCF gas. Unit cost: $9.4 per barrel of oil equivalent (2023 $). AETR = average effective tax rate; Btu = British thermal unit; PSA = production sharing agreement; SCF = standard cubic foot.

Posttax breakeven prices vary widely across countries (Figure 8.12). For onshore projects, most fiscal regimes result in a breakeven price lower than $30 per barrel. For offshore gas projects, most fiscal regimes result in a breakeven price lower than $5 per million British thermal units. Algeria, Jordan, Yemen, and Egypt have higher posttax breakeven prices. Higher breakeven prices result from high explicit and implicit royalties that occur because of the interaction between the cost recovery limit and the lowest profit share taken by the government. Regimes with high breakeven prices have effective royalty rates close to 30 percent.

Assessment of a Carbon Tax

To illustrate the effect of a carbon tax on upstream activities, the earlier analysis is extended with the following scenario: a carbon tax on oil extraction starting at $40 per ton of CO_2 in 2023 and increasing to $80 by 2040 (at constant 2023 US dollars).[22] Figure 8.13 shows the impact of the tax on AETR, and Figure 8.14 shows its impact on the progressivity of the fiscal regimes analyzed in the previous section.[23]

The AETR increment of the carbon tax ranges from about 2 percentage points in Iraq to about 9 points in Yemen, depending on emissions intensity. The carbon tax makes fiscal regimes more regressive, especially where emission intensity is high. These results indicate that if countries introduce a carbon tax, they need to adjust their fiscal regimes, for example, by redesigning other taxes, such as royalites and profit-based taxes.

For producers with 100 percent government ownership, a carbon tax has no impact on the government net revenue take, because carbon tax revenue offsets lower transfers from other fiscal instruments. However, the tax could affect the timing of revenue, and incentives to adopt cleaner production technologies.

The carbon tax also affects a project's economic limit because it increases unit production costs, and emission intensity usually increases over the project life cycle. Before adopting a carbon tax, countries should carefully simulate its impact on both the revenue take and the economic limit of oil and gas fields—that is, the point at which cash flows become negative.

A carbon tax can be an opportunity to shift incentives toward more efficient production (while preserving revenue) or accelerate the energy transition, including reducing and potentially abolishing carbon-intensive gas flaring, helping the region's oil and gas producers achieve their climate mitigation goals. Combined with other policies, a carbon tax can encourage deployment of renewable energy. Anderson and others (2022) find that a phased carbon tax starting at $8 per

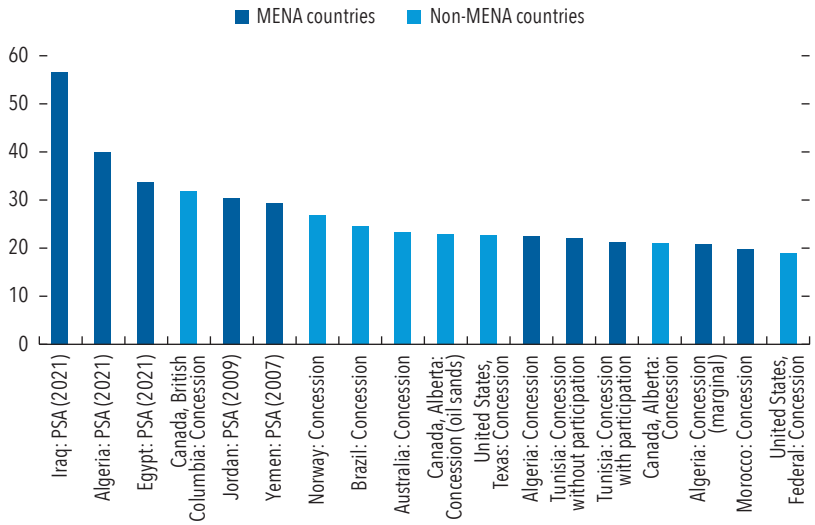
[22] Data on carbon intensity is available only for oil. The carbon tax is simulated on top of the AETR including state participation.

[23] The AETR calculation assumes that the company bears the tax, though it can be passed on to its employees or along the value chain all the way to final consumers. This analysis abstracts from this issue of incidence.

Figure 8.12. Breakeven Price for Selected Regimes

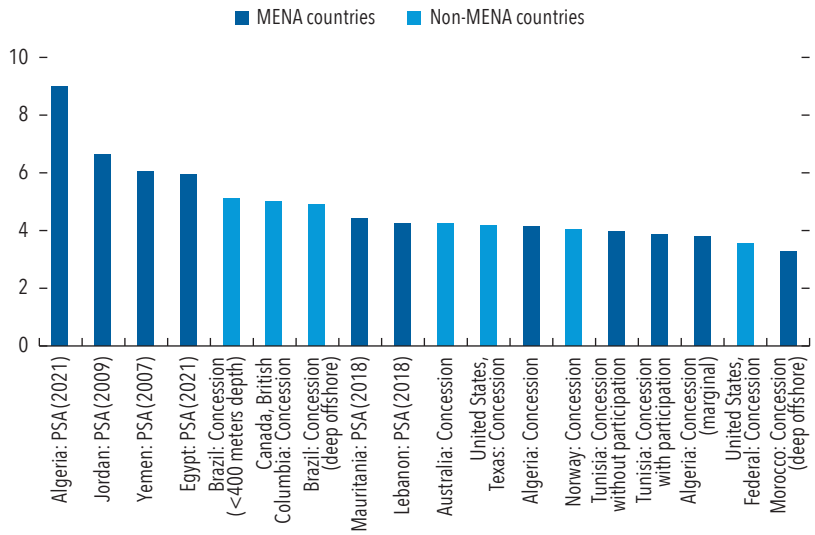
1. Onshore Oil Field

(US dollars per barrel)



2. Offshore Gas Field

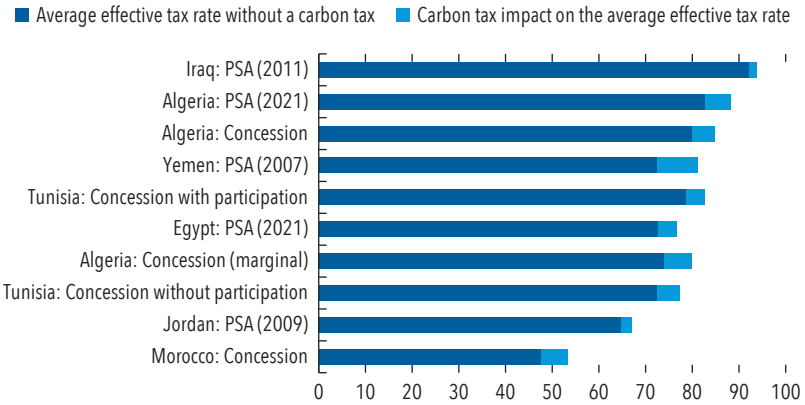
(US dollars per million Btu)



Source: Authors' calculations using the IMF's Fiscal Analysis of Resource Industries model.
Note: Calculations assume a posttax internal rate of return of 13 percent. 2023 fiscal regimes unless specified. In panel 1, production: 373 million barrels. Unit cost: $11.8 per barrel (2023 $). In panel 2, production: 25 million barrels of oil; 12,314 billion SCF gas. Unit cost: $9.4 per barrel of oil equivalent (2023 $). Btu = British thermal unit; MENA = Middle East and North Africa; PSA = production sharing agreement; SCF = standard cubic foot.

Figure 8.13. Average Effective Tax Rates with a Carbon Tax for Selected Onshore Oil Regimes

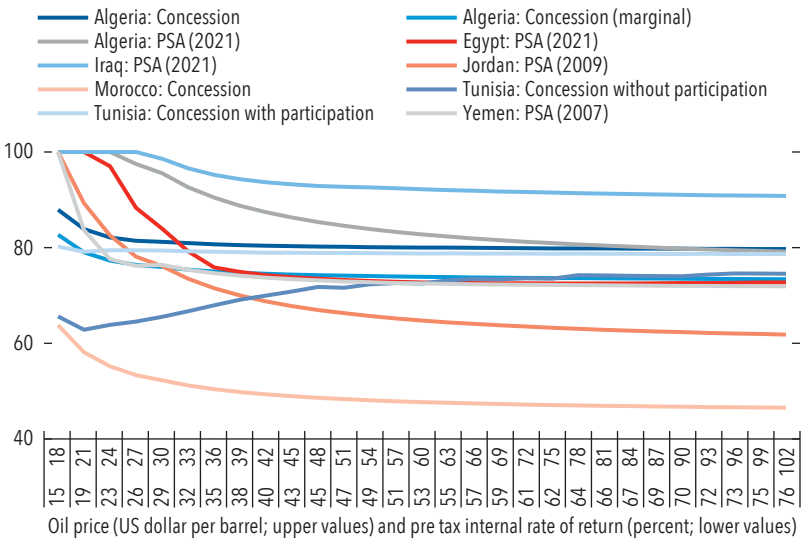
(Percent)



Source: Authors' calculations using the IMF's Fiscal Analysis of Resource Industries model.
Note: 2023 fiscal regimes unless specified. Production: 373 million barrels. Unit cost: $11.8 per barrel; oil price: $60 per barrel (both in 2023 $). PSA = production sharing agreement.

Figure 8.14. Average Effective Tax Rates with a Carbon Tax: Sensitivity Analysis for Selected Onshore Oil Regimes

(Percent)



Oil price (US dollar per barrel; upper values) and pre tax internal rate of return (percent; lower values)

Source: Authors' calculations using the IMF's Fiscal Analysis of Resource Industries model.
Note: 2023 fiscal regimes unless specified. Production: 373 million barrels. Unit cost: $11.8 per barrel (2023 $). PSA = production sharing agreement.

metric ton of CO_2 and increasing to $22 by 2030, along with gradually removing all fossil fuel subsidies, could achieve the region's 2030 emissions abatement goals without additional investments in renewables. A carbon tax also preserves part of the rent within the country instead of transferring it to countries that impose a carbon tax on imports, such as under the EU Carbon Border Adjustment Mechanism.

CONCLUSION

The accelerating global shift to low-carbon energy sources will eventually reduce demand for fossil fuels. The timing of peak oil and gas demand remains uncertain, but as economies decarbonize, the MENA region's oil and gas producers will face a shrinking market and declining revenues. With sizeable reserves that could last for decades at current production levels, the risk of stranded resources remains significant. Climate policies adopted elsewhere—such as carbon border adjustments—will also affect the region's producers.

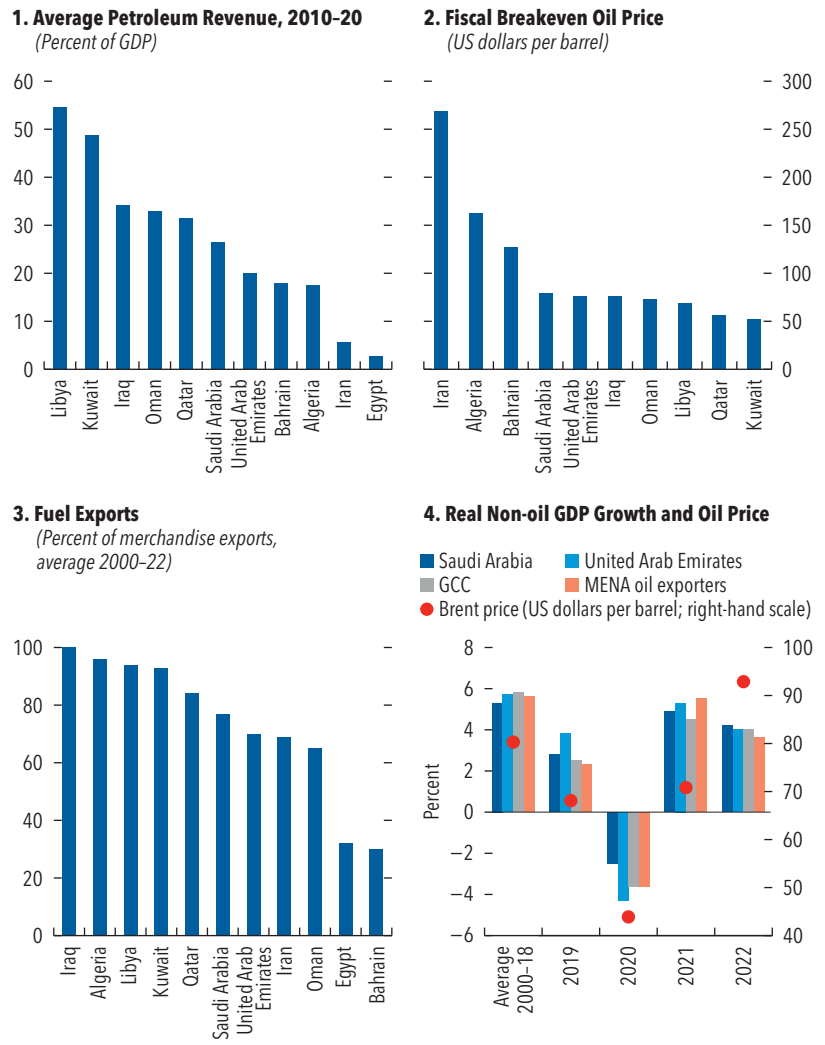
The risks of these trends vary across MENA countries. Low-cost producers will likely be the last to exit a declining hydrocarbon market. Producers with low carbon intensity will have an advantage in a greener world. On both counts, GCC countries hold an advantage over others in the region and beyond.

Estimates of AETRs are not low in the region by international comparisons, reflecting the maturity of the hydrocarbon sector in many countries. The AETRs suggest that some countries can reduce distortions to investment and production (while keeping revenues constant) by replacing or amending regressive fiscal instruments, such as royalties and low cost recovery limits, with more progressive instruments such as rent taxes. Although the case is strongest in FCSs where regimes rely more on royalties, capacity constraints are more binding, making simple levies like royalties more attractive.

MENA countries could use carbon taxes on the extraction of hydrocarbons to change the composition of the overall government take while reducing waste and improving production efficiency. Carbon taxes can help reduce gas flaring and support investment in greener alternatives, thus helping hydrocarbon producers achieve mitigation goals. Another motivation for introducing a carbon tax is to retain revenue domestically instead of transferring it to importing nations that tax imports on the basis of carbon content, as under the EU Carbon Border Adjustment Mechanism. This can also be achieved by other means, such as taxes on consumption of energy from hydrocarbons, as discussed in Chapter 9.

ANNEX 8.1. OIL AND GAS DEPENDENCE INDICATORS

Annex Figure 8.1.1. Oil and Gas Economic Dependence Indicators

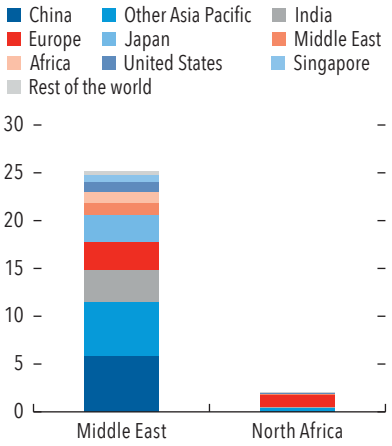


Sources: EI (2023); US Energy Information Administration; World Bank; and IMF.
Note: GCC = Gulf Cooperation Council; MENA = Middle East and North Africa.

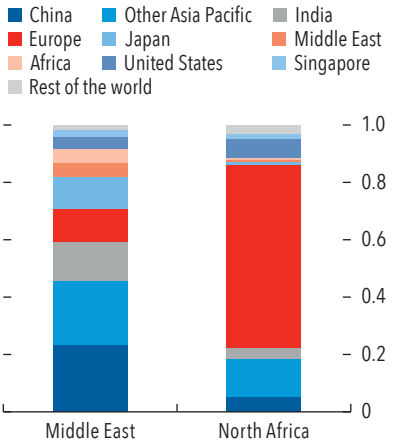
ANNEX 8.2. OIL AND GAS TRADE IN THE MENA REGION

Annex Figure 8.2.1. Oil and Gas Trade in the MENA Region

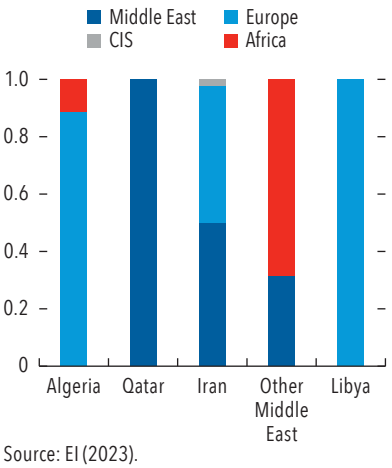
1. MENA Oil Exports by Destination, 2022
(Millions of barrels per day)



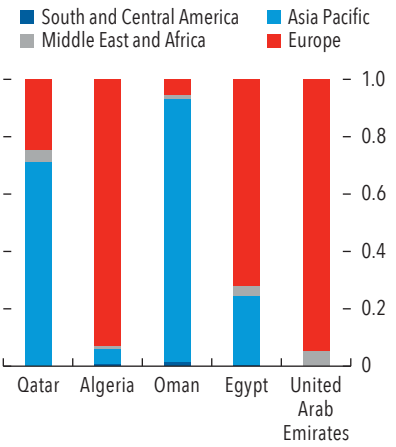
2. MENA Oil Exports by Destination, 2022
(Share of total)



3. Pipeline Gas Exports by Destination, 2022
(Share of total volume)



4. Liquid Gas Exports by Destination, 2022
(Share of total volume)



Source: EI (2023).
Note: CIS = Commonwealth of Independent States.

ANNEX 8.3. MAJOR FISCAL INSTRUMENTS IN OIL AND GAS TAXATION

ANNEX TABLE 8.3.1.

Major Fiscal Instruments in Oil and Gas Taxation	
State participation	The state can take an equity or participation in the oil and gas venture (either a minority or majority interest of 51 percent or more) directly or through its national oil company. The state becomes a partner with other companies and receives a share of production and profits in addition to royalties and taxes. The investing partner often carries state participation until production starts, meaning the state does not contribute its share of costs during exploration. The company carries those costs until a commercial discovery is declared or production starts. Thus, the state does not share the exploration or development risk if nothing is found, but if exploration succeeds, the state repays its carried share—typically with interest—once production starts. If the state does not repay its share, it is free carried, which is uncommon in the oil sector.
Bonus	A company makes a one-time payment when signing a contract (signature bonus), upon making a discovery (discovery bonus), or when reaching a production threshold (production bonus).
Royalty	A government imposes this common fiscal instrument on a specified production level (unit or specific royalty) or on the value of output or gross revenues (ad valorem royalty). The royalty can be at a flat rate (the most common) or on a sliding scale (varying with volume, price, or water depth).
Profit petroleum	Production sharing has two main fiscal parameters. The first, the cost recovery limit, caps the amount an investor can deduct each year. A lower cost recovery limit increases the taxable profit during the period when the investor recovers investment costs and raises the risk that the investor cannot fully recover the investment. This parameter makes the fiscal regime more regressive. The second parameter determines how the profit oil (the remaining oil after cost recovery) is shared. Under contractual arrangements, profit petroleum is typically shared using a proxy indicator for profitability with a variable tax rate.
Resource rent tax	A cash flow–based resource rent tax is meant to capture a larger share of the economic rent. The tax becomes payable when a project reaches payback on the initial investment and achieves a normal rate of return that compensates for the cost of capital.

Source: Authors.

ANNEX 8.4. FISCAL ANALYSIS ASSUMPTIONS

ANNEX TABLE 8.4.1.

Fiscal Regimes Overview

	Algeria: Concession	Algeria: Concession (Marginal)	Algeria: PSA (2021)	Egypt: PSA (2021, Onshore)	Egypt: PSA (2021; Offshore)	Iraq: PSA (2011; Onshore)	Jordan: PSA (2009)
Bonuses							
Signature bonus ($, millions)	n.a.	n.a.	n.a.	5	5	20	0.1
Production bonus ($, millions)	n.a.	n.a.	n.a.	3-Jan	0.5–2	2.5–20	0.25–6
Production bonus type	n.a.	n.a.	n.a.	DROP	DROP	Cumulative production	Cumulative production
Royalty							
Oil royalty rate (percent)	10	5	7	10	10	10	n.a.
Gas royalty rate (percent)	10	5	7	10	10	10	n.a.
Royalty type	Flat	Flat	Flat	n.a.	n.a.	Flat	n.a.
Production Sharing							
Profit petroleum sharing method	n.a.	n.a.	DROP	DROP and Price	DROP and Price	R–factor	DROP
Cost recovery limit (percent)	n.a.	n.a.	60	35	35	45/55	70
Profit petroleum share to government (percent)	n.a.	n.a.	60–88	60–69	65–71	70–84	40–70
Carbon Tax (Tax per ton of CO_2 eq emitted)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Carbon Tax							
Tax per ton of CO_2 equivalent emitted	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Corporate Income Tax							
CIT rate (percent)	30	30	–	–	–	–	15
Type of CIT	Standard	Standard	Paid on behalf	Paid on behalf	Paid on behalf	Paid on behalf	Standard

	Lebanon: PSA (2018; Offshore)	Mauritania: PSA (2018; Offshore)	Morocco: Concession (Onshore)	Morocco: Concession (Deep Offshore)	Tunisia: Concession without Participation	Tunisia: Concession with Participation	Yemen: PSA (2007)
	n.a.	0	1	1	n.a.	n.a.	0
	n.a.	18-Apr	7-Jan	7-Jan	n.a.	n.a.	5-Feb
	n.a.	DROP based	DROP based	DROP based	n.a.	n.a.	DROP based
	5–12	n.a.	10	7	2–15	2–10	3–10
	4	n.a.	5	3.5	2–15	2–8	n.a.
	Variable DROP based for oil	n.a.	Flat	Flat	Variable R-factor based	Variable R-factor based	Variable DROP based
	R-factor	R-factor	n.a.	n.a.	n.a.	n.a.	DROP
	65	60/65	n.a.	n.a.	n.a.	n.a.	50
	30–40	31.5–52	n.a.	n.a.	n.a.	n.a.	64–82
	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
	17	27	32	32	50–75; maximum 65 for gas	50	–
	Standard	Standard	Standard after 10 years holiday	Standard after 10 years holiday	Variable R-factor based	Fixed if state participation is ≥ 40 percent	Paid on behalf

ANNEX TABLE 8.4.1. (*continued*)

Fiscal Regimes Overview

	Algeria: Concession	Algeria: Concession (Marginal)	Algeria: PSA (2021)	Egypt: PSA (2021, Onshore)	Egypt: PSA (2021; Offshore)	Iraq: PSA (2011; Onshore)	Jordan: PSA (2009)
Additional Profit/Rent Tax							
Tax Rate (%)	10–50	10–20	n.a.	n.a.	n.a.	n.a.	n.a.
Type of Tax	R-factor based on taxable income	R-factor based on taxable income	n.a.	n.a.	n.a.	n.a.	n.a.
State Participation							
State participation rate (%)	51	51	25	n.a.	n.a.	20	n.a.
Type of state participation	Working interest	Working interest	Working interest	n.a.	n.a.	Carried through development	n.a.
Withholding Taxes							
Services: nonresident WHT rate (percent)	30	30	30	20	20	0	10
Interest WHT tax rate (percent)	0	0	0	10	10	0	5
Dividend WHT rate (percent)	0	0	0	0	0	0	5

Source: Authors and IMF's Fiscal Analysis of Resource Industries model.
Note: n.a. = not applicable; CIT = corporate income tax; DROP = daily rate of production; MENA = Middle East and North Africa; PSA = production sharing agreement; WHT = withholding tax.

	Lebanon: PSA (2018; Offshore)	Mauritania: PSA (2018; Offshore)	Morocco: Concession (Onshore)	Morocco: Concession (Deep Offshore)	Tunisia: Concession without Participation	Tunisia: Concession with Participation	Yemen: PSA (2007)
	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
	n.a.	10	25	25	n.a.	50	5
	n.a.	Carried through development	Carried through exploration	Carried through exploration	n.a.	Carried through development	Carried through development
	8	15	10	10	15	15	10
	0	10	10	10	0	0	0
	0	10	0	0	0	0	0

ANNEX TABLE 8.4.2.

Summary of International Comparator Countries Fiscal Regimes Modeled

	Australia: Concession	Brazil: Concession (Onshore)	Brazil: Concession (Deep Offshore)	Canada, Alberta: Concession (Onshore)
Bonuses				
Signature bonus (US$, millions)	n.a.	5	5	n.a.
Production bonus (US$, millions)	n.a.	n.a.	n.a.	n.a.
Production bonus type	n.a.	n.a.	n.a.	n.a.
Royalty				
Oil royalty rate (percent)	n.a.	10	10	10–40
Gas royalty rate (percent)	n.a.	10	10	5–36
Royalty type	n.a.	Flat	Flat	Variable price based
Production Sharing				
Profit petroleum sharing method	n.a.	n.a.	n.a.	n.a.
Cost recovery limit	n.a.	n.a.	n.a.	n.a.
Profit petroleum share to government	n.a.	n.a.	n.a.	n.a.
Carbon Tax				
Tax per ton of CO_2 equivalent emitted	n.a.	n.a.	n.a.	20–75
Corporate Income Tax				
CIT rate (percent)	30	34	34	23
Type of CIT	Standard with investment credit	Standard	Standard	Standard
Additional Profit/Rent Tax				
Tax rate (percent)	40	10–40	10–40	n.a.
Type of tax	Resource rent tax with uplift	DROP and profit margin based	DROP and profit margin based	n.a.
State Participation				
State participation rate (percent)	n.a.	15	15	n.a.
Type of state participation	n.a.	Carried through development	Carried through development	n.a.
Withholding Taxes				
Services: nonresident WHT rate (percent)	5	15	15	15
Interest WHT rate (percent)	0	15	15	10
Dividend WHT rate (percent)	0	0	0	5

Source: Authors and IMF's Fiscal Aanalysis of Resource Industries model.
Note: n.a. = not applicable; CIT = corporate income tax; DROP = daily rate of production; PSA = production sharing agreement; WHT = withholding tax.

Canada, Alberta: Concession (Oil Sands)	Canada, British Columbia: Concession	Norway: Concession	US, Federal: Concession (Offshore)	US, Federal: Concession (Onshore)	US, Texas: Concession
n.a.	n.a.	n.a.	10	10	10
n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
1–40	0–40	n.a.	18.5	12.5	27.2
5–36	9–27	n.a.	18.5	12.5	30.1
Variable price based	Variable DROP and price based	n.a.	Flat	Flat	Flat
n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
20–75	20–75	65–220	n.a.	n.a.	n.a.
23 Standard	27 Standard	22 Standard	21 Standard	21 Standard	22 Standard
n.a.	n.a.	71.8	n.a.	n.a.	n.a.
n.a.	n.a.	Resource rent tax with uplift	n.a.	n.a.	n.a.
n.a.	n.a.	27	n.a.	n.a.	n.a.
n.a.	n.a.	Working interest	n.a.	n.a.	n.a.
15	15	0	15	15	15
10	10	0	n.a.	n.a.	n.a.
5	5	0	n.a.	n.a.	n.a.

ANNEX TABLE 8.4.3

Projects		
	Onshore Oil Project	**Offshore Gas Project**
Oil production (millions of barrels)	373	25
Gas production (trillion cubic feet)	0	12
Production years	40	41
Capital expenditure (millions of 2023 $)	2,476	6,749
Unit operating cost (US dollars per barrel of oil equivalent)	5.1	6.1
Total costs (millions of 2023 $)	4,399	19,505
Total costs per barrel of oil equivalent (millions of 2023 $)	11.8	9.4
Pretax internal rate of return at constant real terms price of $60 per barrel and $6 per million British thermal units (percent)	53.1	25.7
NPV10 at constant real terms price of $60 per barrel and $6 per million British thermal units	5,357	6,301

Source: Authors and IMF's Fiscal Aanalysis of Resource Industries model.
Note: NPV10 = net present value at discount rate of 10 percent real.

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CHAPTER 9

The Potential for Corrective Fiscal Instruments on Energy Products

Nate Vernon-Lin and Alice Pirlot

INTRODUCTION

Environmental taxes, including carbon pricing, are key policy tools that address polluting activities by correcting market mispricing. These taxes ensure that households and firms consider (and pay for) the societal cost of undertaking polluting activities, which includes direct financial costs (captured by market prices) and the costs for other individuals, such as pollution-related diseases. The corrective tax reduces environmental damage, including greenhouse gas (GHG) emissions, to economically efficient levels while generating government revenue. Environmental taxes cover energy products, waste, transportation, water consumption, logging, and fishing. For statistical purposes, taxes imposed on physical units of consumption or production that have a "proven, specific negative impact on the environment" are generally classified as environmental taxes (European Union 2024).

This chapter focuses on fiscal instruments that apply to pollution from fossil fuels, the leading source of environmental costs in the Middle East and North Africa (MENA) region.[1] Fossil fuel use releases GHGs and other pollutants that contribute to costly global warming and local health damage.[2] It also connects indirectly to external costs such as congestion and road damage. These costs are macroeconomically significant in the region. For example, air pollution from fossil fuels and road vehicle accidents each cause 90,000 deaths per year, with annual economic costs of 4 percent of GDP. Congestion causes the average urban resident to spend two full days per year sitting in traffic at an economic cost of 0.2 percent of GDP.[3] Global warming risks are especially severe in the region because of relatively large projected increases in temperature and vulnerability to

[1] Focusing on pollution from fossil fuels does not imply that other environmental problems, such as water pollution and scarcity, do not exist in the region, but this chapter does not address them directly.

[2] The use of fossil fuels increases the concentration of harmful pollutants, which are small enough to enter the bloodstream and lungs, causing cardiovascular, lung, and other diseases, leading to more than 4 million deaths worldwide (IHME 2023).

[3] IHME (2023). See also Black and others (2023).

droughts, natural disasters, and sea level rise, with projected mortality-related costs of 1.6 percent of GDP by mid-century under a moderate temperature increase scenario (Duenwald and others 2022).

More ambitious policies are needed for MENA region countries to meet their domestic and international GHG reduction commitments. All but three countries in the region (Iran, Libya, Yemen) are parties to the Paris Agreement and have submitted emissions reduction commitments through the Nationally Determined Contributions (NDC) framework. Eleven have also pledged to achieve net zero emissions by mid- to late century,[4] and several have set methane reduction targets for the oil and gas sector. Under current policies, most MENA countries are projected to fall well short of emissions reduction targets, so stricter mitigation policies are needed.

Despite fossil fuel's large external costs and commitments to reduce emissions, most MENA countries underprice fossil fuel use. Explicit subsidies in the region (consumer prices below the international price of a fossil fuel) amounted to about 7 percent of GDP ($570 per capita) in 2023, well above global averages. In addition, undercharging for the external costs of local air pollution, global warming, road accidents, congestion, and road damage reached 14 percent of GDP, compared with 6 percent of GDP globally, reflecting low or no taxes on fossil fuels in many MENA countries.

This chapter provides guidance on designing fossil fuel pricing policies in the MENA region. It assesses both taxes and subsidies applying to oil, gas, and coal use against fiscal, environmental, economic, and distributional objectives and is divided into three main sections. The first section summarizes fuel use and related policies in the region. It highlights significant differences in energy consumption, efficiency, and sources among MENA countries and the general lack of common policies to address fossil fuel–related externalities, revealing substantial untapped potential for environmental and energy taxes. The second section describes and applies a framework to estimate economically efficient fuel price levels for all MENA countries, providing a benchmark for assessing existing pricing policies and reforms, and quantifies the impact of removing subsidies and implementing other reform options. The section also describes first-best measures to correct for these externalities. The third section provides practical guidance on how countries can select fiscal instruments to address environmental challenges while considering economic efficiency and other objectives, such as equity and competitiveness. The analysis highlights differences across countries and explains their implications for policy design.

[4] Net Zero Tracker (www.zerotracker.net).

CONTEXT

Energy Use and the Energy Mix

Aggregate energy use varies significantly across MENA countries, and some are among the most reliant on fossil fuels to power economic activity, while others are among the least (Figure 9.1, panel 1). The region stands out for its relatively small reductions in the energy intensity of GDP over the past two decades, that is energy consumed for each unit of economic output (Anderson and others 2022). In most hydrocarbon-exporting MENA countries, energy intensity far exceeds global averages and ranks among the highest in the world. This reflects near-total dependence on fossil fuels (Figure 9.1, panel 2), heavy reliance on energy-intensive sectors (especially oil and gas extraction and processing), a lack of energy efficiency (Islam, Moosa, and Saliola 2023 and UN 2019), and high demand for building cooling and water desalination. By contrast, hydrocarbon-importing countries have on average about half the energy intensity of exporters and are slightly less dependent on fossil fuels.

Energy use per capita also varies substantially in the region (Figure 9.1, panel 1), due largely to two factors: (1) electricity access is nearly universal in all exporters except for Libya and Yemen, but less than two-thirds in several importers; and (2) the scale of industrial and power generation energy use, which is much higher in many exporting countries.

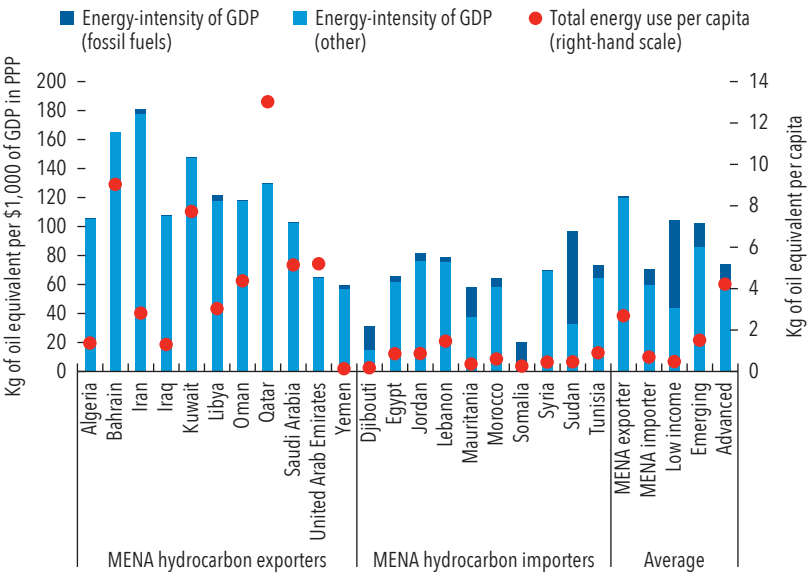
Hydrocarbon exporters consume far more natural gas than importers and devote a larger share of energy to industrial activity (Figure 9.1, panels 2 and 3). Exporters rely almost entirely on natural gas and oil, which account for about 60 percent and 40 percent of total energy, respectively. Importers show more variation: Some use mainly oil (Lebanon, Mauritania), others use biomass (Djibouti, Somalia, Sudan), and one-third of countries have more diversified energy sources (for example, Egypt, Morocco, and Tunisia). The region uses significantly less coal than the rest of the world, which has important implications for pollution because coal- and biomass-based energy are the most harmful. Across MENA countries, about 40 percent of energy is used for power generation and 20 percent to 30 percent each for transportation and industry. The share used for power generation varies by country—for example, Djibouti's and Somalia's shares are less than 10 percent because they lack industrial-scale power plants.

The share of renewables in electricity generation is currently low in most MENA countries but is rising in some (Figure 9.1, panel 4). Hydrocarbon exporters generate only about 3 percent of their electricity from renewable sources, although several countries have ambitious plans to increase renewable electricity generation and have recently mobilized significant private investment (for example, Saudi Arabia and the United Arab Emirates). Hydrocarbon importers generate a larger share of electricity from renewables—22 percent in 2021. Overall, the region has some of the world's best solar power potential (World Bank 2020).

National oil companies play an important role in the economies and energy transitions of several MENA countries (see Chapter 8). Investment in clean

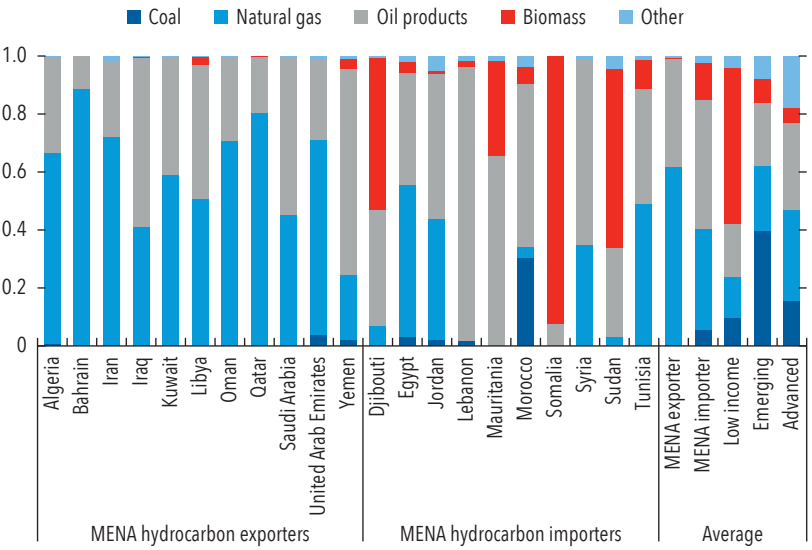
Figure 9.1. Summary of Energy Use

1. Fossil Fuel Intensity of GDP and Energy Use per Capita



2. Shares of Energy Use by Source

(Share of total energy use)

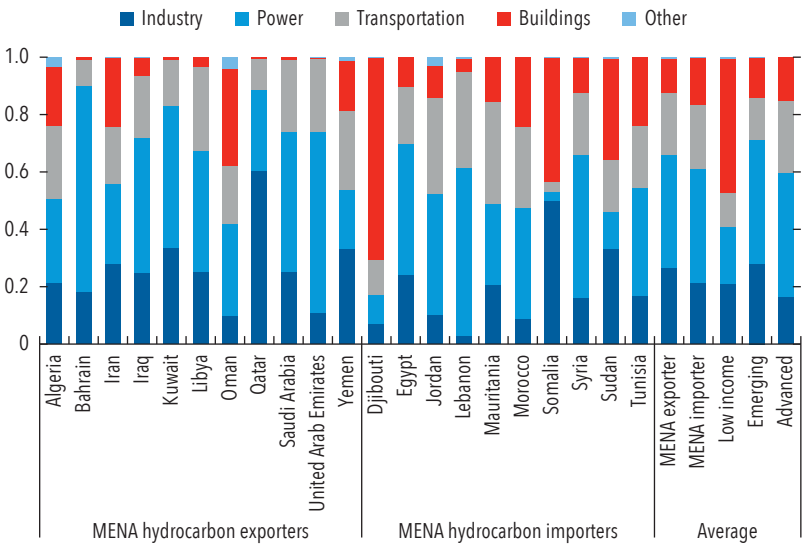


Sources: Authors' calculations using Enerdata (renewable share); and the Carbon Pricing Assessment Tool.
Note: Oil products include liquified petroleum gas. MENA = Middle East and North Africa; PPP = purchasing power parity.

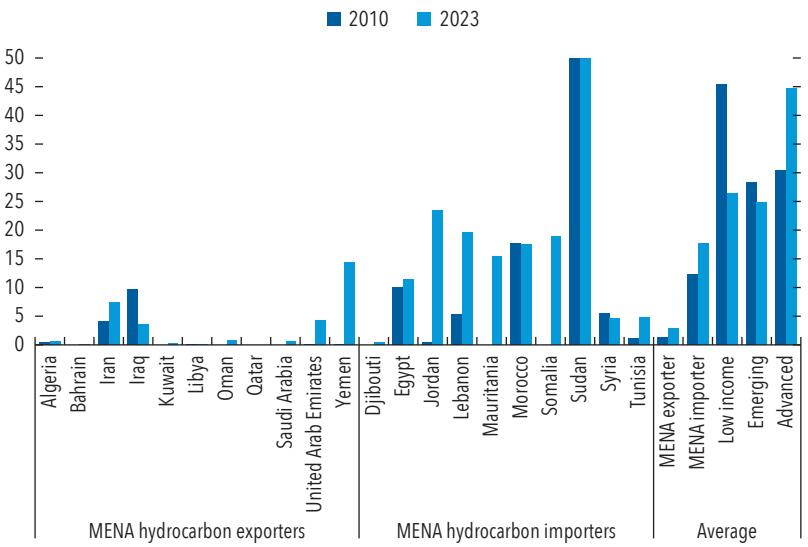
(Continued)

Figure 9.1. Summary of Energy Use *(Continued)*

3. Energy Use by Sector
(Share of total use)



4. Renewable Energy Share in Electricity Generation
(Percent)



Sources: Authors' calculations using Enerdata (renewable share); and the Carbon Pricing Assessment Tool.
Note: Oil products include liquified petroleum gas. MENA = Middle East and North Africa; PPP = purchasing power parity. .

energy remains low compared with fossil fuels, but increased investment in solar energy shows that a transition is possible (Oman, Saudi Arabia, United Arab Emirates). In addition, foreign demand for clean energy is boosting investment in hydrogen projects in Egypt, Oman, Saudi Arabia, United Arab Emirates (IEA 2023a).

MENA countries have different economic and energy mix starting points. Hydrocarbon-exporting economies are highly energy-intensive and rely almost entirely on fossil fuels, while hydrocarbon-importing countries have more diverse energy sources but lower access to energy. In exporting countries, the fossil fuel intensity of production and household activities highlights the need for revenue recycling to protect industrial competitiveness and vulnerable households when policies raise energy prices. Less developed countries, with lower energy access and likely limited fiscal space, must balance higher energy prices with broader developmental considerations. Energy subsidies are an ineffective way to support vulnerable households, and corrective taxes can support revenue mobilization. Poor energy efficiency and strong renewable energy potential across most MENA countries (because of sunlight intensity and available land) produce opportunities to reduce pollution cost-effectively if policies create the appropriate enabling environment.

Environmental Policies Related to Fossil Fuel Use

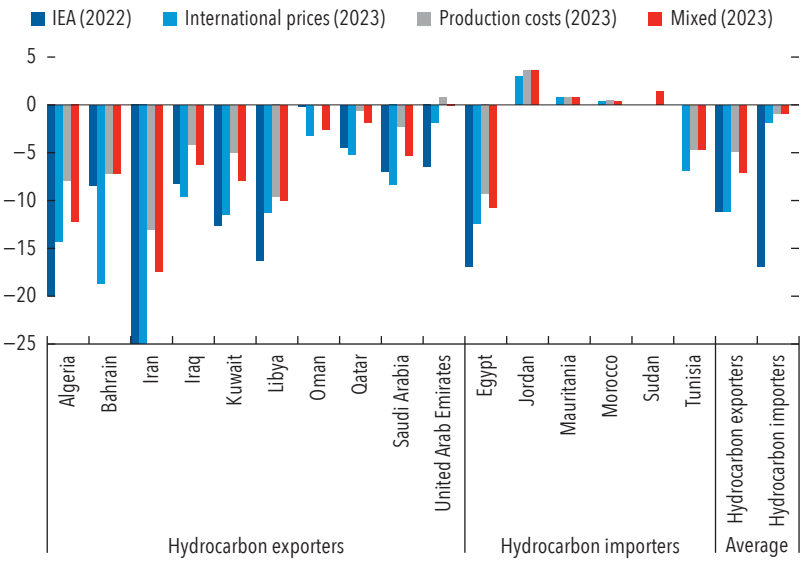
Few MENA countries tax fossil fuel consumption, and none explicitly prices the externalities of fossil fuel use. Several countries (Egypt, Jordan, Lebanon, Morocco, Sudan, Tunisia) apply excise duties on energy products, which put an implicit price on carbon emissions for at least some fossil fuel products, though at extremely low levels in some cases. Other MENA countries generally fall into two categories: those that set fossil fuel prices at fixed levels (for example, Algeria, Libya, and Mauritania until 2025), and those that allow prices to fluctuate with international prices but do not tax fuel use (for example, Oman and the United Arab Emirates). Fixed-price regimes can result in implicit taxes when prices are low and subsidies when prices are high. Some countries impose import duties on fossil fuels (for example, Jordan, Mauritania, Morocco, Sudan).[5] No MENA country has adopted explicit carbon pricing.

Many MENA countries impose excises on other socially harmful products, which provides a legislative framework that could extend to fuel taxes. A few countries have introduced excise duties on products such as cigarettes, alcoholic beverages, soft drinks, energy drinks, and luxury goods, but not on energy (see Chapter 7).[6] In some of these countries, excise legislation is relatively recent. For example, Gulf Cooperation Council (GCC) countries concluded the Common

[5] Import duties increase fossil fuel prices but target externalities ineffectively because the external cost of consuming a unit of fossil fuel is fixed, while duties are usually expressed as a proportion of value.

[6] These countries are Algeria, Bahrain, Egypt, Mauritania, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

Figure 9.2. Revenues and Subsidies of Fossil Fuels
(Percent of GDP)



Sources: Authors' calculations using Parry and others 2023; and IEA (2023b).
Note: The *y*-axis is capped at –25 percent of GDP. Djibouti, Lebanon, Somalia, Syria, and Yemen are excluded for lack of retail price data. IEA data provides only subsidies, not taxes, and are available only for hydrocarbon exporters and Egypt. Authors' calculations use a pretax price equal to international prices for oil products and, for others, the weighted average domestic production costs and international prices, recognizing that international trade in natural gas, coal, and electricity could be limited by the lack of export and import infrastructure (Mixed [2023] reflects this scenario). IEA = International Energy Agency.

Excise Tax Agreement of the States of the Gulf Cooperation Council in 2016, which became the basis for adopting or proposing excise duty legislation.[7] Other MENA countries, such as Iraq, have not yet introduced such legislation.

The lack of excise taxes on energy products is unsurprising because many MENA countries continue to subsidize energy products heavily, although several have begun to reduce or remove these subsidies. Because comprehensive, consistently measured data are unavailable to assess tax and subsidy levels in MENA countries, this chapter presents estimates that compare retail prices with pretax market prices (that is, reference prices or supply costs) for each energy product. When retail prices exceed pretax levels, taxes are assumed to apply; when they fall below, subsidies are assumed to be in place. Figure 9.2 shows estimated fiscal costs of subsidies and revenues from taxes across MENA countries, along with data from the International Energy Agency (IEA 2023b). The methodology, which is

[7] The GCC agreement does not require GCC members to impose excises on energy products. It states that excise taxes apply to a list of goods "deemed harmful to human health and the environment" to be determined by a ministerial committee.

generally referred to as the price-gap approach, and alternative approaches are explained in the following section.

Fossil fuel exporters generally provide explicit subsidies for fossil fuel use, while other countries tend to impose light taxes. Oman, Qatar, and the United Arab Emirates are the only exporters that do not provide large energy subsidies. Other exporters provide subsidies ranging from 5 percent to 25 percent of GDP in 2023. Average explicit subsidies among exporters increased from 5 percent to 8 percent of GDP between 2019 and 2022 (because the 2021–22 surge in international fossil fuels prices was generally not passed on to consumers) and then fell to 7 percent in 2023. Hydrocarbon importing countries maintained subsidies at 1 percent of GDP during this period. Jordan is the only MENA country that raises more than 2 percent of GDP from fuel taxes or that regulates prices above international levels. Most governments—both hydrocarbon importing and exporting—subsidize electricity generation, which effectively subsidizes fossil fuel use because almost all power in the region is generated from natural gas, oil, and coal. Several countries cross-subsidize some energy products (for example, Mauritania and Morocco for liquified petroleum gas [LPG] and electricity), and most subsidies go to natural gas and electricity.

Some MENA countries provide explicit tax incentives to the energy sector. Certain incentives favor polluting and harmful activities by granting tax exemptions to carbon-intensive sectors, while others promote renewable energy products and clean technologies. For example, all fossil fuel–exporting countries have special regimes for oil and gas extraction activities (see Chapter 8), and some provide special tax incentives for hydrocarbon processing activities. By contrast, Jordan exempts electric vehicles from customs duties and registration taxes, Morocco exempts hybrid and electric vehicles from the special annual vehicle tax (also called the circulation tax), and Egypt allows tax deductions for investments in projects that rely on renewable energy or produce it (equal to 30 percent of investment costs).

Other taxes, charges, and tax incentives related to polluting activities also apply in the region. Some countries (for example, Algeria, Djibouti, Egypt, and Morocco) have introduced ad hoc taxes on specific sectors and activities, such as airlines and mining, and on certain products and materials, deemed harmful to the environment, such as plastics and cement. Several countries charge tolls for highway use (Iran, Morocco, Saudi Arabia, and the United Arab Emirates), but only Iran varies tolls according to (a proxy of) congestion levels. In addition, through state-owned entities, governments have direct managerial and financial influence over energy- and emissions-intensive activities of extraction, processing, and distribution of crude oil and natural gas.

Other measures addressing pollution from fossil fuels remain scarce in the region. While corrective pricing measures generally provide the most efficient ways to reduce pollution, regulatory and other nonfiscal policies can be useful complements. Key policies include (1) fuel economy standards for new vehicles, adopted in several MENA countries including Morocco, Oman, Qatar, Saudi Arabia, and the United Arab Emirates (BNEF 2023); (2) air quality standards

that set limits on pollutant levels at city, regional, or country levels, which are in place in more than 10 MENA countries, though their administrative strength and stringency were not analyzed (UNEP 2021); and (3) taxes on initial vehicle registration and annual road use, applied in most MENA countries with some varying by a vehicle's emissions intensity (Jordan and Morocco).

The social protection system's ability to provide targeted support to vulnerable households is crucial for social cohesion and political acceptance of carbon pricing reforms. Social protection systems in most MENA countries remain weak. The region spends less on cash transfers than any other region, but Iraq and Jordan are exceptions (Ridao-Cano and others 2023). Fossil fuel subsidies are a large share of social spending but are targeted poorly, because wealthier households receive most of the benefits (IMF 2014; Ridao-Cano and others 2023).

Electricity market design is another key consideration. When prices are regulated and investment is restricted, changes in fuel prices for power generation may not pass through to consumers, which limits the effectiveness of price-based policies in influencing consumption and investment decisions.

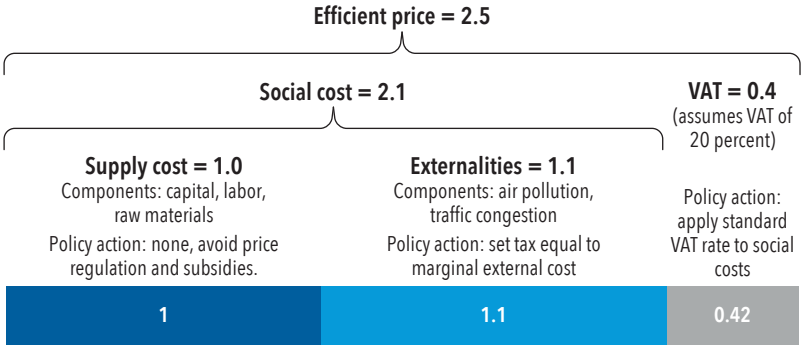
In summary, there is substantial scope to strengthen and expand environmental policies related to fossil fuel use in the region. Fuel taxation and related policies are limited, leading to underpricing of environmental costs compared with most other regions and reducing fiscal space. However, several countries already have the institutional and legal frameworks to improve policy effectiveness at low administrative cost, including raising fuel taxes and tightening fuel economy standards. Increasing fuel prices while expanding income-based social support could improve the efficiency of social spending and create fiscal space for other objectives.

EFFICIENT FUEL PRICING AND EXTERNALITIES

This section estimates efficient fuel prices for MENA countries and compares them with current prices, which helps quantify the scope to increase prices by removing subsidies and increasing taxes. The efficient price estimates in the chapter use a well-established framework (following Parry and others 2014 and Parry and others 2023).

Designing a tax on fossil fuel pollution begins with considering the efficient price level, which is the price that reflects all social costs, which include (1) financial or monetary value (supply costs), (2) marginal external cost (externalities), and (3) generally applicable consumption tax (as shown in Figure 9.3). The resulting price leads to the economically efficient level of fuel consumption and environmental damage because fuel users face the full cost of consumption. Because pricing externalities often involves fiscal measures, the economically efficient price level also generates revenue. The following discussion examines each component of efficient prices, and Box 9.1 summarizes the basic economics of efficient pricing.

Figure 9.3. Efficient Pricing Policy



Source: Authors.
Note: VAT = value-added tax.

Box 9.1. Economics of Fuel Pricing

To assess the economics of fuel price reform in a given country, assume an example where the fossil fuel supply cost remains constant regardless of quantity (the country is a price-taker because it accounts for a small share of global consumption) and that demand for fossil fuels is downward sloping (households and firms consume less as prices rise) (Figure 9.1.1).

With an explicit subsidy, consumer prices (P1) are less than the supply cost (P2). The value of the subsidy equals the per-unit consumption subsidy multiplied by consumption (represented by the area C + F + I + H). Environmental costs equal the per-unit environmental cost multiplied by consumption (B + E + D + G). Consumer welfare equals the difference between the value to the consumer and consumer price (A + B + C + E + F + I). Economic efficiency costs equal the portion of consumption that consumers value less than the supply cost (H). Total welfare equals consumer surplus minus environmental, efficiency, and subsidy costs (A minus D, G, and H).

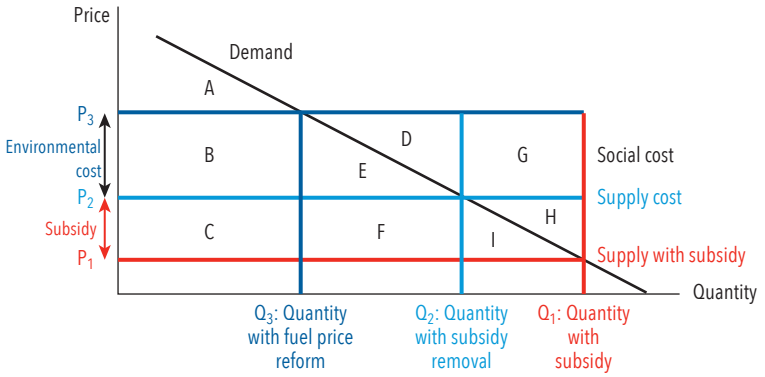
Removing explicit subsidies requires raising the price from P1 to P2. This reduces consumption from Q1 to Q2 and results in a fiscal gain equal to the initial subsidy amount (C, F, I, H), an increase in economic efficiency (because fossil fuels are now consumed only if the benefit exceeds the supply cost [H]), and a reduction in environmental costs due to lower consumption (G). Consumer surplus decreases (C, F, I), with a portion attributed to additional consumer costs/lost welfare to reduce consumption (represented by triangle I). Overall, there is a net welfare gain (G, H) and, importantly, fiscal benefits exceed the loss of consumer surplus (by H), implying that the government has enough revenue from the reform to fully

compensate those whose losses in consumer surplus exceed environmental benefits.

Full price reform requires increasing prices from P2 to P3, which would result in tax revenue and environmental costs of B and create an additional welfare gain of D.

GDP and welfare impacts could vary for several reasons, including that GDP considers changes in investment and the trade balance but not environmental benefits (Black and others 2022). Research finds small or no GDP impacts from carbon pricing, especially when carbon pricing and revenue recycling policies are well designed (Chateau, Jaumotte, and Schwerhoff 2022; IMF 2023; Metcalf and Stock 2023). Research also finds increased benefits when tax evasion and informal sectors are considered because fuel taxes are relatively easy to collect (Liu 2013). The welfare calculation here considers only domestic policies, not coordinated international climate policies that reduce global demand for fossil fuels significantly; does not capture income and employment impacts; and is partial equilibrium.

Figure 9.1.1. Revenue and Welfare Gains from Fuel Pricing Reform



Source: Authors.

Source: Authors.

Supply Costs

Supply costs reflect the fuel's monetary value. For nontraded products such as electricity, the supply cost equals production and delivery costs. For traded products, such as oil and to some extent natural gas and coal, the monetary value represents the price that would be received for exporting the product, paid for importing it, or paid in a well-functioning domestic market, with upward adjustments for delivery costs.[8] This concept is crucial for fuel exporters because the supply cost is the value that could be received from exporting the fuel, and not the domestic production cost.

If export capacity for natural gas and coal is limited and no imports or domestic markets exist, then international prices arguably do not reflect the short-term opportunity cost of domestic consumption. Alternative valuation options include: (1) the international price that would be received if production were postponed until export capacity becomes available, discounted at the time value of money and a deduction for the per-unit cost of export facilities; (2) the weighted average international price and per-unit domestic production cost, including up-front capital costs, decommissioning costs, a return on capital to provide producers with full repayment of their investment, and distribution and marketing costs;[9] the average is weighted by the share of domestic versus imported consumption; and (3) the international price of the good minus non-fossil fuel production costs for fuels used to produce internationally traded goods (petrochemicals and steel).[10] For each option, transport and marketing costs to end users are deducted to determine the wellhead price. For electricity, which is generally not traded internationally, the domestic production cost is most relevant.

From an economic (or national wealth) perspective, the highest of those values should apply because a profit-maximizing fossil fuel resource owner would charge the highest possible price. Option 2 may best reflect budgetary costs because it relates to the financial costs of producing and transporting the fuel and is the most straightforward to calculate.

For the efficient price calculations, the supply costs were estimated as follows: the nearest international hub price (for oil products), the average posttax domestic production cost and the nearest international hub price weighted by the share

[8] Assuming that no policies increase the cost of exports, a competitive domestic market is preferred because it best reflects the value of consuming the fossil fuels domestically. In practice, the difference between international and domestic prices matters only for natural gas and coal because oil markets are internationally integrated and price differences are small.

[9] Associated natural gas complicates estimation because calculating per-unit costs requires allocating production costs to oil and natural gas separately, even though many costs—such as exploration and drilling—are likely shared.

[10] For example, if subsidized natural gas is used to produce petrochemicals, an efficient petrochemical producer earns excess profits when selling those products on international markets. These excess profits should accrue to the fossil fuel resource.

of consumption that is domestically produced (for natural gas and coal),[11] or the estimated cost-recovery level (for electricity). Each estimate includes margins for transportation, distribution, and processing (see Parry and others 2023 for more details).

Externalities

Climate Change

GHG emissions differ widely across MENA countries. Saudi Arabia and Iran both emit more than 1 percent of global emissions (counting only emissions within domestic boundaries, not exported fossil fuels), while countries such as Djibouti, Jordan, Mauritania, and Yemen contribute less than 0.1 percent. Overall, the region's share of global emissions has risen from less than 1 percent in 1960 to about 8 percent today and is expected to increase further with population and economic growth (Arslanap, Kostal, and Quiros-Romero 2022).

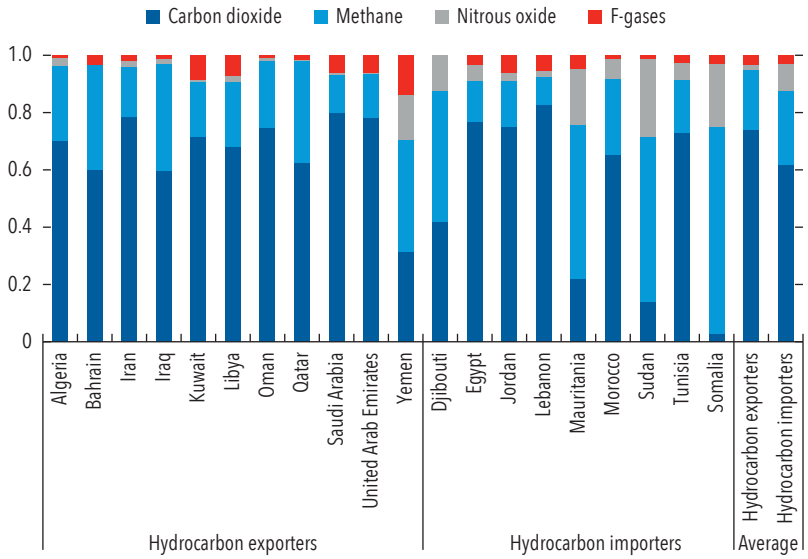
Damage from global warming results from emissions of carbon dioxide and short-lived climate pollutants, mainly methane and nitrous oxide (Figure 9.4). Carbon dioxide is the primary GHG in all MENA countries except for Mauritania and Yemen, where methane emissions from agriculture and waste are relatively high. Oil and gas extraction emits methane primarily through venting and leaks during the production process, which explains its significant contribution in some MENA countries. Across hydrocarbon exporting countries, industry and oil and gas extraction account for 45 percent of total emissions. Power generation and transportation each contribute about 20 percent, ranging from less than 20 percent in Yemen and Qatar to more than 50 percent in Jordan, Saudi Arabia, and others. Mauritania and Tunisia record negative emissions from land-use change because of net increases in forest carbon capture, while most other countries have little or no emissions from this sector. The large variation in GHG sources and types across MENA countries reveals that the effects of mitigation policies and the economic costs of reducing emissions reductions will differ across the region.

CO_2 emissions are relatively easy to tax, compared with other externalities and non-CO_2 emissions. A carbon tax can be levied on the carbon content of a fuel because emissions and therefore damage do not depend on who consumes the fuel or where it is consumed. This differs from local air pollution, for which damage varies by location and other factors. A carbon tax is most easily applied at the points of importation and production, with rebates for firms that capture carbon and for exported fuels. Globally, more than 40 countries now have some form of carbon pricing either through a tax or an emissions trading system (ETS) (World Bank 2023). Methane and nitrous oxide are more difficult to tax because

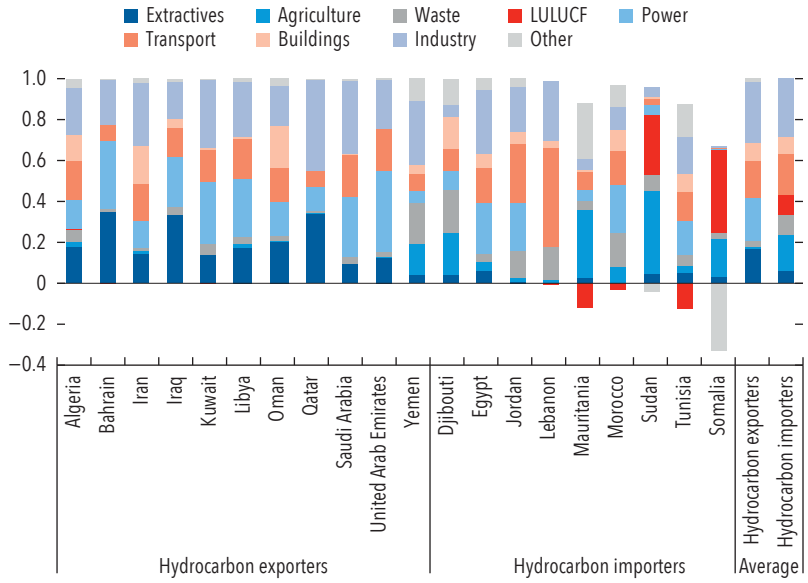
[11] Domestic production costs for natural gas and coal are used for simplicity because reliable country-level data on the timing of additional export capacity and the share of fuel used for traded goods are either unavailable or uncertain. A detailed country-level analysis could use the hierarchy of options listed in the previous paragraph.

Figure 9.4. Greenhouse Gas Emissions

1. Shares by Type of Greenhouse Gas



2. Shares by Source of Greenhouse Gas



Source: Authors' calculations using the Carbon Pricing Assessment Tool with data from the United Nations Framework Convention on Climate Change and the Emissions Database for Global Atmospheric Research.
Note: "Industry" includes industrial processes. "Extractives" covers only methane emissions. F-gases = flourinated gases; LULUCF = land-use, land-use change, and forestry.

they come from various sources such as farms, oil and gas wells, and waste sites, but some countries tax methane or impose penalties on excessive methane emissions (such as Brazil, Nigeria, Norway, and the United States until 2025).

The efficient carbon price level is highly uncertain, but a simple approach is to determine the level needed to achieve climate mitigation targets.[12] A target-aligned price can be calibrated to meet global or national mitigation goals. For example, to limit global warming to 2°C (the upper bound of the Paris Agreement), several prominent studies estimate that the additional global carbon price must reach $75 to $100 per ton by 2030 (World Bank 2017). To promote equity, this price could vary by income level: for example, Black and others (2022) estimate prices of $115, $65, and $45 per ton by 2030 for high-, middle-, and low-income countries, respectively. Alternatively, countries can align their pricing policies with the levels required to achieve their NDCs. Based on the Carbon Pricing Assessment Tool,[13] additional effective carbon prices of $7 to $140 per ton of emissions may be needed if no other policies are introduced (Figure 9.5).[14] However, this approach would fail to deliver economically efficient mitigation because efficient mitigation requires carbon prices to be aligned across countries. Differences in needed carbon prices reflect variations in NDCs, baseline emissions projects (mainly affected by GDP and population growth), and abatement costs. Emission reductions in agricultural, transport, and building-related emissions are relatively costly, while reductions in coal use in power and industry or methane emissions from extractives are less costly.[15] Abatement is also relatively cheap in countries with existing subsidies or low taxes because low-cost abatement options have not yet been incentivized.

The equivalent carbon tax of $75 per ton of CO_2 can be calculated using emissions factors per unit of fuel, as outlined in the example table below. The effect of the tax on electricity prices depends on the degree of market competitiveness and the energy sources used for generation. In liberalized markets, higher generation costs are passed through to consumers, allowing consumption decisions that reflect the carbon content of generation.

[12] The efficient GHG price level is highly debated. One approach uses the social cost of carbon, which is the marginal cost of an additional ton of emissions. Estimates of the social cost of carbon are sensitive to assumptions.

[13] The Carbon Pricing Assessment Tool (CPAT) was developed jointly by the IMF and the World Bank. The IMF uses CPAT to assess and support the design of environmental tax and climate mitigation policy options. The tool is a reduced form model of several subsectors and fuel types across the economy (see Black and others 2023 for more details).

[14] For example, the United Arab Emirates plans to implement several policies not captured in the baseline emissions trajectory presented here. Together, these policies are projected to achieve the country's NDC and correspond to a mitigation effort equivalent to a $134 per ton carbon price (MOCCAE 2023).

[15] For example, the NDCs of Jordan and Morocco imply similar emission reductions relative to business-as-usual levels, but Morocco's significant coal use allows it to reduce emissions at relatively low cost by switching to natural gas and renewables. Jordan's emissions, concentrated in transport, are costlier to abate, and the country already applies significant taxes with minimal coal use.

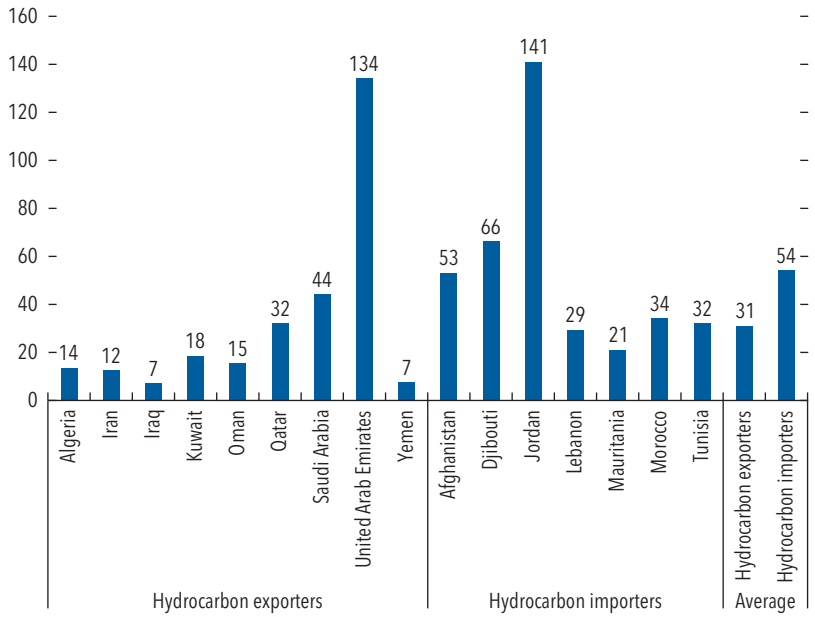
EXAMPLE TABLE

Estimated Impact of a $75 per Ton CO_2 Tax

Fuel Type	Emissions Factor	Unit	Equivalent Carbon Tax (US dollars per unit)
Coal	88–98 kg CO_2 (depending on coal type)	per gigajoule	7.10
Natural gas	56 kg CO_2	per gigajoule	4.20
Oil	70 kg CO_2	per gigajoule	5.20
Diesel	2.7 Kg CO_2	per liter	0.20
Gasoline	2.3 kg CO_2	per liter	0.18

Source: Energy Information Administration, "Carbon Dioxide Emissions Coefficients" (https://www.eia.gov/environment/emissions/co2_vol_mass.php, accessed August 14, 2023).

Figure 9.5. Carbon Price Required to Achieve Targets
(US 2021 dollars per ton)



Source: Authors' calculations using the Carbon Pricing Assessment Tool.
Note: The average of unconditional and conditional NDCs are used. Bahrain, Egypt, Libya, Sudan, and Syria have NDCs without quantifiable economy-wide targets. Somalia is excluded because it achieves its NDC without additional policies. Bahrain has a target in its Energy Strategy. MENA = Middle East and North Africa; NDC = Nationally Determined Contribution.

Local Air Pollution

Burning fossil fuels is a major source of air pollution, which is the third leading risk factor for premature death globally after high blood pressure and smoking

(IHME 2023). Combustion of fossil fuels releases or contributes to fine particulate matter (PM2.5) and low-level ozone, which cause or worsen heart and lung diseases.[16] Other sources of particulate matter include dust, sea salt, waste burning, and land-clearing fires. PM2.5 accounts for about 92 percent of air pollution–related deaths, and fossil fuel use contributes about 60 percent of global PM2.5 emissions (IHME 2023). The MENA region's share is slightly lower, partly because urban areas lie close to sand and the sea, with estimates ranging from 20 percent to 52 percent.[17] For example, almost 90 percent of pollution in Tunis comes from fossil fuels, compared with only 34 percent in Baghdad. Industry and transportation are the main fossil fuel sources of PM2.5 (Heger and others 2022; Hopke and others 2020; Karagulian and others 2015).

IHME (2023) estimates that about 290,000 people in the MENA region died from outdoor air pollution in 2019.[18] PM2.5 concentrations exceed global averages, especially in some of the region's most populated cities, and all countries have average exposure to PM2.5 concentrations well above the World Health Organization guideline of less than 5 micrograms per cubic meter (Figure 9.6). The levels are slightly higher in hydrocarbon exporting countries. Overall, outdoor air pollution contributes to 10 to 25 percent of premature deaths (except in Somalia). Some less developed countries in the region have limited access to clean cooking fuels, which contributes to high rates of indoor air pollution–related deaths.[19] Abu Dhabi, Bahrain, Dubai, Doha, Kuwait City, and Tehran rank among the 25 cities with the highest PM2.5 concentrations globally, while Doha, Bahrain, Kabul, and Kuwait City rank similarly for ozone levels. No cities in the region fall within the lowest one-third globally.

The monetary cost of premature deaths and mortality caused by air pollution from fossil fuels ranges from 0.5 to 3.5 percent of GDP across countries.[20] In most MENA countries, diesel and natural gas are the main causes of fossil

[16] PM2.5 is a particulate matter with diameters of up to 2.5 micrometers and is especially harmful because it is small enough to enter the bloodstream and lungs, causing heart disease, stroke, lung cancer, and other diseases. PM2.5 is released directly from burning fossil fuels—primarily coal, diesel, and biomass—and formed indirectly through precursors emitted from fossil fuel consumption (such as nitrous oxide and sulfur dioxide) reacting with the atmosphere. Ozone forms through reactions between precursors emitted during fuel consumption or leaks (including methane) and the atmosphere, exacerbating lung disease. Other harmful pollutants are associated with fossil fuel use but have comparatively minor effects.

[17] Hopke and others (2020) and Karagulian and others (2015) find the share of PM2.5 from fossil fuel use is 52 percent, and Black and others (2023) find 20 percent. For this analysis, 20 percent is taken as a conservative approach.

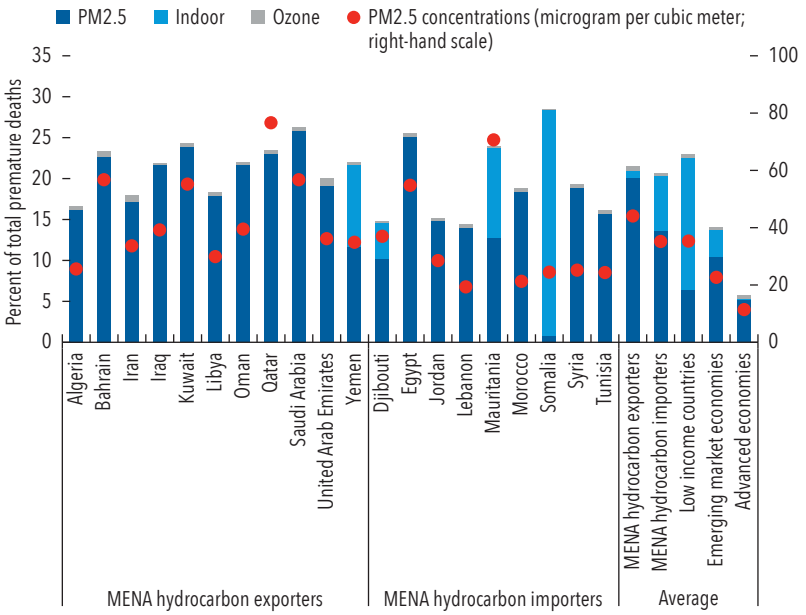
[18] While evidence links air pollution to an increased number of deaths, the exact relationship is uncertain. One study estimates 10 million deaths per year from ambient air pollution (Vohra and others 2021), which is 50 percent higher than the Global Burden of Disease estimate (IHME 2023).

[19] Data are from Global Health Observatory database, "Cooking Fuels: Proportion of Population with Primary Reliance on Clean Fuels and Technologies for Cooking (%)," accessed November 8, 2025 (https://www.who.int/data/gho/data/indicators/indicator-details/GHO/gho-phe-primary-reliance-on-clean-fuels-and-technologies-proportion).

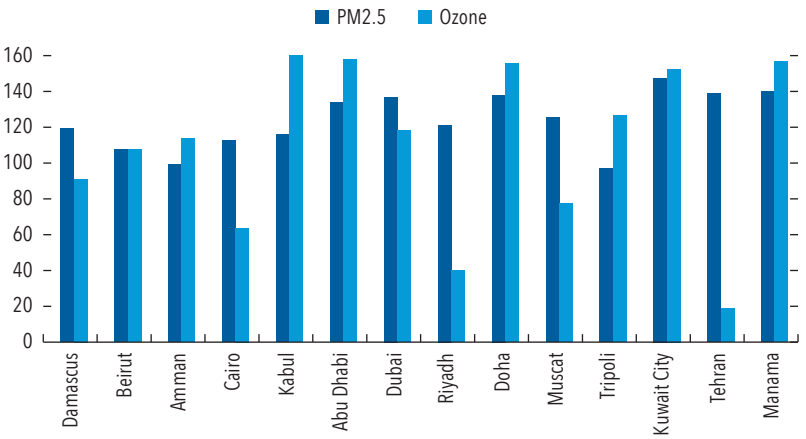
[20] Economic costs are measured by multiplying deaths from air pollution by the value of statistical life.

Figure 9.6. Air Pollution Deaths and Concentrations

1. Deaths and PM2.5 Concentration



2. Air Pollution by City



Sources: CEIC (www.ceicdata.com); and authors' calculations using the Carbon Pricing Assessment Tool based on IHME (2023).
Note: Country-level air pollution concentrations and premature deaths refer to 2019. City-level air pollution is averaged between January 2019 and March 2023 and covers major cities.

fuel-related air pollution deaths, while other energy use (including biomass) and air pollution not linked to any specific fuel are major sources in some countries, such as Djibouti and Egypt (Figure 9.7, panel 1). Damage from gasoline is small compared with diesel, but diesel-related pollution can be reduced through abatement technologies (such as catalytic reduction systems that reduce nitrogen oxide emissions), fuel sulfur standards which reduce sulfur dioxide emissions, engine standards, and incentives to replace older vehicles with newer, cleaner ones. Other oil products also cause significant health damage in the region, including diesel used for non-road activities and oil used in petrochemical or other industrial processes. Diesel used for power generation in urban areas is especially harmful because pollutants are released at ground level. Coal is the largest fossil fuel contributor to air pollution deaths globally but plays a minor role in the region because of minimal use and reliance on natural gas.

The monetary cost of pollution translates directly into efficient corrective taxes. Figure 9.7, panel 2 shows average corrective taxes for selected pollutants and sources for MENA countries with available data. Efficient fees for key pollutants from power generation range from $500 to $11,000 per ton, reflecting differences in per capita income (which are assumed to translate into differences in the value of statistical life), and the relationship between pollutant emissions and population exposure across countries. This exposure depends partly on the proximity of power plants to population centers, prevailing wind patterns, and baseline pollution levels. These corrective tax levels may exceed sulfur dioxide and nitrogen oxide abatement costs for power plants and industrial sources, although costs can vary with the type of industrial activity and technologies used (for example, Zhang and others 2020). In most countries, costs are highest for oil-based power generation (and coal, not shown in the figure) and are higher for residential than for industrial and power sector natural gas. These patterns likely result from pollution being released closer to population centers and closer to the ground, without abatement equipment. While Figure 9.7 presents a single efficient tax for each country, in theory, the tax should be specific to each polluting facility, varying with the damage from pollution emitted at that specific location and the facility's configuration (for example, smokestack height). For instance, Chile's tax on local pollutants differentiates the tax level to some extent.[21]

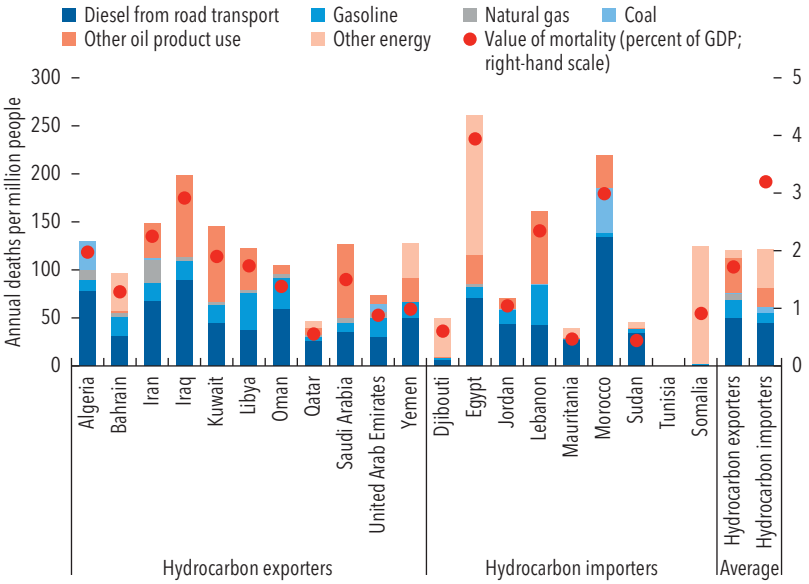
Driving-Related Externalities

Driving externalities (beyond deteriorating air quality) include road congestion (time lost), accidents, and road damage (which increases the need for public spending). Households and businesses do not consider (1) the increase in congestion their driving causes, which results in greater delays for other drivers and reduces their time value; (2) the cost of accidents to pedestrians or occupants of

[21] Specifically, Chile's law applies a tax to PM2.5, nitrogen oxides, and sulfur dioxide based on the surrounding air quality (worse air quality results in a higher tax), the estimated per-unit damage of each contaminant (a specific level across the country), and the size of the local population (Puyo and Zhunussova 2023).

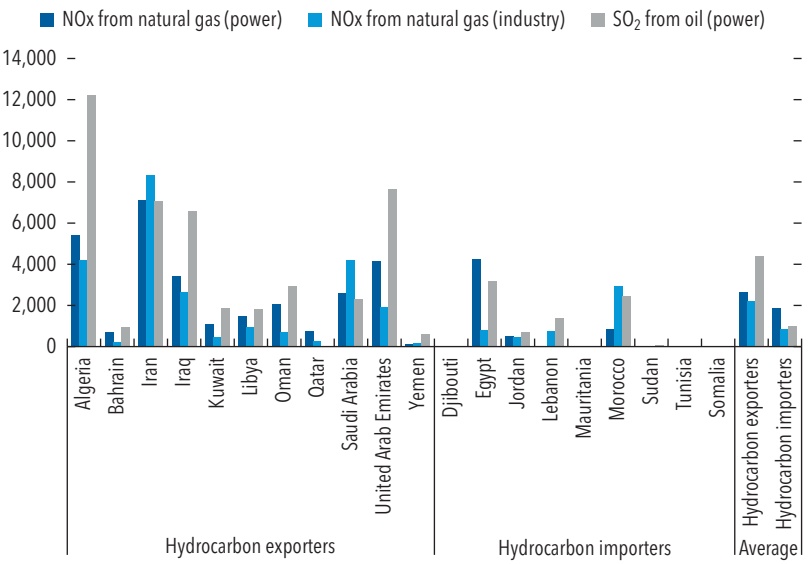
Figure 9.7. Air Pollution, Deaths, and Concentrations

1. Deaths and Monetary Value of Mortality and Morbidity from Fossil Fuels



2. Efficient Fees and Fuel Taxes for Local Pollutants

(US dollars per ton)



Source: Authors' calculations using the Carbon Pricing Assessment Tool.
Note: The relationship between emissions and pollutants inhaled by individuals uses the average of an intake fraction and TM5-FAst Scenario Screening Tool approach. Bars are excluded if the sector combination has no consumption of the given fuel. NOx = nitrogen oxides; SO_2 = sulfur dioxide.

other vehicles, which results in injuries and deaths; and (3) road damage, which must be funded through higher taxes or causes damage to other vehicles.

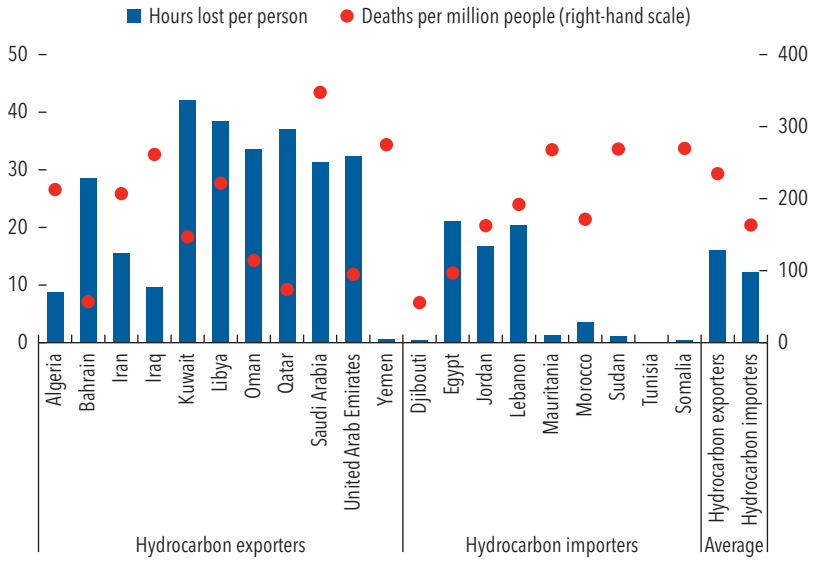
In hydrocarbon exporting countries, congestion and road fatality rates are highest, partly because of higher vehicle ownership and urbanization. On average, people in several countries (for example, the GCC countries and Libya), spend more than one day per year sitting in traffic, while in others, such as Yemen, they spend less time.[22] One study estimates that congestion in the greater Cairo area costs about 3.6 percent of national GDP, including additional local air pollution, reduced reliability, and lost time (World Bank 2013). Road fatality rates vary across countries and do not clearly follow the exporter-importer or income-level distinctions.

Indicators of congestion, accidents, and road maintenance spending are converted into estimates of the external cost per kilometer driven, following Parry and others (2023). Marginal congestion costs are assumed to be a multiple of the average congestion level because each additional driver delays multiple vehicles (Baumol and Oates 2012). Non-external damage from road accidents is excluded because drivers should consider their own and their passengers' safety. Road damage is disaggregated between natural wear-and-tear and damage caused by vehicles. Marginal congestion costs are highest in GCC countries, reflecting the higher value of time (linked to higher wage levels), heavy average congestion, and the large share of driving in urban areas, while congestion costs are minimal in many other countries. Accident costs are significant in many of the region's developing countries because, despite a lower value of statistical life, fatal accidents per kilometer driven are extremely high. These high fatality rates generally result from faster driving in rural areas, more pedestrians near roads, and older vehicles with fewer safety features (Parry and others 2014; Figure 9.8). Road damage is more uniform across countries and is mainly attributed to diesel vehicles (often traveling longer distances) because damage increases exponentially with vehicle weight, and diesel engines power heavier vehicles (Figure 9.9).

These externalities are addressed most effectively through distance-based charges that vary according to (1) actual congestions levels (for congestion); (2) a driver's and vehicle's fatal accident risk (for accidents) because heavier, larger vehicles pose greater risks to others and some drivers are more cautious than others; and (3) the vehicle's axle weight (for road damage). Some countries have introduced congestion pricing (for example, Nordic countries) and heavy-vehicle distance charges (such as Western European countries), using GPS data or, more simply, existing toll road systems. A driver's and vehicle's accident risk could incorporate data from insurance companies or be internalized indirectly by promoting vehicle insurance priced by distance driven. Taxes on road transportation fuels reduce driving and lower these external costs. They provide an approximate mechanism to ensure that drivers consider external costs when making transportation-related decisions.

[22] Because these data show per capita averages, they mask large differences across people within a country. For example, the amount of time people living in urban areas spend in traffic is above average.

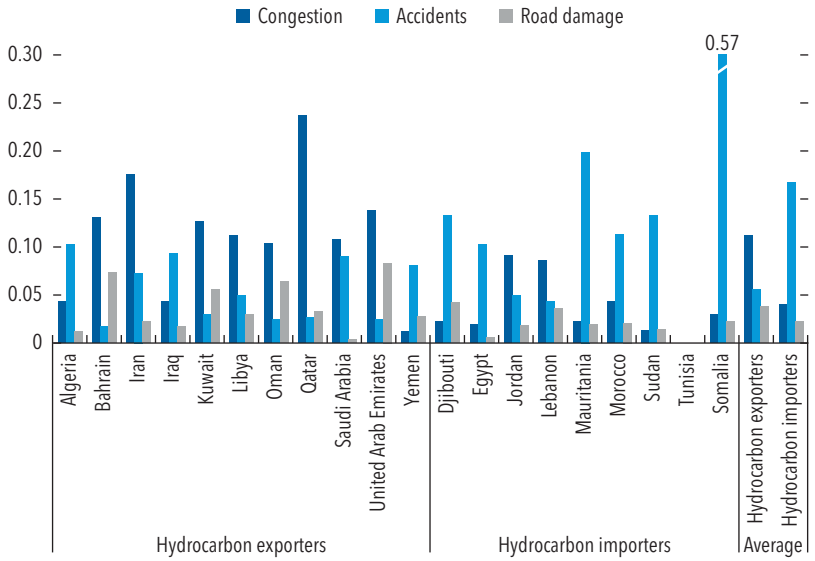
Figure 9.8. Congestion and Road Fatalities



Source: Authors' calculations using the Carbon Pricing Assessment Tool.

Figure 9.9. Efficient Road Transportation Prices

(US dollars per kilometer)



Source: Authors' calculations using the Carbon Pricing Assessment Tool.

General Consumption Taxes

The general consumption tax rate—typically a value-added tax (VAT)—should apply to all energy products and include any taxes that cover externalities in the tax base. This approach prevents the VAT from distorting relative prices, which improves the VAT's efficiency and revenue potential and aligns with the treatment of external costs.

Efficient Fuel Prices

The social cost for each fuel is estimated by aggregating the costs of individual externalities and the supply cost to determine the efficient price. External costs per kilometer and ton of local pollutant are converted to values per unit of fuel based on emissions factors (for example, kilometers per liter or tons of nitrogen oxide per gigajoule of natural gas). The efficient tax for driving-related externalities is then adjusted downward to capture only the portion of fuel demand reductions that results from reduced driving, rather than from energy efficiency improvements such as buying more efficient vehicles. This adjustment reflects that congestion, road damage, and accidents depend on distance driven, not fuel consumed. The general consumption tax rate is then applied based on the portion of fuel consumed by households relative to firms.

Comparing efficient fuel taxes with retail prices shows substantial scope to increase prices (Figure 9.10). Key findings include the following: (1) Existing prices result in significant subsidies, especially for natural gas, in several countries where prices are held below supply costs; (2) prices reach efficient levels in only a few cases (for example, gasoline in Mauritania and Jordan); (3) local air pollution costs as a share of supply costs are highest for diesel (50 percent to 100 percent of supply costs in most countries), while global warming damage is highest for natural gas; (4) road transportation externalities are substantial, driven by high congestion in wealthier countries and road accidents in poorer ones; and (4) diesel prices are generally lower than gasoline prices, despite diesel's higher external costs.

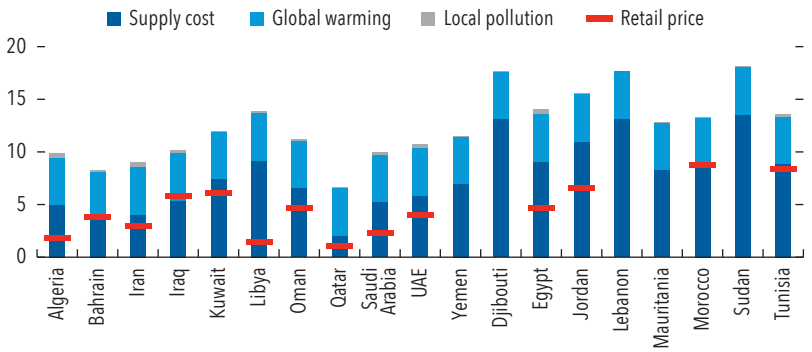
POTENTIAL ACTIONS

This section presents different options to reform energy pricing, given the significant scope for improvement and the need to correct for externalities. It first examines the sequencing of pricing reforms—from removing explicit subsidies to introducing fuel and carbon pricing—and quantifies their fiscal and environmental impacts. It then covers alternative policies that address fossil fuel–related externalities without raising consumer prices. The section also analyzes the main factors MENA countries should consider when adopting pricing and nonpricing policies: effects on competitiveness, distributional effects, administrative considerations, and legal aspects. It concludes with a set of potential policy packages that

Figure 9.10. Efficient Fuel Taxes in 2023

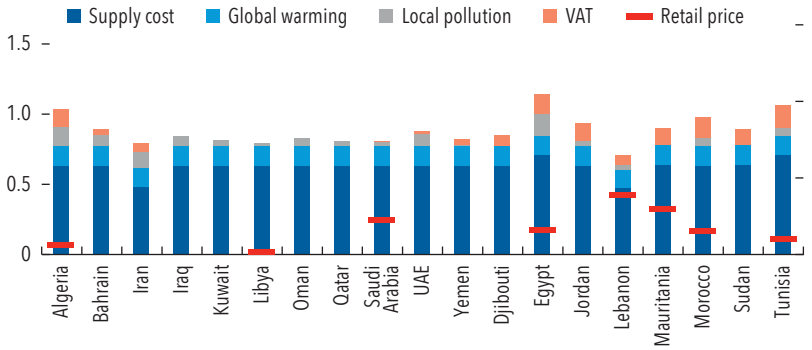
1. Natural Gas

(US dollars per gigajoule)



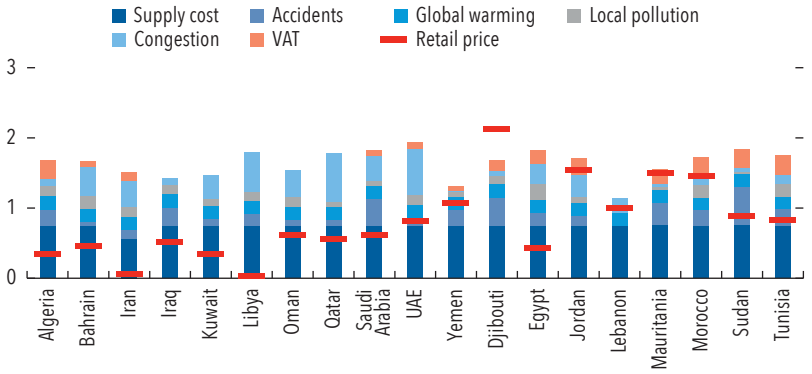
2. Liquified Petroleum Gas, 2023

(US dollars per liter)



3. Gasoline

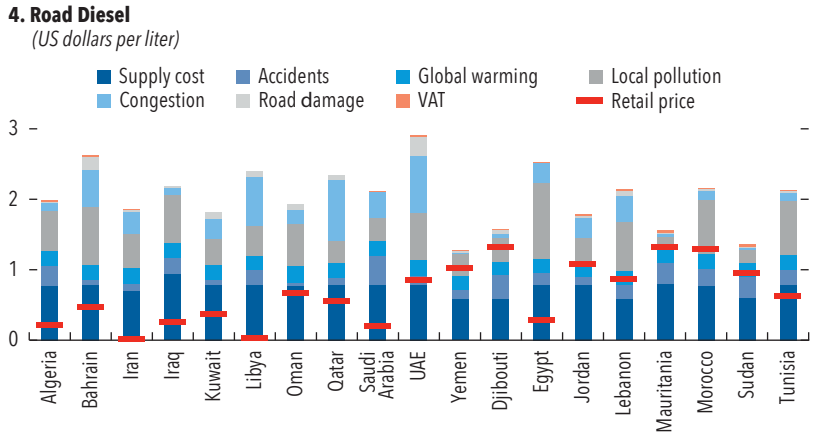
(US dollars per liter)



Source: Authors' calculations using Parry and others (2023).
Note: In panel 1, Morocco: 2021. In panel 2, Lebanon: 2019; Egypt and Tunisia: 2022. In panel 3, Djibouti, Sudan and Yemen: 2018; Lebanon: 2019; Iran and Iraq: 2022. Retail prices are not available for all countries. UAE = United Arab Emirates; VAT = value-added tax.

(Continued)

Figure 9.10. Efficient Fuel Taxes in 2023 *(Continued)*



Source: Authors' calculations using Parry and others (2023).
Note: Djibouti, Lebanon, Sudan, and Yemen: 2019; Iran and Iraq: 2022. Retail prices are not available for all countries. UAE = United Arab Emirates; VAT = value-added tax.

may be relevant for low- and high-capacity tax administrations, emphasizing that reform packages should be comprehensive rather than piecemeal.

Fossil Fuel Subsidy Removal

Because many MENA countries maintain large, explicit energy subsidies, fossil fuel subsidy reform is the essential first step toward environmentally consistent energy pricing. Retail prices must be liberalized to reflect international price levels (that is, the supply cost concept discussed), and the standard VAT rate should apply to fuels, as several countries in the region have already done (Box 9.2). Although politically challenging, such reform delivers fiscal benefits, including space to provide targeted and progressive support to vulnerable households. It also reduces pollution and fuel demand, increasing the share of production available for export.

Lessons from successful fossil fuel subsidy reform and from broader energy price increases (such as through taxes) can be adapted to increase the likelihood of successful reforms: (1) prepare and study the reform thoroughly and then publicly communicate the incidence of fuel subsidies; (2) phase in energy price increases to allow households and firms time to adjust their behavior; (3) establish a depoliticized mechanism for setting prices; (4) expand social assistance to poor people transparently, credibly, and in a fiscally sustainable way and, if needed for political acceptance, to a broader set of the population; (5) improve access to low-carbon alternatives by addressing market failures (for example, credit constraints) and by strengthening the provision of related public goods such as public transportation; and (6) implement reforms during periods of low inflation and strong growth and, when possible, when international fossil fuel prices are

Box 9.2. Energy Pricing Reforms in the MENA Region

Egypt introduced an energy price reform in 2014. Afterward, energy prices increased but remain disconnected from international prices. In 2018, however, the prime minister announced automatic fuel price indexation for most fuel products (IMF 2023). A cash transfer system was introduced and expanded throughout the reform, which has been shown to target poor households more effectively (Ridao-Cano and others 2023).

Iran eliminated subsidies on gasoline, diesel, natural gas, and electricity in late 2010, causing prices to increase by more than 1,000 percent for diesel and electricity but with little social resistance. The government launched a broad-based cash transfer program, with transfers made the day subsidies ended and then monthly transfers afterward. However, after a few years, subsidies were reintroduced, and Iran now ranks among the largest providers of fossil fuel subsidies in the world (IEA 2023b; Parry and others 2023; Salehi-Isfahani 2014).

Morocco deregulated fuel prices gradually between 2012 and 2015. This fossil fuel subsidy reform reduced the budget deficit and has remained in place. It was accompanied by cash transfers and investments in renewable energy (Gass and Echeverria 2017).

Oman raised electricity prices for government and large commercial and industrial users in 2017 (IMF 2017). The increase reduced consumption and encouraged modernization of production processes (Amann and others 2021).

The United Arab Emirates was the first Gulf Cooperation Council country to deregulate gasoline and diesel prices in 2015 and link them to global fuel prices. The reform did not trigger social unrest, likely because the country's large expatriate community is less sensitive to energy prices (Boersma and Griffiths 2016).

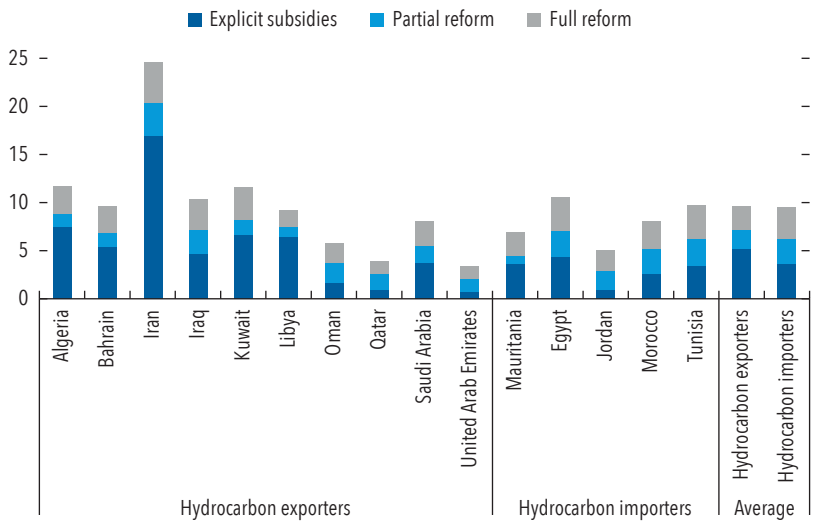
Source: Authors.

declining to lessen the posttax impact on consumer prices (recognizing that growth and fossil fuel prices are positively correlated in exporting countries).

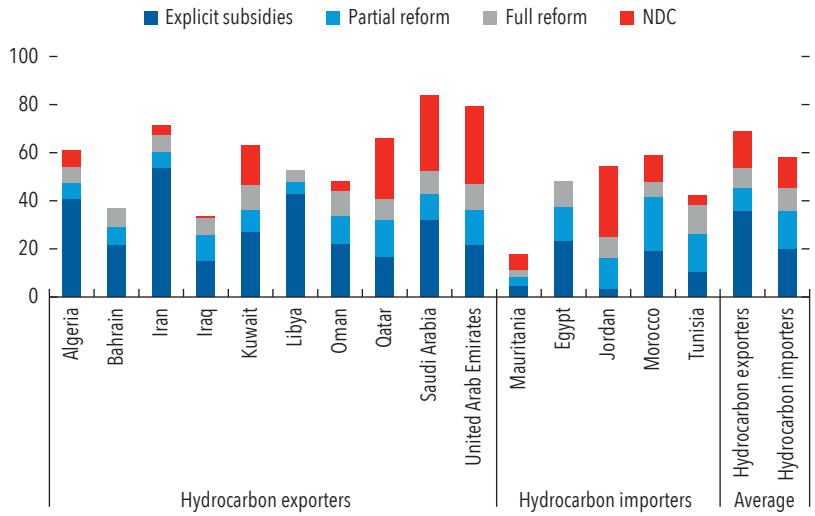
The fiscal and emissions impacts of removing explicit energy subsidies are substantial (Figure 9.11). Aligning subsidized fuel prices with supply costs by 2030 would raise revenues by more than 5 percent of GDP in seven countries (Algeria, Bahrain, Egypt, Iran, Iraq, Kuwait, and Libya), even after accounting for lower supply costs caused by falling international prices and base erosion as renewable energy shares increase and fuel consumption declines in response to

Figure 9.11. Projected 2030 Impact from Removing Explicit Subsidies

1. Revenue Impact
(Percent of GDP)



2. Emissions Reductions
(Percent of total emissions)



Source: Authors' calculations using the Carbon Pricing Assessment Tool.
Note: The weighted average of international and domestic production costs is used for natural gas and coal reference costs, and the international price is used for oil products. NDC = Nationally Determined Contributions.

higher prices—all of which result in fiscal gains below those of explicit subsidies.[23] GHGs would decline by more than 10 percent in most countries because of greater renewable energy adoption (assuming concurrent liberalization of electricity markets where relevant), reduced driving and more efficient vehicles, and improvements in industrial energy efficiency. The emissions reductions would be enough to achieve NDCs in all countries with large subsidies. Partial and full reform scenarios are discussed next.

Pricing Externalities

For unsubsidized fuels, the next step is to introduce price-based mechanisms that reflect externalities in consumer prices. Policy options vary in their effectiveness, impact on consumer prices, fiscal impact, and administrative practicality. The options discussed next are ordered from more to least economically efficient.

Fine-tuned instruments, such as congestion charges and fees on local pollutants, are most efficient but could be challenging to implement, given administrative constraints. Several examples of such instruments were discussed previously, and several countries have introduced most types of efficient taxes, sometimes in simplified forms. Fine-tuned measures are most effective in reducing environmental costs to efficient levels because they price external damage directly, enabling firms and households to incorporate the social cost in decision making. However, they require extensive information and advanced administration. Moreover, it is difficult to estimate the size of the external marginal cost. All these challenges could undermine the acceptability and effectiveness of these instruments. Still, they are worth considering over the longer term as monitoring and measurement technology improve and tax administrations in the region strengthen.

Fuel taxes provide a practical alternative to fine-tuned instruments and can be combined with rebates to firms that demonstrate pollution reductions. Compared with fine-tuned instruments, fuel taxes—applied per unit of fuel used—only encourage lower fuel use (the extensive margin) but still address a portion of the externalities. Fuel taxes and fine-tuned instruments perform similarly when few cost-effective options exist to reduce the emissions intensity of a given fuel, such as carbon dioxide. Fuel taxes can also be combined with rebates to facilities that reduce emissions intensity of local pollutants and carbon dioxide, allowing them to closely mimic fine-tuned instruments. Table 9.1 compares fine-tuned and efficient fuel taxes.

As with explicit subsidy removal, countries can improve fiscal positions while reducing emissions through corrective taxation. Full price reform generates additional fiscal revenue of more than 10 percent of GDP in several cases and closes half of the price gap, in addition to removing explicit subsidies, which would raise more than 5 percent of GDP in all but eight countries. These numbers compare

[23] Revenue gains for some countries far exceed the net subsidy levels illustrated in Figure 9.2 because the simulated policy reform retains existing taxes and removes only subsidies.

TABLE 9.1.

Comparison of Fine-Tuned Instruments and Fuel Taxes

Externality	Source	Fine-tuned/ First-best Instruments	Fuel Tax	Weakness of Fuel Tax
Local air pollution	Stationary	Tax level: varies with proximity to population, smokestack height, etc.	Tax level: average marginal external cost across country, scaled by portion of reductions from extensive margin	None if rebates given to firms demonstrating actual emission-intensity of pollutants
	Mobile	Tax level: varies with engine type, location, etc. Tax base: distance driven and EI of nitrogen oxides, PM2.5 (maybe others)	Tax base: fuel use	No incentive to purchase diesel vehicles that emit less nitrogen oxides, PM2.5
Congestion	All	Tax level: varies with realized congestion levels (location and time)	Tax level and base: differentiated by externality, fuel, and sector	Incentivizes less driving across entire country but not specifically in congestion areas/times
Road damage	All	Tax level: varies with vehicle weight Tax base: distance driven		No incentive to purchase vehicle that is less likely to damage the road
Accidents	All	Tax level: varies with driver safety, vehicle type (for example, lower or none for motorcycles) Tax base: distance driven		No incentive to purchase safer vehicles and adapt driving style
Climate damages	All	Tax level: carbon content of fuel, process emissions, and leaks, with rebate for carbon capture Tax base: fuel used (same as fuel tax)		None if rebates given to firms demonstrating actual carbon capture and covers process and non-CO_2 emissions

Source: Authors.
Note: Stationary sources include power plants and industrial facilities, could include household heating and cooling, and mobile sources generally cover transportation. EI = emission intensity.

with tax revenue of about 8.5 percent of GDP and nontax resource revenue of about 17.7 percent of GDP on average in 2022, indicating that fuel price reform could reduce reliance on oil and gas extraction significantly.[24] Under full price reform, emissions reductions are sufficient for all countries to achieve their NDCs except for Jordan. A partial reform that closes half of the gap to efficient prices achieves about 75 percent of the emissions reduction from full reform because abatement costs rise as emissions decline.

[24] An additional benefit of price reforms that these estimates do not capture is reducing domestic consumption frees more oil and gas production for exports.

Pricing Greenhouse Gas Emissions

For pricing GHGs, ETSs are an alternative to taxes.[25] ETSs require large emitters to surrender emissions allowances to cover their emissions. Trading allowances across firms sets their price. Governments can auction allowances or grant them for free (free allocation lowers firms' burden but yields no revenue). ETSs provide certainty about emissions levels, which can be desirable, but a pure ETS has disadvantages: (1) Emissions prices often fluctuate, which can increase abatement costs by increasing uncertainty about future prices; (2) other mitigation policies, such as fuel excises and fuel economy standards, do not lower economy-wide emissions if they apply to ETS-covered emissions because they are offset by lower emissions prices; (3) administration can be more difficult because it requires measuring emissions from several different sources (for example, each power plant and industrial facility),[26] setting up a trading market, and preventing market manipulation—especially a concern if market participants are few; and (4) authorities face pressure to grant free allowances to firms, which reduces revenue. A price floor and ceiling (minimum and maximum allowance prices) can complement an ETS to improve price certainty and support overlapping policies.

Revenue Neutral Pricing Instruments

Price reform of fossil fuels can be combined with pricing instruments that lower the relative cost of environmentally friendly activities in a revenue neutral manner. These policies generally do not raise direct costs to households and firms, making them more politically acceptable, especially because large price increases are needed to capture external costs, and energy-intensive, trade-exposed (EITE) firms may worry about losing international competitiveness and market share. Revenue-neutral pricing measures should operate along with fuel tax reform.

Feebates, tradable performance standards (TPSs), and ETSs with free allowances are flexible revenue-neutral policies that support reductions in emissions intensity. Feebates are revenue-neutral tax subsidies that use a sliding scale of taxes on relatively polluting activities and rebates on cleaner ones. Many European countries use versions of feebates that vary the tax or subsidy level based on a vehicle's local pollutant and carbon dioxide emissions (see IMF 2019 for examples). TPSs have a similar economic effect as feebates: firms with emissions below a set threshold earn credits that they can sell to firms exceeding the threshold (as with ETSs, this requires a trading market). Canada's Output-Based Pricing System for industry is an example of a TPS. An ETS with free allowances linked to output works in much the same way as feebates and TPSs: lower-emitting firms

[25] ETSs could also regulate local pollutants. The US Acid Rain Program and the state of Gujarat in India are two examples of such instruments targeting sulfur dioxide and nitrogen oxides.

[26] Carbon taxes usually require monitoring of fossil fuel supply at the point of import or domestic production. In some cases, they also require monitoring of large industrial facilities when the tax applies to industrial process emissions or a subset of sectors, such as fuels used for power generation but not road transportation.

have surplus allowances that they can sell to higher-emitting firms. ETSs and feebates can also generate revenue by granting only a portion of allowances for free under the ETS or by setting the feebate pivot point (the emissions level at which the subsidy switches to a tax) below the average results in the policies. If the pivot point is above the average, feebates can provide an average subsidy. Under an ETS, free allowances can be granted to selected firms (for example, a portion for EITE in Europe until 2026) to make them revenue-neutral for a given sector and revenue positive for others.

These policies can operate at the sector or subsector level and do not raise the average firm's cost of polluting. Feebates inherently target a single sector or good (for example, passenger vehicle sales, appliances, power generation), while TPSs and ETSs can apply across sectors. Each of these policies reduces pollution by rewarding lower emissions intensity, which raises production costs (for example, installation of cleaner but more costly equipment) but by less than under taxes, especially at low abatement levels. These instruments are flexible, allowing firms and households to decide whether to abate or pay more to pollute, increasing their economic efficiency.

Subsidies and Public Investment

Subsidies and public investment can also make clean alternatives more attractive. Subsidies can include reduced or zero-rated custom duties and VAT on clean technologies, tax credits, and concessional finance. Subsidies for zero-carbon energy reduce pollution less effectively than pricing carbon with taxes because they do not promote switching from emissions-intensive activities to lower-emissions options (for example, coal to gas), and they impose fiscal costs. Their appeal lies in their political acceptance and the strong economic rationale for their use if they address market failures such as learning spillovers from research and development or credit constraints for low-income households. Well-designed subsidies should limit fiscal costs and avoid subsidizing activities that would have proceeded without them.[27] Public investment helps address coordination problems (for example, standards and coverage of electric vehicle charging stations) and supplies goods that substitute for the use of fossil fuels or improve their efficiency (for example, public transportation). Carbon contracts for difference guarantee a price for emissions reductions under an ETS, reducing exposure to ETS price volatility. Auctions can set these contracts to limit fiscal costs and support early-stage technologies, potentially providing benefits comparable to an ETS with a price floor (Gerres and Linares 2020).

[27] Awarding subsidies through auctions can limit their costs. Examples include auctions for renewable energy companies to receive feed-in tariffs and contracts for differences (as is common in Europe), and more recently the Netherlands' green hydrogen auctions.

Regulatory Instruments

MENA countries might also consider regulatory instruments. Many countries use fuel efficiency standards for producing and selling vehicles (usually light-duty vehicles). Carbon product requirements (discussed in the literature but not yet adopted) would set near-zero-emission limits for sales of carbon-intensive products (such as steel, iron, aluminum, and cement) and can provide producers with market certainty (Gerres and others 2021). Labels and standardized energy ratings, such as Europe's Energy Performance Criteria for the building sector, can encourage consumers to choose carbon-neutral or near-carbon-neutral products. Net metering promotes residential and commercial solar use by providing credits for excess electricity generation. Renewable portfolio standards and renewable purchase obligations ensure that a set share of the electricity mix comes from renewable sources by issuing credits to renewable energy producers and obliging other producers or buyers to cover part of their generation or purchases with renewable credits.

State-owned entities and public investment decisions can incorporate environmental externalities through shadow pricing, which adds the cost of environmental damage to project-level investment decisions, even without a financial payment to the government. Private sector companies—especially in high-emissions-intensity sectors—are using this approach more frequently (CDP 2021; Fan, Rehm, and Siccardo 2021).

Competitiveness and Carbon Leakage

Increasing energy prices in the MENA region could raise competitiveness concerns. Energy-intensive sectors have benefited from a competitive advantage because domestic energy prices have often been lower than international fuel prices. Reforms removing that advantage might require targeted support for energy-intensive export-oriented firms (for example, fossil fuel producers and steel manufacturers) to smooth the transition toward efficient fuel pricing because these firms are price takers in international markets. However, firms that produce nontradable goods (for example, electricity) can pass price increases through to end users. Alternative measures discussed previously can have positive impacts on competitiveness (subsidies) or neutral ones (feebates and tradable performance standards).

The region's policymakers are likely to view pollution leakage as a key economic and environmental risk linked to environmental pricing and regulation. Carbon leakage occurs when domestic emission reductions are offset by higher emissions abroad, potentially driven by production moving abroad because of higher domestic production costs in countries with higher carbon pricing policies. Uncertainty remains about the scale of carbon leakage, but empirical evidence so far suggests limited leakage associated with carbon pricing policies. Policy measures that largely exempt energy-intensive sectors from the carbon price likely explain much of this outcome (Grubb and others 2022).

Traditional anti-leakage measures include target tax exemptions and allocating free allowances to at-risk sectors. However, some jurisdictions are now planning to adopt carbon border adjustment mechanisms (CBAMs). The European Union intends to implement CBAMs in 2026, extending a carbon price to imported energy-intensive products to ensure fair competition between domestic and foreign products (Box 9.3). Under a pure CBAM, exporters would also receive rebates for the carbon price paid during production so that exported goods compete on equal terms with foreign production.

MENA countries that adopt carbon pricing will need to assess measures to prevent carbon leakage—including free allowances and CBAMs—based on the size and scope of their EITE industries. CBAMs would charge imports based on emissions incurred in the producing country at the importing country's carbon price, creating equal pricing treatment regardless of production location and increasing pass-through to domestic consumer prices. CBAMs could also rebate carbon prices paid on exports to avoid harming export competitiveness. Besides CBAMs, MENA countries could mitigate leakage through coordination instruments or revenue recycling. Regional coordination instruments that harmonize carbon pricing would apply the same price to all EITE industries within the region but would still risk leakage to outside the region. Recycling revenues from new carbon pricing instruments to support EITE firms can also ease carbon leakage concerns.

Greater coordination among countries' carbon pricing policies can lower carbon leakage risks, and existing coordinating bodies could play a key role in harmonizing fossil fuel initiatives across the region. For example, countries could draw on the GCC's experience with VAT and excise duties, and Saudi Arabia's Middle East Green Initiative can provide a forum to discuss policy measures aimed at targeting fossil fuel externalities. One of the initiative's key aims is to reduce GHG emissions in the region, though it has not committed to common pricing instruments. Its activities have focused instead on building expertise in carbon capture, use, and sequestration; expanding access to clean cooking fuels, and reinforcing investment in clean technologies.

Distributional Effects

Political discontent over higher energy prices is a major obstacle to reform. Poor individuals might view fossil fuel subsidies as supporting energy access, yet the economic literature finds that such subsidies have adverse impacts on income distribution (Couharde and Mouhoud 2020). Subsidy reform should include a clear strategy to protect poor households, such as targeted cash transfers. Research on the impact of Saudi Arabia's subsidy reform suggests that cash transfers that favor the social and health sectors could offset the negative effects of full subsidy removal and lead to overall positive effects on the economy (Sarrakh and others 2020). Several other studies find that fuel subsidies benefit wealthy households disproportionately (for example, IMF 2014; Ridao-Cano and others 2023).

Box 9.3. Impact of Other Regions' Carbon Leakage Policies on MENA Countries

The European Union's introduction of carbon border adjustment measures (CBAMs) might affect countries in the MENA region. The extent of this effect depends on three main factors.

First, CBAMs on imports are unlikely to affect countries with a carbon price level similar to that in the CBAM jurisdiction. Adopting carbon pricing policies is therefore the easiest way for MENA countries to avoid CBAMs on their exports.

Second, in the near term, CBAMs will affect only MENA countries that export specific products to the CBAM jurisdiction. For example, the EU CBAM proposal covers only cement, iron and steel, aluminum, fertilizers, electricity, and hydrogen until 2028, after which it will expand to some downstream goods. According to the European Commission's impact assessment, Algeria, Egypt, and Morocco would be among the most exposed countries. Egypt and Algeria account for 21 percent and 20 percent, respectively, of EU fertilizer imports, and Algeria and Morocco provide 6 percent and 5 percent, respectively, of EU cement imports. Other affected MENA countries include the United Arab Emirates (which supplies 8 percent of EU aluminum imports), Bahrain (3 percent of EU aluminum imports), and Tunisia (3 percent of EU cement imports). Over time, CBAM could reduce EU demand for energy-intensive, trade-exposed goods and potentially have a modest impact on global prices.

Third, because CBAM covers only a small set of exports and domestic emissions, it might not create a strong incentive to introduce domestic, economy-wide carbon pricing. Countries could consider carbon prices on CBAM-covered products to retain revenue that would otherwise go to the European Union, but that approach brings challenges. For example, adopting a carbon price targeted only at products exported to the European Union would in principle violate World Trade Organization rules unless it was extended to all exports, which could raise competitiveness concerns and likely violate free trade agreements with the European Union. Moreover, if a country applies a carbon price to the share of exported products rather than to total production, it is unlikely that the European Union would fully recognize it when calculating CBAM certificates to be paid upon importation.

Source: Authors.

Governments can support low-income households through several policy options. The optimal policy is one that redistributes part of the revenue from energy price reform directly to low-income households via cash transfers. Where social protection systems are lacking, governments can increase spending on items that poor households consume disproportionately—public health care, education, and transportation. However, if poorer households might switch from clean cooking fuels to woody biomass (leading to deforestation), then authorities could maintain LPG subsidies and phase them out more slowly (as in Morocco) or target up-front costs (for example, LPG canister purchases, which are often too costly for lower income households). Similarly, governments can subsidize grid connections for electricity. For natural gas and electricity, authorities could retain a subsidy for consumption up to a basic-needs level for a low-income household. This would allow the nonsubsidized price signal to affect marginal consumption choices for most households, though it carries fiscal costs.[28]

Revenue Considerations

Pricing and nonpricing instruments differ fundamentally in revenue generation. Nonpricing instruments do not generate revenue and might even reduce it if they lower energy consumption in countries that rely on fossil fuel taxes. Pricing instruments typically generate revenue, though the amount depends on the instrument. Revenue from carbon taxes and ETSs depends on their scope and carbon price. By contrast, feebates are designed to be revenue-neutral but can be adjusted to raise or lose revenue by changing the pivot point. For example, when the pivot point is set below the industry average, the feebate increases revenue because more emissions are taxed than subsidized.

Administrative Considerations

Pricing instruments differ in how easy they are to administer. Fuel taxes, including carbon taxes, are relatively simple to manage, and several MENA countries already use them. Expanding these taxes to include a carbon component allows authorities to draw on their own experience to support compliance. This administrative ease is especially important in fragile states. ETSs are generally more difficult to administer because they require creating and monitoring a trading market. Policies that include subsidies, such as feebates or ETSs with free allowances—can increase the risk of leakage, though this risk can likely be managed.

The administrative ease or difficulty of nonpricing instruments depends on the existing regulatory framework and administrative capacity. Introducing new policy instruments is usually more challenging than strengthening existing

[28] Targeting subsidies for energy sources other than natural gas and electricity at the household level is difficult because these purchases are not directly linked to a household—for example, individuals buy fuel at gas stations. Some support programs use digital tools to target a broader set of subsidies—for example, Colombia uses its national identification system to provide discounts on LPG purchases for low-income households.

measures such as fuel and air quality standards. In addition, two factors might affect compliance costs. First, administrative and compliance costs are likely to be lower with policies that involve fewer economic actors and individuals in their implementation. For example, fuel standards apply to car manufacturers and vehicle importers, making them relatively easy to enforce because of the small number of economic actors involved. Second, administrative costs tend to be lower or at least more predictable when policy measures have been tested abroad. MENA countries that have not yet adopted fuel or air quality standards can learn from other countries' experiences and avoid implementation mistakes.

Legal Aspects

The constitutions of many MENA countries refer to environmental protection and the need to guarantee a safe and clean environment to all inhabitants. Some go further, mentioning the negative effects of climate change (such as Algeria's 2020 Constitution), guaranteeing the rights of future generations (Article 46 of the Constitution of Egypt), and the right to participate in protecting the climate (Article 45 of Tunisia's 2014 Constitution). These provisions do not impose a direct legal obligation to adopt carbon pricing but could support legislative action on climate change, including carbon pricing and other instruments. Many MENA countries have also ratified human rights treaties relevant to climate change. For example, all have ratified the UN Convention on the Rights of the Child, which the Committee on the Rights of the Child recognized in 2021 as having legal implications for states that fail to prevent and mitigate the effects of climate change.[29] Such treaties could provide a legal basis for national courts to require sufficient measures to reduce GHGs.

In most countries, adopting environmental tax measures faces stricter requirements than adopting nonfiscal instruments such as ETSs. The principle of legality requires that taxes be adopted only by law.[30] In some countries, specific voting requirements also apply, which could complicate carbon tax adoption.

Some constitutions include substantive rules for tax legislation design. For example, the Constitutions of Algeria, Mauritania, and Morocco refer to the ability-to-pay principle. Whether this principle applies to environmental taxation is unclear and, if so, whether environmental taxes deviate from it (Pitrone 2013). In theory, the taxpayers' ability to pay does not influence the design of carbon taxes because their main goal is to internalize the cost of GHGs and change behavior, not to promote redistribution. However, carbon taxes can also be viewed as taxes on activities that reflect the taxpayer's economic capacity and could therefore be consistent with the ability-to-pay principle. The equality principle is another substantive principle that could shape the design of carbon taxes.

[29] *Convention on the Rights of the Child*, signed November 20, 1989, 1577 *United Nations Treaty Series*.

[30] For example, Article 86 of the Constitution of Algeria, Article 38 of the Constitution of Egypt, Article 111 of the Jordanian Constitution, Article 134 of the Constitution of Kuwait, Article 20 of the Constitution of Mauritania, and Article 133 of the Constitution of the United Arab Emirates.

This principle could prevent countries from granting preferential tax treatment (for example, a carbon tax reduction) to certain companies but not to others in similar situations.

In addition, some constitutions require that all tax revenues be included in the general budget rather than earmarked for specific goals (see, for example, Article 115 of the Jordanian Constitution). This principle, the non-affectation principle, supports efficient budget resource allocation independent of their sources, and thus it limits policymakers ability to earmark carbon tax revenue (or revenue of any other tax).

Countries can also consider international legal obstacles to adopting carbon pricing, including trade law and investment law. In trade law, the national treatment principle prohibits discrimination against imported products, and the most-favored-nation principle prohibits discrimination between imported products. The Agreement on Subsidies and Countervailing Measures bans export subsidies, though some developing- and least-developed countries may qualify for an exemption under Article 27. Carbon pricing instruments that target imported or exported products specifically might thus conflict with these rules. For example, CBAM measures could conflict with international trade law unless justified under the General Agreement on Tariffs and Trade Article XX, general exceptions provision (Mehling and others 2019; Pirlot 2017). International investment law can also restrict countries' taxation powers. For example, bilateral investment treaties often prohibit using tax systems to expropriate foreign investors, and the Energy Charter Treaty is especially relevant for MENA countries that have ratified it, such as Jordan and Yemen. Because the Energy Charter Treaty might complicate the adoption of policies needed for the transition to a climate-neutral economy, other MENA countries could consider avoiding ratification.

Potential Policy Packages

A comprehensive policy package is needed to address environmental externalities. It should account for revenue needs, competitiveness concerns, the scale of prereform environmental damage, administrative capacity, and the existing legal framework (summarized in Table 9.2).

Broad-based policies to increase the price of environmental damage should form the core of environmental fiscal policy reform. Removing explicit subsidies and introducing or expanding taxes are the most efficient ways to address environmental costs and can be implemented even by governments with weak administration capacity. Reform should be gradual over several years, with prices moving toward covering the full marginal cost of pollution. Facilities that demonstrate carbon capture or below-average emissions intensity of local pollutants should receive rebates. Competitiveness concerns may require compensatory policies for EITE sectors, such as free allowances or output-based rebates. Governments with stronger capacity could consider a cap-and-trade system to capture the climate portion of externalities, though tax measures offer several advantages. Increases in prices should be paired with stronger social protection, ideally through

TABLE 9.2.

Potential Fiscal Policy Packages

Sector	Capacity Level		Complementary Policies
	Low	**High**	
Cross-cutting	Remove explicit subsidies; increase/introduce fuel taxes.	Remove explicit subsidies; increase/introduce fuel taxes (or cap and trade system).	Increase social spending, targeted support for vulnerable households and temporarily for firms.
Power	Feebates (emissions price * (CO_2 per kWh minus average CO_2 per kWh)) and shadow pricing.		Liberalize markets, create enabling financial and legal conditions for private investment.
Industry	Feebates with progressively tightening pivot-point (either sub-sector average or converging to international best practice) and (if there is fiscal space) incentives for clean, new technologies.		Methane fees for extractives, shadow carbon pricing for state-owned enterprises.
Transportation	Feebates based on fuel economy, diesel vs. gasoline, and/or engine type; regulations on diesel sulfur content.		Public transportation investment to provide alternatives and support low-income households.
		Tolls varying with (proxies for) congestion.	
Buildings	Feebates based on appliance and (potentially) building energy efficiency and (if there is fiscal space) credit support for low-income households.		Requirements for energy efficiency labeling of buildings and appliances.

Source: Authors.
Note: kWh = kilowatt-hour.

income-based support to vulnerable households or, alternatively, higher spending on goods and services consumed by poor households, such as public education, transportation, and health care.

Price reform can be politically difficult because high taxes may be needed to internalize environmental costs and address global warming. Thus, social and competitiveness reasons likely make second-best policies necessary complements to partial pricing reform. The design of non-pricing policies is crucial, and flexible instruments like feebates are relatively efficient. These policies are often applied at the sectoral level and can work effectively with or without higher fuel taxes, but they should at least be coupled with a phase-out of explicit subsidies.

In the power sector, feebates and market reforms can direct investment toward cleaner energy sources. Several MENA countries have regulated their electricity markets heavily, which can weaken the effects of fuel price reform and feebates. These markets should begin liberalizing the sector and, before full liberalization, adopt policies that promote low-emission investments, such as using shadow pricing that considers both carbon costs and local pollutant emissions. Renewable energy auctions or administratively set feed-in tariff levels, coupled with guarantees that ensure creditworthy purchasers, can attract private investment in renewables at a limited fiscal cost, if well calibrated. Because the number of large-scale power generators in most countries is small, feebates are easier to implement at this level and are likely preferable to TPSs or ETSs for administrative reasons.

Competitiveness is a concern in the industrial sector, and policies should reflect the difficulty in monitoring emissions. Feebates can encourage shifts to more energy-efficient technologies and cleaner fuels, with benchmark emissions intensity set at the subsector average or tightened over time to reach best international practices. Countries with fiscal space can also offer investment-based incentives for emissions reductions, targeting areas for potential innovation such as green hydrogen, while limiting fiscal costs. Reducing methane emissions and commercializing natural gas in fossil fuel–producing countries are especially important because natural gas offers a cleaner alternative to oil and coal. Flaring rather than venting natural gas provides significant climate benefits, along with modest local air quality benefits. A methane fee, combined with requirements for proven cost-effective technology and processes, is recommended (Parry and others 2022).

In the transportation sector, a mix of feebates integrated into registration fees, proxies for congestion charges, and regulatory improvements can address environmental damage. Feebates should vary with CO_2 emissions or fuel economy, possibly with an adjustment for sulfur dioxide and nitrogen oxide emissions either through higher rates for diesel vehicles or for those lacking abatement technologies such as catalytic converters. The feebate could apply to both initial and annual vehicle registration fees, with the latter phased in to avoid perceived unfairness to those who have already purchased vehicles. Linking fees to distance traveled over the previous year could reduce driving even more but could require robust administration. Cities in higher-capacity countries can consider peak-hour tolls and gradually introduce congestion pricing. Improving public transportation is important to reducing pollution and supporting lower-income households. Regulating diesel sulfur content for new and existing vehicles can improve local air quality significantly, while stronger fuel economy standards may suit wealthier countries that are less reliant on used vehicle imports.

In the building sector, policies should promote energy efficiency in renovations, new construction, and appliances. Transparent, consistent information on energy efficiency—through appliance labeling and energy performance criteria for buildings—is needed to introduce incentives and should be prioritized in the near-term to allow for more efficient policies such as feebates. Feebates work well for appliances, with the pivot point reflecting the economy-wide average or best-available technology efficiency level. Credit support for low-income households could correct for financial market failure and help them purchase efficient appliances (such as heat pumps) or renovate buildings.

CONCLUSION

The analysis in this chapter shows that fossil fuel prices in most countries in the region remain well below socially optimal levels, causing excessive pollution, road congestion, and vehicle accidents and limiting fiscal space. Reforming fuel prices, combined with complementary measures such as public investment in

low-carbon transportation, would generate substantial environmental and fiscal benefits and help countries achieve climate mitigation targets at limited cost. Because collecting fuel taxes is relatively simple administratively, such reforms are practical across all countries, including in fragile states.

Reforms must be managed carefully to improve political acceptability and increase their sustainability. Lessons from past reforms in MENA countries highlight several key considerations: clear public communication about reform effects, revenue gains, and revenue uses; using a portion of revenue gains to compensate vulnerable households and industries to help mitigate the impact on livelihood and competitiveness; and phasing in price changes gradually over time.

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CHAPTER 10

Tax Administrations: Overview of Key Functions

Lydia Sofrona and Polina Prokof'yeva

INTRODUCTION

Tax administrations in the Middle East and North Africa (MENA) region are at different levels of maturity because of their environments, policy and legislation, and administrative practice and culture, among other factors (OECD 2020). In some cases, especially in fragile and conflict-affected states (FCSs), the enabling conditions for reform—mainly political consensus—are absent. Within the region, tax systems and tax law frameworks stem from many legal traditions, core taxes have not been introduced at the same pace, and availability and access to resources are uneven across the region. Table 10.1 shows key differences in tax administration organization and functions (organized by three subgroups of countries as outlined in Chapter 2: hydrocarbon exporters, hydrocarbon importers, and FCSs).

Several tax administrations in the region have implemented significant reforms. Key aspects include legislative changes to reduce tax leakage, improved taxpayer services (with many services now available online), a shift toward targeted compliance activities (with improved use of third-party data in audit work), and increased communication efforts through many channels, complemented with better resource allocation through organizational reforms.

Despite these efforts, several MENA tax administrations continue to face challenges, including those brought on by recent changes in the international tax environment (see Chapter 4 on the global minimum tax, for example). Such challenges contribute to low efficiency and hinder tax compliance, especially when coupled with tax policy intricacies, informality, and tax bases eroded by widespread preferential tax treatments that increase complexity and create tax avoidance opportunities (Jewell and others 2015). Key shortcomings to address these challenges include weak autonomy (Verdier and others 2022); lack of integration of all core taxes under a single administration or low degree of cooperation and exchange of information between tax and customs administrations; organizational deficiencies (for example, weak headquarters functions); insufficient resources for infrastructure and modernization; and underdeveloped compliance management functions that are hindered even more by weak information-gathering powers.

TABLE 10.1.

MENA Tax Administrations: Key Structural and Organizational Features

Country	Subgroup	SARA	Functional Organization	Integrated Administration (with Customs)	LTOs	E-filing	E-payment
Algeria	HE	No	Yes	No	Yes	Yes	No
Bahrain	HE	No	No	No	No	Yes	Yes
Djibouti	HI	No	Yes	No	No	No	No
Egypt	HI	No	Yes	No	Yes	Yes	Yes
Iran	HE	No	No	No	Yes	n.a.	n.a.
Iraq	HE, FCS	No	No	No	Yes	No	Yes
Jordan	HI	No	Yes	No	Yes	Yes	Yes
Kuwait	HE	No	No	No	No	No	No
Lebanon	HI, FCS	No	Yes	No	Yes	Yes	Yes
Libya	HE, FCS	No	No	No	No	No	No
Mauritania	HI	No	Yes	No	Yes	No	No
Morocco	HI	No	Yes	No	Yes	Yes	Yes
Oman	HE	Yes	Yes	No	Yes	No	No
Qatar	HE	No	n.a.	No	No	Yes	Yes
Saudi Arabia	HE	No	Yes	Yes	Yes	Yes	Yes
Somalia	HI, FCS	No	No	No	n.a.	No	No
Sudan	HI, FCS	No	n.a.	No	Yes	No	No
Syria	HI, FCS	No	Yes	No	Yes	No	No
Tunisia	HI	No	Yes	No	Yes	Yes	Yes
United Arab Emirates	HE	Yes	Yes	No	Yes	Yes	Yes
Yemen	HE, FCS	No	No	No	Yes	No	No

Sources: Authors' compilation based on ISORA 2018–2022, and various government websites.
Note: In Mauritania, e-filing and e-payment are possible only for large taxpayers. FCS = fragile and conflict-affected state; HE = hydrocarbon exporting; HI = hydrocarbon importing; ISORA = International Survey on Revenue Administration; LTO = large taxpayer office; MENA = Middle East and North Africa; n.a. = not applicable; SARA = semi-autonomous revenue agency.

This chapter distills the key features of tax administrations in the MENA region, focusing on organization and governance issues, legal frameworks, procedures, compliance management and modernization. It offers a comparative analysis on reform and modernization efforts and key challenges, building on IMF staff hands-on experience and empirical work.[1] The findings show that some administrations have achieved remarkable sophistication over the years, while others have not improved or have even deteriorated.

[1] Publicly available comparative data on tax administration in the MENA region are limited. According to the International Survey on Revenue Administration, a partnership of institutions that surveys countries on revenue administration, only 2 of the 159 participants in the 2018 survey were from the region (Mauritania and Morocco), and only 9 of 149 national assessments recorded by the Tax Administration Diagnostic Assessment Tool (TADAT) Secretariat are from the region (www.tadat.org, accessed June 14, 2025). Those nine include Djibouti in 2019, Egypt in 2015 and 2024, Iraq in 2022, Jordan in 2016, Lebanon in 2018, Mauritania in 2022, Morocco in 2018, Tunisia in 2018, and the United Arab Emirates in 2023. Of those, only one assessment has been published (Jordan). Country examples and references throughout the chapter are based on the authors' research using publicly available data and review of national legislations.

ORGANIZATION AND GOVERNANCE

Tax administrations are government departments in nearly all MENA countries. Of the 159 countries that participated in the 2018 International Survey on Revenue Administration (ISORA), 74 (47 percent) had established semi-autonomous tax/revenue agencies, while the remaining 85 (53 percent) retained control directly within government ministries (Crandall, Gavin, and Masters 2021, Table 15). By comparison, the degree of autonomy in the MENA region is low: Only three countries (Iran, Oman, United Arab Emirates) have established semi-autonomous administrations (Verdier and others 2022). Some countries established separate organizations that are still under the control of the ministry of finance and thus do not qualify as semi-autonomous revenue agencies (Egypt and Qatar).

Since the 1990s, more tax administrations globally have adopted function-based organization structures to replace previous structures based on tax types (Kidd 2010). The MENA region has been relatively slow to adopt function-based structures. Of the 21 countries, 11 have adopted a function-based organization structure, including 4 of 8 FCSs and 4 of 11 hydrocarbon exporters (Table 10.1). These results point to the lack of a general reform momentum across the region.

The degree of integration with customs and across all core taxes also remains low. Integrated administrations are not the norm in the region: Only Saudi Arabia's administration operates as an integrated tax and customs administration (Table 10.1). Some countries have established separate administrations by tax type. In Egypt, for example, the real estate tax administration is a separate organization under the Ministry of Finance, and in Lebanon, two separate directorates for income tax and value-added tax (VAT) operate under the Ministry of Finance.

Governance challenges in the region are often rooted in deficiencies in the legal framework and are manifested mainly through the following:

- *Broad discretionary powers.* Discretion is commonly applied in granting filing and payment extensions, tax waivers, and installments; taking collection and recovery actions; and applying penalties. In Egypt, many penalties under Law No. 206 of 2020 Concerning the Unified Tax Procedures Law have a floor and cap and are applied on a discretionary basis.[2] In Morocco, the Minister of Finance or their delegate can grant, at the taxpayer's request and "in view of the circumstances invoked," remission or moderation of surcharges, fines, and penalties.[3] Several reconciliation procedures are prominent in the region, often through committees outside the tax administration that are awarded the power to waive taxes, penalties, and surcharges and operate as de facto amnesty programs.

[2] Law No. 206 of 2020 Concerning the Unified Tax Procedures Law, Arab Republic of Egypt, art. 68–77.

[3] Code général des impôts, Édition 2024 (General Tax Code 2024 Edition), as amended and supplemented, Morocco, art. 236.

- *Underdeveloped delegation structures.* Formal structured arrangements for delegating authority, where necessary, are imperative to align administration practices and tax laws. If formal arrangements are not in place, tax officers risk being challenged on acting beyond the scope of their legal authority, and tax administration operations risk disruption, including through improper exercise of discretionary powers. In the MENA region, lack of autonomy in tax administrations (which operate as a ministry department in most cases) could lead to an increase in informal delegation arrangements, coupled with the absence of an explicit legal basis for delegation of powers within the tax administration.
- *Weak transparency and accountability arrangements.* Few MENA tax administrations have established key performance indicators (such as those in the United Arab Emirates),[4] and few publish their annual reports (Egypt, Jordan, Morocco, and the United Arab Emirates). Tax Administration Diagnostic Assessment Tool (TADAT) results on the publication of financial and operational performance reports (Performance Outcome Area [POA] 9-32) indicate that the average score for the MENA region is lower than the global average.[5,6] Increased transparency and simplified procedures could go a long way toward addressing perceptions of corruption and should ultimately contribute to applying a more fair and equitable tax system (Jewell and others 2015).

Inadequate or misallocated resources are also common across many of the region's tax administrations. Besides general budget constraints, resource allocation challenges arise from two constraints: (1) human resources policies are tied to those of the public sector, and (2) financial resources are tied to the budget of the ministry of finance. These constraints limit the ability of tax administrations to allocate resources to collect tax revenues effectively and efficiently.

[4] The United Arab Emirates (UAE) Federal Tax Authority ranked 99.7 percent in the use of key performance indicators among UAE federal entities (United Arab Emirates Federal Tax Authority 2023).

[5] TADAT provides an assessment of the health of key components of a tax administration. The framework focuses on nine key POAs that cover most tax administration functions and processes. A TADAT assessment is based on 32 high-level indicators and 55 measurement dimensions. For more information, see www.tadat.org.

[6] The world average for TADAT POA 9 (Accountability and Transparency) is 2.04 against 1.73 for the MENA region (IMF, TADAT Secretariat). The sample of countries uses for these comparisons is uneven across regions; for the MENA region, the average is based on assessment results for eight countries only: Egypt, Jordan, Lebanon, Morocco, Tunisia, Djibouti, Mauritania, and Iraq.

LEGAL FRAMEWORKS FOR TAX ADMINISTRATION AND PROCEDURE

Tax Laws in the MENA Region

The MENA region's legal systems derive from a multitude of traditions. The region inherited a heavily centralized system of taxation and public administration from the Ottoman Empire and other European states (Tosun and Yilmaz 2008). In the late 19th and early 20th century, after the fall of the Ottoman Empire and the advent of the British and French mandates, the Middle East underwent critical changes that affected the region's legal systems (Razai 2019).

Countries in the region differ in how they impose, adopt, and imitate foreign legislation models.[7] After the French and British mandates, new Arab nation-states renewed their efforts to modernize their laws. Some jurisdictions, such as Lebanon, borrowed French law, while others incorporated both Islamic and Western legal values, such as Egypt in the 1949 Egyptian Civil Code. The influence of the French legal tradition is also prominent in the Maghreb countries of the region (Algeria, Mauritania, Morocco, Tunisia), and Djibouti.

Consequently, this multitude of influences is evident both in substantive tax laws and the frameworks for tax administration and procedure. Focusing on tax administration and procedure, three country groups emerge (Box 10.1):

- Countries that have adopted a separate framework for tax administration and procedure, with different degrees of integration across core taxes. For example, Egypt's Unified Tax Procedures Law does not apply to real estate tax administration.
- Countries with separate tax administration and procedure sections as part of a general tax code. Those are mostly in the Maghreb block of countries.
- Countries with nonintegrated tax procedure frameworks. In those cases, procedural provisions differ for each tax type and are found in substantive legislation.

Regardless of legal tradition, some common features of tax systems exist across the region. These include:

- *Complex, fragmented, and often outdated legislation.* For example, in Lebanon, the income tax law was written in 1959 and has been subject to a series of amendments through various subsidiary legal instruments with different legal standing, leading to inconsistencies and complexities that exacerbate implementation.
- *A multilayered system of rules and procedures.* Primary legislation is at the top of a multilayered system of rules and procedures. In the United Arab Emirates issues federal tax authority decisions, cabinet decisions, federal

[7] For example, the British applied a diverse body of laws during their mandate in Iraq (1920–32), which was culled from Ottoman, French, and Anglo-Indian colonial laws, while tribal customary law was applied in the countryside (Hanioğlu 2008).

Box 10.1. Legal Frameworks for Tax Administration and Procedure in the MENA Region

Tax Administration and Procedure Law	No Tax Administration and Procedure Law	Dedicated Chapters on Common Tax Procedures in General Tax Codes
Algeria	Bahrain	Mauritania (LPF chapter)
Egypt	Iran	Morocco (LPF chapter)
Lebanon	Iraq	Somalia (Procedures chapter)
United Arab Emirates (Executive Regulations)	Jordan	Djibouti (CGI 2010, Titre 4: Dispositions communes)
Tunisia	Kuwait	
	Libya	
	Oman	
	Qatar	
	Saudi Arabia	
	Sudan	
	Syria	
	Yemen	

Source: Authors' compilation based on national legislations.
Note: CGI = Code Général des Impôts; LPF = Livre des Procédures Fiscales.

decrees-laws, and executive regulations of federal decrees.[8] In Lebanon, tax law instruments include council of ministers' decrees, decrees by the prime minister, ministerial decisions, ministerial circulars, and decisions made by the tax administration (which are considered administrative guidance). Important provisions are often found in those subsidiary instruments, which adds to uncertainty regarding the applicable framework.

- *Prominence of executive regulations.* Executive regulations are a powerful legal tool across the region, used widely to deal with substantive issues. For example, substance and transfer pricing documentation requirements have been introduced through executive regulations in the Gulf Cooperation Council countries and in Egypt and Jordan.
- *Tax provisions in nontax legislation.* The most prominent example is tax incentives for different types of special economic zones and free zones, which are placed in investment laws instead of incorporated into tax laws. Such incentives include exemptions from corporate income tax (or granting preferential rates), general and special sales taxes, and customs duties. Tax

[8] https://tax.gov.ae/en/legislation.aspx

provisions are also found in oil and mining laws and in concession agreements.

Tax Law Interpretations

Circulars and practice or explanatory notes for interpreting tax laws are common across the region. In many cases, the ministry of finance or the tax administration publishes such guidance regularly on its website, along with other relevant information, such as taxpayer manuals or question-and-answer sections. In Morocco, the General Directorate of Taxes publishes circulars regularly on its website to explain the administration's position on technical issues and issues related to legal interpretation. The directorate also publishes explanatory notes on the website under the heading "Questions of Principle."[9] In some cases, a framework on circulars or practice notes is provided in legislation (as in Djibouti), with the relevant authority generally awarded to the tax administration.[10]

Although some countries issue private rulings (Algeria, Bahrain, Egypt, Somalia, and Saudi Arabia; Deloitte 2024), the legal framework for rulings is undeveloped, and publication (in redacted form) or repository arrangements for rulings are generally not provided. Examples from the region include Jordan, which lacks a formalized rulings system and does not provide legally binding advice (Rozner and others 2016); and the United Arab Emirates, which issues private clarifications for a fee and has a detailed framework for their issuance, though they are in the form of guidelines, which are not legally binding documents.[11] The region also lacks deliberate strategies for formal cooperative compliance initiatives. These issues likely reflect low capacity and a shortage of staff with the expertise needed for a private rulings system.

Dispute Resolution Mechanisms

Graduated dispute resolution mechanisms are generally in place in the region. The first stage involves administrative review structures that operate under various forms and degrees of independence (often not organizationally independent of the audit function), sometimes even operating in parallel with other administrative review structures (for example, reconciliation committees). Second-stage review by external review committees is also available in most countries, though they are generally not fully independent because tax officials serve on the committees. Judicial review is a final stage. However, audit assessment processes in the region can reflect negotiated settlements as a required first step. Parallel review

[9] For more information, see the directorate's website at https://tax.gov.ma/wps/wcm/connect/dgi-fr/dgi-vfr/documentation%20fiscale2/questions%20de%20principe.

[10] *Code Général des Impôts*, Édition officielle 2015, (General Tax Code, Official Edition 2015), Djibouti (https://budget.gouv.dj/wp-content/uploads/2022/07/CGI2015final.pdf).

[11] See Waerzeggers and Hillier (2016) on advance tax rulings regimes (https://www.elibrary.imf.org/view/journals/008/2016/002/008.2016.issue-002-en.xml).

structures also hinder the use and effectiveness of first-stage administrative review mechanisms.

Where dispute resolution mechanisms are well developed, operational shortcomings sometimes undermine their efficiency. Timelines for responding to taxpayer requests are lengthy, and governments do not act on the outcome of the process to reform legislation or administrative procedures (Verdier and others 2022). Deadlines for administrative reviews range from 60 days (Egypt) to 90 days (Mauritania, Morocco, and Jordan) or even up to six months (Lebanon). With few exceptions (Egypt and Morocco), tax administrations generally do not analyze dispute outcomes systematically and routinely or use them to inform changes in policy, law, or administrative procedures. Box 10.2 presents country examples of dispute resolution mechanisms in the region.

Box 10.2. Dispute Resolution Mechanisms in the MENA Region: Selected Country Practices

Egypt: An objections committee that is organizationally separate from the audit department handles the first-stage objection. Objections can be escalated to an appeals committee as a second stage of administrative review before judicial review.

Jordan: Permanent objection panels that report to decision approval committees review administrative objections. Administrative review officers are organizationally located in the audit department but do not conduct tax audits. Second- and third-stage dispute resolution mechanisms are in place, and both are independent tax tribunals reporting to the Ministry of Justice, although the ministry cannot change or overturn their decisions. The government publishes information on the dispute resolution process and ensures that taxpayers are aware of it. No evidence exists of regular or ad hoc analysis of dispute outcomes.

Lebanon: All core taxes have a three-tier dispute resolution system. A dedicated objections department conducts first-stage administrative reviews. A second-stage external appeals committee is in place but is not fully independent. The final stage is an appeal to the State Council, which is the highest judicial appellate court. Procedures exist for informing taxpayers of their dispute rights.

Morocco: The dispute procedure consists of an administrative phase and a judicial phase. If disagreement arises on factual issues, the taxpayer can appeal to a local tax commission or to the national tax appeals commission, neither of which is fully independent and has no jurisdiction over tax laws interpretation, which only judicial bodies can address.

Saudi Arabia: An internal administrative review mechanism exists but lacks a second-tier review stage by an independent administrative body. The taxpayer is not obliged to pursue internal review first as a necessary step before judicial review.

Source: Authors' compilation based on national legislations.

COMPLIANCE GAPS AND MODERNIZATION

MENA countries are in different stages of economic development. The region's tax-to-GDP ratio is lower than comparators on average (see Chapter 2). For some countries, the gap results from their reliance on natural resource revenues, while for others it results from macroeconomic vulnerabilities. Also, administrative challenges and policy choices contribute to low tax-to-GDP ratios.

Despite gradual improvements, the region's tax administrations continue to face compliance challenges. For example, results from a sample of countries participating in the IMF's Revenue Administration Gap Analysis Program highlight compliance issues. The region has a relatively high VAT compliance gap (Figure 10.1), underscoring the need for comprehensive reforms and modernization.

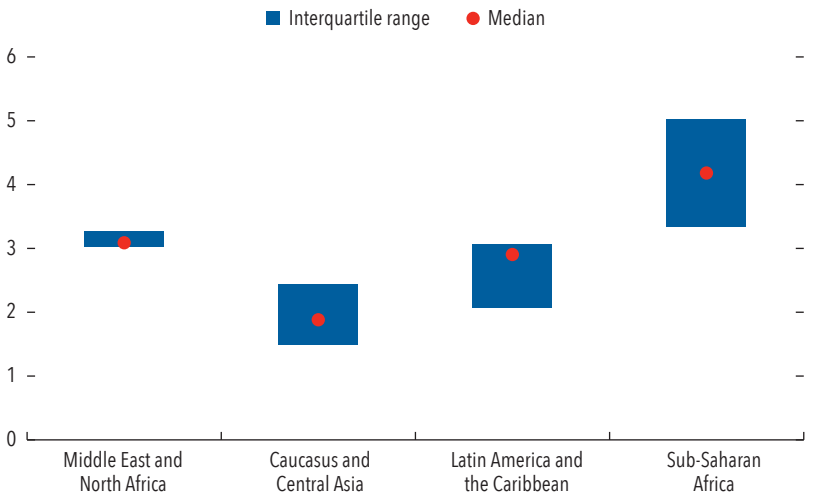
Digitalization has proved to make tax administration more efficient and encourage voluntary compliance. Through technology, tax administrations can mobilize revenue, ensure accuracy and timeliness in tax filing and payment, and strengthen their ability to adapt quickly to changing domestic and international environments, for example, through implementing exchange of information and transfer pricing requirements. Egypt, Jordan, Saudi Arabia, and the United Arab Emirates have implemented e-invoicing systems for more timely and accurate tax filings (PwC 2024). In Iraq, where tax preparation and payment require an extensive 216 hours for a medium-size company, transitioning to a digital tax environment could streamline processes and reduce compliance costs (PwC 2024).

Lower-capacity tax administrations can reengineer business processes while migrating to a digital environment, such as core system redevelopment in the back-end modules of registration, assessment, audit, payment, and collection systems. Along with IT reforms, administrations should implement broader reform measures, mainly moving toward a function-based structure. New IT systems should be based on business processes, not tax types, and be able to process different tax types with various criteria and components. Systems that offer a range of taxpayer services can reduce the need for in-person interactions.

Digitalization Initiatives

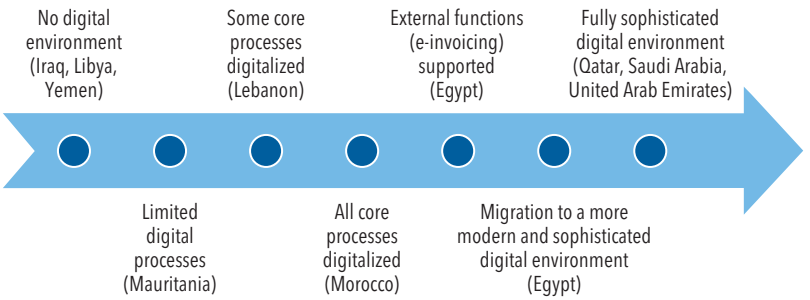
MENA countries' tax administrations are in different stages of digitalization, ranging from no electronic systems to sophisticated IT environments (see

Figure 10.1. Value-Added Tax Compliance Gap
(Percent of GDP)



Source: IMF Revenue Administration Gap Program.
Note: Country coverage varies by region and year. Comparisons should be interpreted with caution as the sample of countries is uneven across regions, and only two countries are included in the Middle East and North Africa result.

Figure 10.2. Digitalization Stages in MENA Region Tax Administrations



Source: Authors' compilations.
Note: Country references are illustrative examples, not a complete picture of the digitalization stage in each of them. MENA = Middle East and North Africa.

Box 10.3 on the United Arab Emirates). Figure 10.2 illustrates the stages of digitalization in the region's tax administrations.

Some tax administrations, especially in FCSs, still use mostly manual procedures or outdated IT systems. Many tax records are paper based, making it nearly impossible to obtain detailed and updated information. Tax administrations have not yet implemented modern digital services to taxpayers and digital core

Box 10.3. Spotlight: The United Arab Emirates Federal Tax Authority's Digital Transformation

The United Arab Emirates Federal Tax Authority's website allows digital participation and provides services in a way that suits each user's needs. It also promotes tax awareness and education and offers direct interaction around the clock between the tax authority, business sectors, other relevant authorities, and stakeholders. The website's virtual assistance service uses sign language to answer visitors' questions directly using AI—for example, translating user-selected text into sign language through the Tax Aware Robot Assistant service. Users can also increase the site's font size, convert text to speech or speech to text, listen to the page, change colors, and switch to a dark mode website reader.

The authority's Advanced Technical Infrastructure Services, Managed Information Security Project established a data center based on private cloud computing and obtained ISO 20000 and ISO 270001 certificates for its International Information Technology Service Management System and the Information Security Management System. The authority also established a Security Operations Center, which prevented more than 115,000 cyberattack attempts in 2022 through security support to the network and internal systems.

Source: United Arab Emirates Federal Tax Authority (2023).

processes because digital transformation requires substantial capital investment and is hindered by limited resources. Simultaneous filing deadlines across taxes and changes in legislation could test the limits of outdated IT systems. In some cases, tax administrations might not own their networks or data centers and instead rely on government facilities or private providers.

The lack of digital registration processes and databases poses significant challenges to collecting revenue efficiently. A complete and well-maintained taxpayer register is fundamental, yet with few exceptions, manual registration is still prominent in some administrations (except for Saudi Arabia, which has only online registration). Also, manual registration is often coupled with separate registration by tax type, effectively making it impossible to build a robust taxpayer registration management system based on complete, accurate, and up-to-date taxpayer information. In Lebanon and Morocco, taxpayers can register by email, mail, or in person.[12] However, the method is still susceptible to errors or manipulation, highlighting the critical need for a comprehensive digital registration system that interfaces with other IT systems.

[12] International Survey on Tax Administration, 2018–2022.

Recent reforms allow taxpayers in more MENA countries to register, file, and pay online and access information and guidance using online self-service tools. Approximately 41 percent of MENA countries have adopted e-filing and e-payment systems (Table 10.1). In Morocco, the 2019 national tax dialogue (Assises sur la Fiscalité) resulted in reforms rooted in information-based tax design (Benitez and others 2023), and the percentage of payments received electronically increased from 56 percent in 2018 to 83 percent in 2021. Egypt (in 2018), Saudi Arabia (in 2020), and Algeria (in 2021) also implemented digital platforms for corporate tax filing and payment, sometimes rolled out gradually, starting with large taxpayers. The Mauritanian tax administration implemented two IT modules that allow e-filing and e-payment for large taxpayers. In the United Arab Emirates, taxpayers can register, file returns, pay taxes, and claim refunds through the EmaraTax online platform, which features real-time dashboard tools and live chat support. The system's integration with government institutions and banks shows a concerted effort in institutional collaboration. Similarly, Qatar's Dhareeba platform allows electronic filing and payment and offers instant feedback to prevent errors during the initial phases of filing returns.

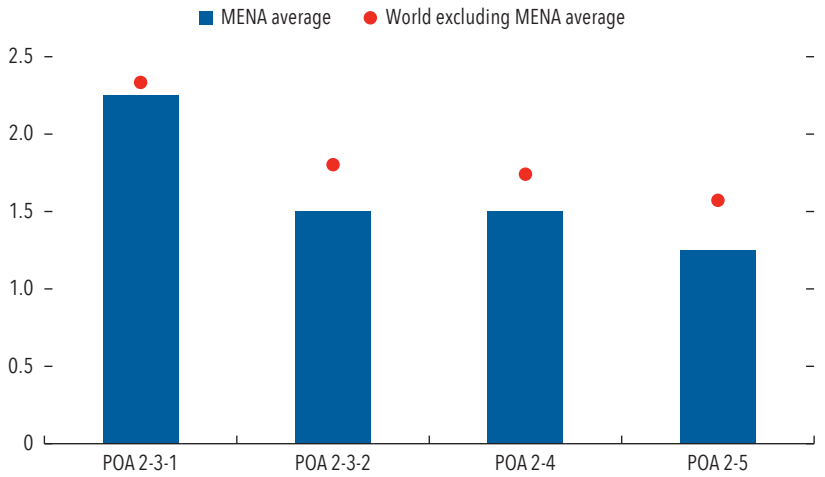
More countries are also moving toward e-invoicing systems. Saudi Arabia's e-invoicing system, Fatoorah, is gradually extending its scope to become mandatory for all taxpayers with VAT-taxable turnover of more than 1 million Saudi Arabian riyals by the end of 2025. In Egypt, mandatory business-to-business e-invoicing was introduced in 2020, after which the Egyptian tax authority implemented an electronic receipt system for business-to-consumer transactions in 2022. The system is a centralized electronic platform through which the tax authority can monitor transactions between businesses and consumers in real time, thus reducing the risks of informality and avoiding the administrative costs associated with traditional receipt systems. Tunisia has had limited business-to-business e-invoices and mandatory business-to-consumer e-invoices since 2016 (Asquith 2025). Several other countries have already introduced legislative reforms to promote e-invoicing (for example, Oman and the United Arab Emirates), and they are in different stages of implementation.

COMPLIANCE MANAGEMENT

Compliance Risk Management

Compliance risk management strategies improve compliance by identifying risks and tailoring decision-making, leading to increased revenue collection. Compliance risk management uses insights into compliance risks and taxpayer behavior to apply three types of treatments: preventive measures such as taxpayer education, facilitative measures such as prefilled tax returns, and enforced measures such as audits, investigations, and penalties (Betts 2022). Creating a compliance improvement plan specifies treatment strategies for a particular risk and usually focuses on industries or taxpayer segments. Countries review and adapt

Figure 10.3. Identification, Assessment, Ranking, and Quantification of Compliance Risks



Source: TADAT Secretariat, TADAT assessments database, 2022.
Note: The TADAT indicators in the figure are as follows: POA 2-3-1 (extent of intelligence gathering and research to identify compliance risks in respect of the main tax obligations); POA 2-3-2 (process used to assess, rank, and quantify taxpayer compliance risks); POA 2-4 (degree to which the tax administration mitigates assessed risks to the tax system through a compliance improvement plan); and POA 2-5 (process used to monitor and evaluate the impact of compliance risk mitigation activities). The MENA average is based on eight country assessments only. MENA = Middle East and North Africa; POA = performance outcome area; TADAT = Tax Administration Diagnostic Assessment Tool.

the compliance risk management process to their own challenges and resources to manage risks proactively and ensure sustainable revenue collection over time.

Only a few MENA countries plan to adopt compliance risk management strategies (IMF 2024). Jordan is actively pursuing it and has established compliance improvement plans for large taxpayers and self-employed professionals, using different approaches to risk rating. Jordan has also recently established a new compliance management unit, introducing the concept of predictive modeling to improve tax compliance. Morocco established a risk management committee, a centralized risk management function, and a risk management analysis unit. Algeria drafted a compliance improvement plan tailored to the oil and gas sector. Most tax authorities in the region still face challenges in identifying compliance risks, indicated by the median TADAT score of C in this area (Figure 10.3).

Taxpayer Segmentation

Taxpayer segmentation is a key element of compliance management. It is an important step in developing effective, targeted mitigation activities as part of a compliance improvement plan with appropriate treatment of the revenue risks and tailored responses to taxpayers' service needs (Brondolo and others 2022).

The segments typically include large enterprises, small and medium enterprises, microbusinesses, and high-wealth individuals.

Most tax administrations in the region (15 of 21 countries) have established dedicated large taxpayer offices (LTOs), including most FCSs. An estimated 88 percent of tax administrations globally have created dedicated units to manage large taxpayers.[13] The units are especially important in developing and transition countries where a relatively small number of taxpayers make a disproportionately significant contribution to revenues collected (Baer 2002).

However, even where LTOs are established, shortcomings in taxpayer selection criteria and LTO structure hinder achievement of their objectives. Key shortcomings include:

- *Taxpayer segmentation criteria.* Although some LTOs apply sector-based criteria together with size and turnover criteria outside of specific sectors, others select taxpayers only according to business sectors. In some cases, LTO thresholds have not been increased in years to reflect inflation. Other LTOs use several combined criteria, such as the amount of total sales, taxable income, or total taxes paid. Applying cumulative criteria to define large taxpayers will likely exclude some large taxpayers from the scope of the LTOs, which also tend to move slowly toward targeted compliance activities.
- *LTO structure and functions.* Distributing the activities related to large taxpayer administration across the LTO, headquarters, and regional offices is rarely an effective approach and adds to fragmentation. LTO management in the region is not always consolidated centrally, and even if a central LTO directorate exists at headquarters, several regional offices also have LTO desks (Algeria, Iran, Iraq, Morocco, and Sudan). Those desks operate according to geographical criteria and might not exercise all tax functions. In some countries, different taxpayer segmentation criteria can even be applied at a regional level. This fragmentation of functions and duplication of structures are obstacles to assessing taxpayers' overall situation and adopting a holistic approach to compliance, especially in countries that lack digitalized core processes. Box 10.4 outlines key considerations for a well-functioning LTO.

Accessing and Using Information

Tax administrations in the region still have limited access to information that is critical for tax compliance—especially for enforcing capital income taxation—and for strengthening governance. Tax administration information powers consist of access to books, records, and information in the taxpayer's possession; information held by financial institutions; and information held by other third parties, including government agencies. Information powers require a strong legal basis

[13] International Survey on Revenue Administration, 2021.

Box 10.4. Steps toward a Well-Functioning Large Taxpayer Office

A well-functioning large taxpayer office (LTO) should achieve two objectives: control over the largest portion of tax revenue through modern organizational arrangements, administrative procedures, and IT systems; and provide taxpayers with better tax-related services to promote a positive investment environment. Key steps toward creating a well-functioning LTO include the following:

- Establishing a full-service, function-based structure to cover all core functions. An LTO organizational structure could consists of a taxpayer services unit; a unit responsible for filing, payment, and assessments; an audit unit, which could establish specializations on industry sectors; a collection enforcement unit to follow up on nonfilers and pursue arrears; and smaller units to handle risk management, legal affairs, and IT support.
- Identifying large taxpayers based on annual turnover (including selected business sectors regardless of turnover) and reviewing the selection criteria regularly. Using multiple criteria (for example, amount of tax paid, tax in arrears, value of assets, and amount of refunds claimed) is inadvisable, because some large taxpayers might not be selected and some small taxpayers might be selected. The focus should be on highly complex business sectors, such as banking and insurance, natural resources, and telecommunications.
- Updating and maintaining the register of large taxpayers (such as every three years) and reviewing the taxpayer population periodically. Both are essential to ensure that the register continues to contain only the largest, economically active taxpayers.
- Designing and implementing targeted compliance activities through dedicated compliance improvement plans.
- Adequate human and financial resources. Because large taxpayers are involved in complex transactions with significant revenue implications, LTO staff should be highly skilled and competent. The required skills typically include accounting and legal training, specialist industry knowledge, audit-related skills, and expertise in risk management, profiling, and communications.

Sources: Baer 2002; and authors' compilations.

and are exercised through a mix of reporting requirements and exchange of information arrangements, including in a cross-border context. In the international setting, several MENA countries (particularly Gulf Cooperation Council members) have committed to the Global Forum on Transparency and Exchange of Information for Tax Purposes and Automatic Exchange of Information[14] and have taken implementation measures.[15] However, in practice, they often face legal and operational shortcomings in receiving cross-border information, for example, because of a lack of domestic implementing legislation or limited IT infrastructure.

The framework for accessing third-party information at the country level is also underdeveloped. Although a legal basis is generally in place for MENA tax administrations to access third-party information,[16] it is insufficient in most cases, especially regarding access to domestic information. The obstacles include:

- *Bank and other secrecy provisions.* With few exceptions (for example, Algeria and Tunisia),[17] bank secrecy laws block tax administration's access to information held by financial institutions (for example, Egypt, Jordan, and Lebanon; Verdier and others [2022]).[18] This is a major inconsistency compared with the reporting system for offshore accounts. Blocking this access is an impediment to tax administrations' capacity to set up proper audit techniques and compliance management and is a significant contributor to tax evasion. Other secrecy provisions also create legal barriers to access to information. In Jordan, the tax administration is unable to obtain data on cash transactions from the anti–money laundering agency because of secrecy provisions (Rozner and others 2016). By contrast, private companies in Djibouti cannot invoke professional secrecy to tax agents in exercising their functions.[19]

[14] For more details visit the webpage of the Global Forum on Transparency and Exchange of Information for Tax Purposes at https://www.oecd.org/en/networks/global-forum-tax-transparency.html.

[15] Bahrain, Kuwait, Lebanon, Morocco, Oman, Qatar, Saudi Arabia, and the United Arab Emirates have ratified the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information (read the agreement at https://www.oecd.org/tax/exchange-of-tax-information/crs-mcaa-signatories.pdf, status is as of March 13, 2025). For an overview of the participation of MENA countries in international initiatives for cooperation on taxation, see Table 10.2 and Annex 4 in Verdier and others (2022).

[16] See, for example, Cabinet Decision No. 74 of 2023 on the Executive Regulation of Federal Decree-Law No. 28 of 2022 on Tax Procedures, art. 17(4), United Arab Emirates.

[17] See *Code des Procédures Fiscales* (2020), art. 51, Algeria, on information from financial institutions, including on a standardized basis. Verdier and others (2022) notes that the Court of Audit in Algeria in 2021 highlights a lack of exchange of information between the revenue administration and banks as a main driver of weaknesses in tax collection. See also *Code des Droits et Procédures Fiscaux* (2023 version), art. 17, Algeria, which mandates banks and financial institutions to provide detailed information to the tax authority on request.

[18] In Egypt, however, authorities lifted bank secrecy to exchange information under tax treaty provisions, after an OECD Global Forum peer review (OECD 2024).

[19] Code Général des Impôts, Édition officielle 2011, art. 240, Djibouti.

- *Access to third party information only on request.* In most MENA countries, the tax administration does not have systematic access to information because the laws often provide for information only on request. The shift from an on-request information process to a more comprehensive standardized information framework provided periodically poses significant implementation challenges and needs a comprehensive design—and potentially link with several other laws.
- *Limited third-party reporting obligations, including for withholding tax agents*. Even in countries that apply broad withholding systems (which can assist in mitigating the effect of bank secrecy laws; Jewell and others 2015), only a limited range of information can usually be required from third parties and a narrow circle of third-party information providers. A filing and reporting system that interacts effectively with third-party information is paramount to ensure that such information is useful for verification and audit purposes.
- *Poor coordination and sharing of information with other relevant government entities*. In most cases, arrangements for exchange of information between domestic agencies are informal through memorandums of understanding or official correspondence. Importantly, accessing data on taxpayers operating in special economic zones from the various investment authorities of those zones is difficult.
- *Inadequate confidentiality framework.* Shortcomings in the confidentiality framework include broad obligation for the tax administration to provide information to other third parties, including any authority based on a provision of a special law; and absence of sanctions for breach of confidentiality obligations. Enhanced information powers for the tax administration should be complemented by adequate confidentiality safeguards to prevent misuse or unauthorized disclosure (IMF 2022).
- *Lack of a proper IT function within the tax administration.* Some countries in the region still use manual processes (for example, Iraq and Libya) or have underdeveloped IT functions (for example, Yemen, where headquarters does not have automatic access to tax returns submitted). A manual environment leads to weak internal controls and limited information to manage workflows and monitor obligations.

Use of information also presents challenges. Although domestic legal requirements and multilateral exchange of information arrangements can address access to information, the information is of little use for compliance purposes unless tax administration systems can easily incorporate and integrate the information and then analyze it properly (OECD 2020). Progress in the region is uneven regarding automated information cross-checking systems. Even where such a system is in place to verify data reported on returns and information obtained from third parties, in practice access to certain information sources is either limited or nonexistent, especially information held by banks and financial institutions. In the United Arab Emirates, direct links with local customs has been strengthened

TABLE 10.2.

Participation of MENA Countries in International and Regional Initiatives for Cooperation on Tax Matters

Country	BEPS IF	Global Forum	MAAC	ATAIC
Algeria	No	Yes	Yes	No
Bahrain	Yes	Yes	Yes	No
Djibouti	Yes	Yes	No	Yes
Egypt	Yes	Yes	No	Yes
Iran	No	No	No	Yes
Iraq	No	No	No	Yes
Jordan	Yes	Yes	Yes	Yes
Kuwait	Yes	Yes	Yes	Yes
Lebanon	No	Yes	Yes	Yes
Libya	No	No	No	No
Mauritania	Yes	Yes	Yes	Yes
Morocco	Yes	Yes	Yes	Yes
Oman	Yes	Yes	Yes	No
Qatar	Yes	Yes	Yes	Yes
Saudi Arabia	Yes	Yes	Yes	Yes
Somalia	No	No	No	No
Sudan	No	No	No	Yes
Syria	No	No	No	No
Tunisia	Yes	Yes	Yes	Yes
United Arab Emirates	Yes	Yes	Yes	Yes
Yemen	No	No	No	Yes

Source: Authors' compilation.
Note: Data were valid on June 14, 2025. Algeria signed the MAAC in October 2024, but it is not yet in force. The Global Forum is the Global Forum on Transparency and Exchange of Information for Tax Purposes. ATAIC = Association of Tax Authorities of Islamic States; BEPS IF = OECD/G20 Base Erosion and Profit Shifting (BEPS) Project Inclusive Framework; MAAC = Convention on Mutual Administrative Assistance in Tax Matters as Amended by the 2010 Protocol; MENA = Middle East and North Africa.

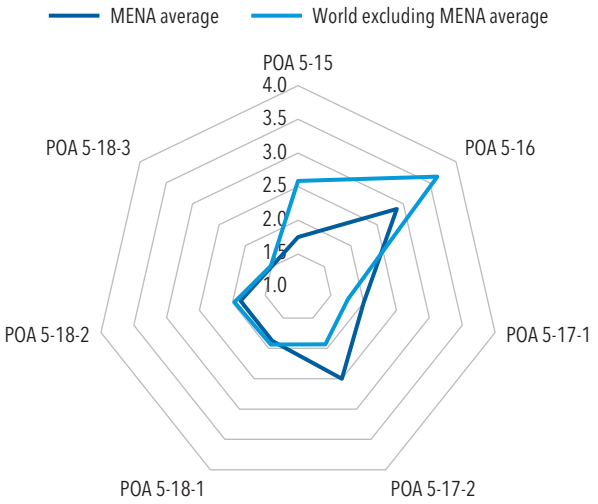
through the Customs Linkage System, and import data are incorporated into tax returns automatically (United Arab Emirates Federal Tax Authority 2023).

Collection and Arrears Management

In an efficient tax system, taxpayers are expected to pay taxes on time, and modern electronic systems and simplified procedures help taxpayers fulfill their obligations. Because of different resources and maturity levels, some administrations in the region struggle to secure a substantial percentage of on-time payments, while others excel in doing so (Figure 10.4). For example, in Sudan, the on-time payment rate for VAT in 2022 was 20.8 percent, but the rate in Saudi Arabia was 94.1 percent.[20] MENA countries outperform the rest of the world in the value of total VAT paid on time, which shows that major VAT payers are prompt with their payments. However, they underperform in the number of VAT returns paid on time (Figure 10.4).

[20] International Survey on Revenue Administration, 2018–2022.

Figure 10.4. Timely Payment of Taxes



Source: TADAT Secretariat, TADAT assessments database 2022.
Note: The TADAT indicators in the figure are as follows: TADAT POA 5-15 (use of electronic payment methods); POA 5-16 (use of efficient collection systems); POA 5-17-1 (number of VAT payments made by the statutory due date in percent of the total number of VAT payments due); POA 5-17-2 (value of VAT payments made by the statutory due date in percent of the total value of payments due); POA 5-18-1 (value of total core tax arrears at fiscal year-end as a percentage of total core tax revenue collections for the fiscal year); POA 5-18-2 (value of collectible core tax arrears at fiscal year-end as a percentage of total core tax revenue collections for the fiscal year); and POA 5-18-3 (value of core tax arrears more than 12 months old as a percentage of the value of all core tax arrears). The MENA average is based on eight country assessments. MENA = Middle East and North Africa; POA = performance outcome area; TADAT = Tax Administration Diagnostic Assessment Tool.

The stock of tax arrears is large, aging, and trending upward.[21] The weak management of arrears can be attributed primarily to the absence of debt management functions in the existing electronic systems. The available data on tax debt is inconsistent and not suitable for rigorous analysis. Without reforms, arrears will continue to age. However, some countries have made positive changes. In Jordan, for example, core tax arrears in 2016 accounted for a significant 54 percent of the total tax collected, nearly 70 percent of which were more than a year old (Rozner and others 2016). In 2022, Jordan increased the on-time payment rate for core taxes above 90 percent, thus decreasing the accumulation of tax arrears.[22] The Algerian General Directorate of Taxes has also achieved significant improvement in managing tax arrears through a dedicated collection directorate created within the central services (IMF 2023).

[21] TADAT POA 5-18 (Stock and Flow of Tax Arrears). The median TADAT score is C, on a scale of A to D, with A being the best score (TADAT Secretariat, TADAT assessments database, 2022).

[22] International Survey on Tax Administration, 2018–2022.

Refunds

Refund mechanisms in the region vary by country and tax type. Administrations provide VAT refunds immediately (for example, Saudi Arabia and Tunisia), through limited carry-forward (Egypt and Jordan, for example), or indefinite carry-forward (such as Algeria and Morocco; Pessoa and others 2021). The immediate refund system is helpful for taxpayers because it allows them to recover funds promptly with a minimal impact on their cash flow. Digitalization has helped make the VAT refund process more transparent and efficient. Some tax authorities (for example, Saudi Arabia and the United Arab Emirates) have developed comprehensive e-services platforms that make collection and refund processes more accessible, or they offer streamlined procedures for VAT refund processing to some taxpayers as part of an enhanced level of service (for example, Jordan; Rozner and others 2016). Despite ongoing reforms, some countries still have underdeveloped tax refund systems that delay refunds.

Use of risk management strategies in refund audits remains limited in the region. Few countries have established comprehensive mechanisms to assess and prioritize risk. Inadequate databases limit tax administrations' ability to apply risk management strategies effectively, leading to audits of refund claims, which can affect taxpayer behavior when showing a net refund. For example, most refund claims in Egypt undergo a desk audit at the tax office where they are filed.

CONCLUSION

Tax administrations in the MENA region are at different levels in their maturity and the operational challenges they face. Organization and governance, legal frameworks, compliance gaps, compliance management, and digitalization are some of the key areas that affect the efficiency of the region's tax administrations.

Looking ahead, MENA countries can focus on strengthening their core functions, transitioning to modern organizational structures, and continuing digitalization to enhance tax administration processes and implement reforms more effectively. Countries with advanced digital systems can streamline tax filing and payment, improve compliance management, and adapt to the rapidly changing international environment. For those with basic digitalization functions, addressing organizational issues and resource constraints will be crucial to make progress in risk management and collection. Tax administrations in FCSs should adopt selective, tailored approaches that prioritize core tax administration operations as a path to gradually implementing more advanced reforms, including the transition to a digital environment.

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Epilogue: Taxation, Conflict, and Fiscal Resilience

This book was completed before the outbreak of the war in the Middle East that now dominates the region's political and economic landscape. The war has transformed uncertainty into a defining condition for fiscal policy. More than episodic shocks, it could represent a fundamental shift that reshapes the assumptions on which revenue systems, fiscal buffers, and reform strategies in the region have long relied on.

The immediate economic effects of the war—disruptions to energy markets, heightened risk premiums, inflationary pressures, and volatility in trade and capital flows—are already evident. Yet the deeper implication is more fundamental. The war underscores the vulnerability of fiscal models that depend heavily on hydrocarbons or on stable global integration. For many countries in the region, the war accelerates a transition that was already underway: from fiscally comfortable equilibria—at least in hydrocarbon exporting countries—toward an environment in which domestic revenue mobilization becomes indispensable for fiscal continuity and policy autonomy.

Many of the book's core messages are therefore sharpened by these recent developments.

First, the war reinforces the centrality of taxation as an instrument of fiscal resilience. In an environment characterized by recurrent shocks and geopolitical fragmentation, revenue systems optimized for efficiency under stable conditions prove brittle. Taxes that are broad-based, predictable, and enforceable—particularly consumption taxes, excises, and recurrent property taxes—emerge not merely as administratively convenient instruments for revenue diversification, but as stabilizers in a high-risk fiscal landscape.

Second, the conflict alters the fiscal calculus for hydrocarbon-exporting countries. Historically, regional conflict has often been associated with higher oil prices and temporary revenue windfalls. Recent experience illustrates the limits of this logic. When production, transport routes, insurance, or access to markets are disrupted—or when risk premiums dominate price changes—hydrocarbon dependence becomes a vulnerability rather than a buffer. The case for diversifying revenue through nonhydrocarbon taxation is therefore no longer confined to long-term sustainability or intergenerational equity; it has become central to near-term fiscal resilience.

Third, for fragile and conflict-affected states, the war magnifies fiscal pressures while narrowing the feasible policy space. Spillovers through higher import prices, disrupted trade, displacement, and rising security needs intensify demands on governments whose administrative capacity is already constrained. In such contexts, the book's emphasis on simplicity, concentration of collection points, and realistic sequencing of reforms becomes even more salient. Incremental,

enforceable tax systems are not second-best options; they are prerequisites for preserving basic state functions.

Fourth, the war elevates the importance of regional tax coordination, particularly among economically integrated subregions such as the Gulf Cooperation Council. In a context of disrupted supply chains, price volatility, and heightened fiscal stress, uncoordinated tax responses—for instance, to revive the tourism sector after the war—risk amplifying distortions and revenue leakage. Strengthening coordination of value-added taxes and excises—through closer alignment of rates and bases and administrative practices—offers a practical avenue for protecting revenues while limiting arbitrage, smuggling, and competitive erosion. The Gulf Cooperation Council's existing institutional framework provides a foundation on which such coordination can be deepened, moving from light harmonization toward more effective joint enforcement and information sharing.

Fifth, the war sharpens the link between taxation and the social contract between governments and citizens. Conflicts amplify demands for public spending—on security, subsidies, reconstruction, and social protection—while simultaneously constraining fiscal space. In this setting, tax systems perceived as inequitable or selectively enforced risk exacerbating social tensions. The book's finding that taxation in the region plays only a limited redistributive role becomes more consequential under conditions of conflict and stress. Strengthening the legitimacy of taxation—through fairness, transparency, and credible enforcement—is therefore not only a governance objective, but a condition for political stability.

Finally, the war reorders priorities in tax administration reform. Digitalization, withholding mechanisms, and third-party reporting—already highlighted as sources of efficiency—take on added importance as tools of continuity under stress. Administrations that rely on automated processes and electronic systems are better positioned to sustain revenue collection when mobility is constrained or institutions are under strain.

Taken together, the war in the Middle East transforms the interpretation of this book. What might previously have been read as a forward-looking agenda for gradual modernization must now be understood as a framework for fiscal resilience in an era of sustained uncertainty. The policy options discussed across chapters—broadening tax bases, rationalizing tax incentives, strengthening administration, and cautiously expanding income taxation—are no longer only about convergence with international norms and revenue diversification. They are about preserving the fiscal function of the state in a world where shocks are frequent, alliances uncertain, and external buffers increasingly unreliable.

In this sense, the central proposition of the book is reinforced rather than diminished: in times of conflict as much as in times of peace, taxation is not only a means of financing the state; it is one of the foundations of the state itself.

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