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Diversifying Government Revenue in the GCC: Next Steps

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CONTENTS

EXECUTIVE SUMMARY 3

A. Introduction 4

B. The Current Structure of Tax Systems in the GCC 4

C. Tax Reforms in the GCC – What is Needed and Why? 7

D. VAT and Excises: Moving to Implementation 11

E. Business Profit Tax 17

F. Other Taxes and Fees 21

G. Policy Recommendations and Conclusions 25

References 29

BOX

1. France: Excise Tax on Beverages 14

FIGURES

1. Composition of Government Revenues in 2015 9
2. Non-oil Tax Revenues in 2015 9
3. Composition of Total Tax Revenues in 2015 9
4. Workers Remittances from GCC Countries, Outward 21

TABLES

1. GCC: Non-oil Revenue Reforms Agenda (2015-21) 7
2. GCC Countries: Revenue Structure (2012–15) 7
3. GCC Countries: Breakdown of Tax Revenue 8
4. Tax Rates in Major Resource-rich Countries, 2016 10
5. Cross-Country Comparison of VAT Rates, VAT and Tax Revenues, and C-efficiency Ratios 16
6. GCC Countries: Estimated VAT Revenue 17
7. Revenue Estimates for a Proposed Business Profit Tax for GCC Countries 20
8. Revenue Estimates from Personal Income Tax of Foreign Workers 23

ANNEX

I. Main Characteristics of Tax Systems in the GCC Countries 27

EXECUTIVE SUMMARY[1]

GCC governments have intensified efforts to increase non-oil revenues as part of their broader fiscal consolidation strategies. Negotiations of the two GCC agreements on VAT and excises have intensified over the last year, although challenges remain. Some countries are considering or have already introduced other type of taxes and fees.

There is considerable scope for increasing non-oil tax revenues in the GCC. Tax revenues in the region are low by international standards. Tax reform can raise new revenues, provide an opportunity to remove existing less productive taxes and fees, and build the required institutions and tax culture of a modern tax system.

It is important that tax reforms are implemented at a pace that allows businesses and individuals time to adjust and that is consistent with administrative capacity. Ensuring that the reforms are underpinned by the necessary tax infrastructure and are clearly explained and communicated will be essential to their success and long-term sustainability. This will require careful prioritization and sequencing of the introduction of new taxes.

The first priority should be the successful implementation of the planned VAT and excise taxes. While there are benefits to countries moving together in introducing these taxes, there is also scope to move separately or with a sub-set of countries given differing fiscal needs and status of preparations. On the VAT, if countries do move separately, they should decide on a reasonable transitional period (3-5 years) by the end of which the VAT would go into effect across the region. Exemptions/zero ratings should be minimized, while issues relating to the treatment of inter-GCC trade need to be resolved.

For excises on tobacco and sugar sweetened beverages (SSBs), there are no strong arguments for full harmonization. The rates should be set at levels that balance health and revenue goals. Substitution across similar products will take place if the excise bases are not carefully defined and/or if the rates are set too high.

Over time, the GCC countries should also move to introduce or expand the tax on business profits. This, together with the VAT and excises will help ensure efficient and progressive tax systems in the region and generate the bulk of non-oil tax revenues for most countries' budgets.

[1] Prepared by Ali Alreshan, Nabil Ben Ltaifa, Tim Callen, Zhe Liu, and Vahram Stepanyan (all MCD) and Mario Mansour (FAD). Input was also provided by Artur Swistak (FAD). Editorial support was provided by Diana Kargbo-Sical. This paper complements the paper "Tax Policy Reforms in the GCC Countries: Now and How?" that was prepared for the 2015 GCC Ministerial meeting.

A. Introduction

1. GCC governments have been relying largely on oil revenues to finance their expenditures. Oil revenues accounted for between 50 and 90 percent of total government revenues during 2012–15 across the six countries compared with an average of 24 percent for a comparator group of countries.[2] Non-oil tax revenues averaged only about 1.7 percent of GDP (about 3 percent of non-oil GDP) during the same period. The large and rapid decline in oil prices has led to sharp cuts in GCC government spending and a slowdown in economic activity since 2015. Despite these efforts and projected reforms, the fiscal deficit for GCC countries is projected to widen to 11 percent in 2016 and to remain above 4 percent of GDP in 2021.

2. In view of these fiscal deficits, and given the expectation that oil prices will stay low, GCC countries have appropriately begun to extend fiscal reforms to diversifying budgetary revenues. Initial efforts have focused on raising some fees in 2015–16, while intensifying preparations to overhaul and broaden tax structures. Negotiations among GCC governments of two agreements relating to the implementation of VAT and excise taxes on tobacco and sugar sweetened beverages (SSBs) have led these efforts. In addition, member countries have been exploring a multitude of measures to raise additional revenue through other taxes and fees, including introducing or expanding the implementation of the business profit tax, taxes on remittances, taxes on income and wages paid to foreign workers, and taxes on financial transactions.

3. This paper discusses how to diversify government revenues in the GCC, with a particular focus on implementing VAT and excises and the business profit tax at the GCC level. The paper is organized as follows. Section B provides an overview of the current tax systems in the GCC. Section C reviews the benefits of a modern tax system for GCC countries, what would be its main elements, and its implications. A more detailed discussion of the main features of the VAT and excises as defined in the GCC agreements, including issues relating to their application are discussed in D. Section E looks in greater detail at the business profit tax and section F at taxes on remittances, taxes on income and wages paid to foreign workers, and taxes on financial transactions. Section G concludes with some policy recommendations.

B. The Current Structure of Tax Systems in the GCC

4. The development of tax systems in the GCC has been largely shaped by the size of oil revenues available to governments. While efforts to raise tax revenues date back to the mid-twentieth century, increasing oil revenues—albeit with considerable volatility—led governments to adjust their tax policies in favor of promoting direct investment and attracting expatriate labor to support rapid growth in public/private sector investment and broader economic activity. Saudi Arabia introduced personal income, capital gains, and corporate taxes in 1950 on both nationals and non-nationals. Within six months of introduction, however, the tax law was reformed to exclude

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[2] The comparator group focuses on other major resources-rich countries in emerging markets and advanced economies, including Algeria, Indonesia, Mexico, Nigeria, Norway and Canada. The selection of countries in the text and charts is based on the availability of tax data relevant to the discussion.

nationals and in 1975, income taxes on foreigners were suspended. Kuwait introduced a corporate tax in 1955, and then other GCC countries followed suit. UAE introduced taxes in the mid-1960s and Oman in the early 1970s. Corporate taxes in the GCC, however, were reduced substantially during the first decade of this century to promote foreign direct investment (FDI). Most countries established free zones and introduced tax holidays, thus further reducing effective tax rates on foreign corporations.

5. At present, non-oil revenues in the GCC come mainly from customs duties, profit tax on foreign companies, and a myriad assortment of fees and fines. The main characteristics of the tax systems in the GCC countries are as follows (see Annex I for more details):

- ***There are limited personal income taxes.*** There are no taxes on wage income for either nationals or non-nationals. However, two countries—Qatar and Saudi Arabia—have very limited income taxes on non GCC-nationals that carry out business or professional activities. National individuals and companies are subject to Zakat, which is levied at 2.5 percent of net worth.[3]

- ***Profit taxes apply mostly to foreign non-oil companies, while the oil sector is subject to a special profit tax regime***. All GCC countries except Bahrain impose non-oil corporate income taxes. These range from 10 percent in Qatar to 20 percent in Saudi Arabia and apply only to foreign companies, except in Oman, where the tax applies at a 12 percent rate on taxable income (in excess of a threshold) for both national and foreign-owned companies. Tax relief for losses and tax incentives are provided to foreign companies which lowers the effective tax rate. The tax on companies engaged in petroleum and natural gas extraction ranges from 15 percent in Kuwait to 85 percent in Saudi Arabia and UAE (irrespective of nationality).

- ***Customs duties are unified across the GCC.*** After implementation of the new Common External Tariff (CET) on January 1, 2003, all non-GCC products, except for those exempted, are subject to 5 percent customs duty. Products of the GCC countries enter into each other's markets free of customs duties.[4] However, there are many items such as medicines, most food products, and capital goods and raw materials for industries which are exempt from duty.

- ***Tourism, entertainment, rental property, and modest consumption taxes are present in a number of countries.*** Bahrain, Oman, and UAE impose municipal/consumption taxes ranging from 3 to 10 percent on property rents, hotels, entertainment, and some government services. In UAE, some of these taxes are collected at the local (emirate) level. Bahrain imposes a 12 percent sales tax on gasoline, while Oman imposes a 2 percent consumption tax on electricity. The GCC countries also collect different fees and stamp duties on government services—such as for the issuance of passports, commercial registrations, or driver licenses—and these vary from one

[3] The collection of Zakat is not fully enforced in all GCC countries. Zakat is an obligatory contribution of a certain portion of one's wealth (2.5 percent) in support of the poor or needy or other charitable purposes.

[4] Products are considered as originating in a GCC country if the value added to such product in the said country is more than 40 percent of the value of the product in question and if the factory that manufactured the product is at least 51 percent owned by GCC nationals.

(continued)

country to another and yield little revenue.[5] There are no property taxes in most of the GCC. Saudi Arabia imposes 2.5 percent Zakat on real estate if held for speculative purposes.

- ***Taxes and fees on the employment of foreign workers are used to support national labor.*** Bahrain and Saudi Arabia impose monthly fees on foreign workers to finance training for nationals. Oman has a similar scheme, but determines the fee as a percent of the foreign worker wage bill. UAE imposes biannual work permit fees, while Kuwait imposes a tax on the annual net profits of Kuwaiti companies listed on the stock market to fund training. Qatar is the only country that does not impose any fees or taxes on wages for the training of national labor force.

- ***Social security taxes are mandatory in all GCC countries for nationals.*** Employers and employees must pay the social insurance tax. The contributions are shared equally between the employers and employees in Saudi Arabia, and in other countries, the employers pay a higher share.

6. Faced with the substantial and rapid decline in oil revenues, GCC countries have intensified efforts to deepen tax reforms since 2015. These are part of substantial fiscal consolidation efforts that are underway. In this regard, countries are working at the GCC level on agreements relating to VAT and excise taxes on tobacco and sugary drinks. A target date for implementation of the VAT has been set for January 2018, while the implementation date for the excises varies across countries (2017 for Saudi Arabia and Qatar). In addition, a number of GCC countries have separately implemented or taken steps to introduce new revenue-raising measures which will contribute to achieving medium-term fiscal objectives (Table 1). Furthermore, the GCC countries are considering a number of additional reforms to raise non-oil revenue in the years ahead. These include introducing or expanding the implementation of the business profit tax, taxes on remittances, taxes on income and wages paid to foreign workers, and taxes on financial transactions. A discussion of these measures is presented in sections E and F below.

[5] Stamp duties/registration fees on transfer of land and property are in effect in Bahrain, Oman and UAE, and range from 1.5 to 4 percent of the property value, depending on the country. Detailed data on fees and charges is not available to staff for the other GCC countries.

Table 1. GCC: Non-oil Revenue Reforms Agenda (2015–21)

		VAT	Excise	Others
Bahrain	Measure (Implementation date)	VAT at 5 percent (2018)	NA	• Increase EWA administration fees, sand mining fees, hotel service fees, cost recovery on municipalities, and fee on sand extraction (2016) •Fees on alcohol and tobacco (2016)
Kuwait	Measure (Implementation date)	VAT at 5 percent (2018)	NA	Business profits tax
Oman	Measure (Implementation date)	VAT at 5 percent (2018)	NA	• Increase civil aviation fees and other fees (2015) • Training tax and municipal tax on rents (2016) • Increase in corporate income tax from 12 to 15 percent and remove the threshold (2017)
Qatar	Measure (Implementation date)	VAT at 5 percent (2018)	Excise on tobacco, energy and soft drinks (2017)	• Increase water and electricity tariffs (2015) • Increase gasoline price (2016) • Introduction of pricing mechanism to revise fuel prices regularly (2016)
Saudi Arabia	Measure (Implementation date)	VAT at 5 percent (2018)	Excise on tobacco, energy and soft drinks (2017)	• Increase visa fees except for Hajj and Umrah (effective October 2, 2016) • Introduction of white land taxes
UAE	Measure (Implementation date)	VAT at 5 percent (2018)	NA	• Introduction of a 3 percent municipal fee on expat property rental in Abu Dhabi (2016) • Increase government fees for intellectual property rights registration, including trademarks, patents, copyrights and designs (2015) • Fees on alcohol and tobacco (2015)

Sources: IMF country teams.

C. Tax Reforms in the GCC – What is Needed and Why?

7. **In light of the above tax structure, GCC tax revenue collection has been low** (Tables 2 and 3 below; and Annex 1, Table 1 with a detailed breakdown by country). Non-oil revenue including investment income represented only 20 percent of total revenue and hovered around 8 percent of GDP (15 percent of non-oil GDP) in 2012–15. The share of tax revenue to total revenue was around 4 percent and its ratio to GDP averaged about 1.7 percent (3 percent of non-oil GDP) for the GCC countries during this period. There is, however, significant variation among countries. Oman has the highest non-oil tax-to-non-oil GDP ratio at 6 percent and Bahrain the lowest at about 0.8 percent of non-oil GDP.

Table 2. GCC Countries: Revenue Structure (2012–15)

	2012	2013	2014	2015	2012-2015
	(in percent of GDP)				
Total Revenue	46.4	45.7	41.9	31.8	41.5
Non-oil Revenue	6.6	7.8	7.9	10.0	8.1
o/w Tax revenue	1.7	1.6	1.7	2.0	1.7
Oil Revenue	39.8	37.9	33.9	21.8	33.4
	(in percent of non-oil GDP)				
Total Revenue	101.6	94.1	80.7	47.4	81.0
Non-oil Revenue	13.9	15.6	14.9	14.6	14.8
o/w Tax revenue	3.4	3.0	3.0	2.9	3.1
Oil Revenue	87.7	78.5	65.8	32.8	66.2
	(in percent of total revenue)				
Non-oil Revenue	14.2	17.0	19.0	31.6	20.4
o/w Tax revenue	3.6	3.4	4.1	6.3	4.3
Oil Revenue	85.8	83.0	81.0	68.4	79.6

Sources: IMF WEO; and staff estimates.

Table 3. GCC Countries: Breakdown of Tax Revenue
(In percent of non-oil GDP)

	Total	Personal Income	Corporate Income	Goods & Services	Trade	Property	Other
Bahrain	0.8	...	...	...	0.8	...	0.0
Kuwait	2.2	...	0.5	...	...	...	1.6
Oman	6.0	...	3.0	...	1.6	...	1.4
Qatar	3.8	...	2.5	...	0.8	...	0.5
Saudi Arabia	2.3	...	0.8	...	1.5	...	0.0
UAE	3.5	...	0.8	...	0.6	...	2.0

Sources: IMF staff estimates.
Note: Latest data is for 2015 where available; UAE and Qatar's corporate and trade data are for 2014.

8. GCC non-oil tax revenue collections are low compared with a group of LICs and emerging markets oil exporter countries:[6]

- **Non-oil revenues as a share of non-oil GDP in the GCC are on average similar to those of a group of large oil exporters**. They are higher than in Nigeria and Kazakhstan and lower than Mexico, Algeria, and Angola (Figure 1).

- **However, non-oil tax revenues as a share of non-oil GDP are on average much lower in the GCC than the other oil exporters**. The average non-oil tax revenue as a share of non-oil GDP is about 13 percent for the comparator group. It is higher in Algeria at 17 percent and exceeds 10 percent in all other countries except Nigeria, where it is only 3 percent and similar to the average for the GCC. Accordingly, the share of non-oil non-tax revenue in non-oil GDP, at about 12 percent on average for the GCC countries, is much higher than that of all countries in the group. This reflects higher sovereign investment income. For the other countries, this type of revenue ranges from 1 percent of non-oil GDP in Nigeria to 6 percent in Mexico (Figure 1).

[6] Countries are Algeria, Angola, Kazakhstan, Mexico, Nigeria, Canada, and Norway. Tax data allowing the split of oil and non-oil tax revenue is not available for Canada and Norway, and data allowing the split between corporate income tax and individual income tax is not available for Angola and Nigeria. The choice of countries is based on the availability of tax data relevant to the discussion in the text.

- **Consequently, non-oil tax revenues cover a much larger share of government spending in the other oil exporters than in the GCC.** Its ratio to government expenditures is near or above 40 percent in Mexico and Kazakhstan, and above 20 percent in the rest of the countries (Algeria, Angola and Nigeria). However, non-oil tax revenue covers less than 5 percent on average of government expenditures in the GCC countries (Figure 2).

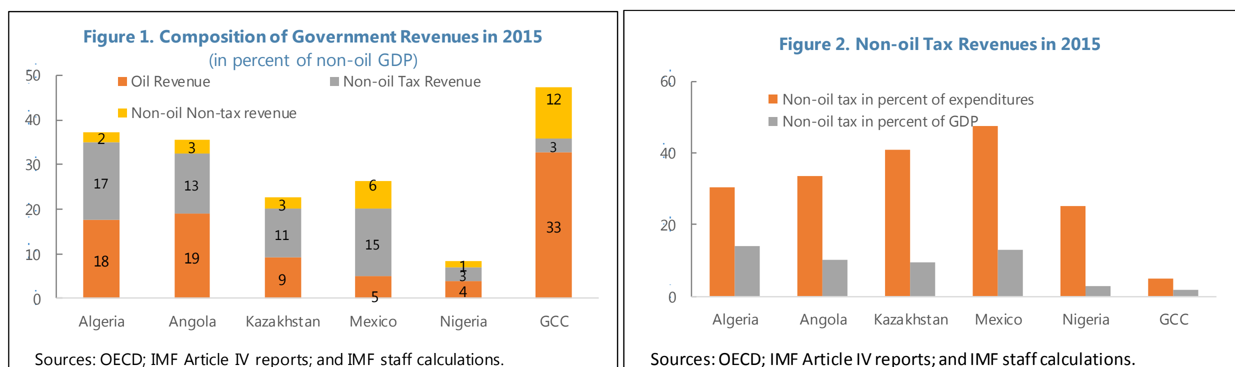

Figure 1. Composition of Government Revenues in 2015
(in percent of non-oil GDP)

Sources: OECD; IMF Article IV reports; and IMF staff calculations.

Figure 2. Non-oil Tax Revenues in 2015

Sources: OECD; IMF Article IV reports; and IMF staff calculations.

9. Large oil exporters have relied on broad based and diverse tax structures to achieve those high tax revenues levels (Figure 3 and Table 4). For all countries except Canada, taxes on goods and services (including the VAT) accounted for the larger portion of their tax revenue. The average VAT rate for the group is 13 percent and only Canada and Nigeria have a lower rate of 5 percent. Algeria has the highest taxes on trade accounting for over 17 percent of its tax revenue. Canada, however, relies the most on personal income taxes, collecting over 30 percent of its tax revenue from this source. Algeria, Canada, Norway and Mexico have the highest personal income tax rates at over 35 percent and Angola and Kazakhstan, much lower, at 17 percent and 10 percent respectively. Corporate income tax rates ranged from 15 percent in Canada to 35 percent in Angola. Norway has the most balanced revenue structure, with corporate income, individual income, and consumption taxes each contributing to around 30 percent of its tax revenue (Figure 3) (Table 4).[7]

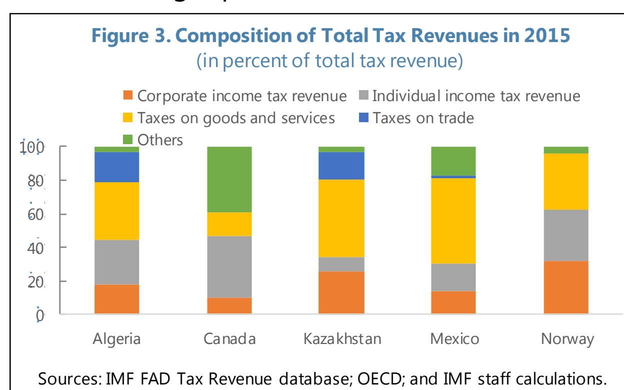

Figure 3. Composition of Total Tax Revenues in 2015
(in percent of total tax revenue)

Sources: IMF FAD Tax Revenue database; OECD; and IMF staff calculations.

[7] For Canada, in addition to the federal rate, provinces collect corporate taxes ranging from 2.5 in British Columbia to 4 percent in Northwestern territories and Yukon for the lower rates, and 11 percent in British Columbia to 15 percent in Yukon for the higher rates. It has also provincial taxes on top of the federal personal income tax.

Table 4. Tax Rates in Major Resource-rich Countries, 2016
(In percent, unless otherwise noted)

	Corporate Income	Personal Income [1/]		VAT	
	Rates	Top Rates	Threshold (US$)	Rates	Threshold (US$)
Algeria	23	35	13,324	17	…
Angola	35	17	2,418	…	…
Mexico	30	35	165,420	16	…
Nigeria	30	24	16,245	5	…
Kazakhstan	20	10	…	12	113,323
Canada	15	50	104,388	5	26,951
Norway	25	39	104,858	25	8,192

Sources: Ernst & Young.
1/ Refers to the top statutory tax rates.

Tax reform in the GCC

10. There is a need for GCC countries to increase non-oil revenues to reduce their reliance on oil and meet priority spending needs in the context of a potentially prolonged period of low oil prices. To this end, GCC governments should consider a greater role for income and consumption taxes, or forms of wealth taxes such as a recurrent property tax. The successful and carefully sequenced introduction of a VAT and a business profits tax (with an exemption threshold for individuals) would efficiently raise needed revenues. The two would act for most individuals as a progressive tax on income: for those earning wage income (and having a low savings rate), the VAT would be the only tax paid; for those earning business income, the business profits tax would be paid in addition to the VAT on income spent. Furthermore, the introduction of a VAT at a higher rate (or reducing the exempted sectors and zero rated products and/or services) could eliminate the need for a common external tariff (CET). However, the revenue strength of the VAT, relative to the tariff, would come primarily from taxing services. These new taxes would also provide an opportunity to simplify the current system of fees and stamp duties which is complex in many GCC countries and yields little revenue.

11. The appropriate pace and scope of tax reform may, however, differ across countries. In particular, the design of the tax system, the level of taxation, and the speed of implementation of reforms would vary depending on local budget financing needs and the level of readiness of various tax legislations and local tax administration capacity. For example, in Oman and Bahrain, oil reserves are expected to be exhausted sooner than in the other countries and the need for alternate revenue sources is more pressing. The UAE is a federation where tax policy at the national level must attend to emirates' varying revenue needs, which calls for some form of revenue sharing among emirates, either through an explicit assignment of taxation powers or through transfers. In this regard, taxes at the local (emirate) level should be streamlined/harmonized with the application of new federal taxes such as the VAT for example.

12. Taxes should start at low rates. This will encourage the design of simple and broad based taxes which are easier to administer and will have little or no efficiency costs and not stand in the way of efforts to diversify the economy. Further, the reform agenda should focus on a few broad based taxes and avoid the proliferation of small fees and other levies. This is particularly important to avoid overstretching the capacity of tax administrations. Focusing reforms on a few well sequenced tax measures will help ensure successful implementation, which in turn will signal the strong commitment of governments to reforms and strengthen the credibility of the reform effort.

13. Countries could also introduce new taxes as soon as ready, ahead of other GCC members, with limited risk to their regional/external competitiveness. This is especially true if the introduction of the new taxes is accompanied by reforms aimed at strengthening the overall business environment. Introducing new taxes and/or adopting higher tax rates (or wider tax bases) could potentially lead to part of consumption, trade, or investment shifting to other countries in the short term, particularly if tax differences across countries were large. In the longer term, the potential adverse effects of such reforms on competitiveness and the government budget could be addressed through measures to improve the business and investment environment along with increasing transparency and simplicity of the tax system, which would reduce production costs and help attract foreign investment.

14. In the early stage of the implementation of new taxes, challenges related to public attitude and administration capacity may emerge. The process of any new tax design should address issues of its transparency and governance, and the law, related regulations, and other documents, including explanatory materials should be accessible to general public (Stepanyan, 2003). For many would-be taxpayers, the tax will be totally new and may generate concern. Hence, it will be important to consult with stakeholders and communicate transparently with the public. The tax administration should also be well prepared to handle all aspects of the new tax implementation. The preparation process should involve training tax administration employees in the use of the law and related regulations, organizing the structure of the administration, hiring new staff, acquiring necessary technology, printing forms and booklets, and planning the communication. It would be also important to engage the accountant community for technical consultations on the compliance and enforcement of the tax.

D. VAT and excises: Moving to Implementation

15. The GCC countries have announced their intention to introduce a VAT staring in 2018, but significant challenges remain. They have also committed to implementing excises on tobacco and sugar-sweetened beverages (SSBs), potentially beginning in 2017. Many GCC states have devoted substantive effort to policy design issues,[8] but still need to make the necessary investment in building tax administration capacities to implement the taxes. Moreover, difficult issues relating to the taxation of intra-GCC cross border trade remain under discussion at the regional level to finalize

[8] For more details on key design issues in a VAT, please refer to the staff paper on "Tax Policy Reforms in the GCC Countries: Now and How?", which was prepared for the 2015 GCC Ministerial meeting.

the VAT and excise taxes agreements. These national and regional dynamics need to be addressed for a successful and on-time implementation of VAT and excises.

16. Three dimensions to the policy design and coordination of VAT and excises in the GCC are still under discussion:

a. The regional policy design: The extent to which countries should adopt similar tax bases and tax rates.

b. The collection of the taxes in the context of the customs union: How taxes should be collected on intra-GCC cross border trade in goods, and transit trade from the rest of the world destined for a GCC member.

c. The timing of implementation, which is relevant because the VAT and excises are being introduced for the first time in the region: Should all members implement at the same time, or can a transitional arrangement be used to allow some flexibility regarding the timing of implementation.

17. This section addresses these issues in the context of current negotiations at the regional level, reflected in the draft VAT and excise tax agreements. It also looks at the revenue and inflation implications of the VAT. It does not address national policy issues, where the agreement allows more scope for setting their tax base—which is especially the case of the VAT agreement. These national issues should be considered in the context of national fiscal strategies, which can differ across member states, yet remain consistent with the regional agreements.

Policy design issues in the VAT and excise agreements

The Draft VAT Agreement

18. The "VAT agreement" under consideration sets a single tax rate of 5 percent and harmonizes the main features of the VAT, but leaves significant discretion for member countries to set the tax base. It prescribes a common legal framework for the VAT, which is binding on all countries. It calls for some harmonization of the tax base, but leaves to countries the liberty to decide the tax treatment of six sectors: education, health, financial services, real estate, domestic transportation, and oil and gas. Countries have substantial leeway to define these sectors, and have the option to tax, exempt, or zero-rate these sectors. They also have similar leeway in determining the VAT treatment of the government and agriculture sectors. The Agreement also allows member countries to zero-rate certain domestic food items from a common list of about 100 items drawn up using customs Harmonized System (HS) codes.

19. Given the higher flexibility in tax base setting, effective tax rates will be lower than the envisaged statutory rate. Depending on national policy choices, the resulting revenue loss (from exemptions, zero rating, and definition of the six sectors discussed above) could be as high as 50 percent of potential VAT revenues. This has led policymakers in some member states to discuss the possibility of setting the statutory tax rate higher; possibly at 10 percent.

20. Some variation in effective tax rates across countries is manageable as the risk of increased cross border shopping is likely to be limited. This is true at least in the short-to-medium term given the proposed low VAT rate and the relative immobility of the taxable items being considered for exemption or zero-rating. One exception, however, is the financial sector: in the absence of coordination, it is likely that most countries will zero-rate financial intermediation and fee-based financial services (such as portfolio and wealth management), given the mobility of such services and competition among GCC countries to attract them—including from outside the region.

21. However, the high flexibility accorded to countries in defining the tax base (i.e. particularly the scope of exemptions and zero-rating), could be potentially problematic on three fronts. First, it is likely to undermine the objective of revenue generation intended from this reform. Furthermore, it will increase price distortions across and within countries. Third, this will complicate VAT administration, both within member states and in the context of the GCC customs union, as it will likely open tax loopholes at the country level and make tax collection at the GCC level more complex if for example the tax is collected in the origin states for the destination state.

The draft excise taxes agreement

22. The draft excise agreement proposes to fully harmonize the rates, bases, and coverage of two excise taxes: tobacco, and SSBs. Research shows that there are no strong arguments for full harmonization of excise taxes; some flexibility in rate setting could be given to countries, either within a range, or by setting minimum rates. Smuggling and bootlegging in the case of tobacco may be an issue, but is not specific to the GCC—i.e. even if the GCC had the same rate, illegal consumption could come from outside the GCC. This simply reinforces the standard view that high rates on tobacco must be accompanied by effective enforcement and control of illegal activities to be successful in their revenue and health impacts.

23. Nevertheless, agreement on some important design issues needs to be reached. The underlying objectives of the proposed excises, as expressed publicly by member countries, are additional revenues and health concerns. Given these objectives, the two key policy design issues are whether the excise should be specific, ad-valorem, or a mix; and the definition of the tax base.

24. In the case of tobacco, the system should include specific taxes, possibly with an ad-valorem component. The latter would capture more revenue from high-quality cigarettes—for which the substitution effect in favor of lower-quality cigarettes may be low. It is also worth considering consolidating the current higher CET on tobacco with the contemplated excise. Given the absence of domestic production, there is no good argument in favor of a tariff on cigarettes; and even if domestic production were allowed, it would be contrary to the health objectives to tax imported tobacco at higher rates than domestic tobacco. Finally, the excise on tobacco should also cover a wider category than cigarettes, in particular shisha tobacco and cigars.

25. For SSBs, the application of the excise for the purpose of addressing health concerns is made difficult by the challenge of defining exactly what should be taxed. The key harmful effect of SSBs on consumers is the contribution of sugar to obesity. Although obesity and overweight are the result of an overall imbalance between energy intake (of all forms) and physical activity, higher intake of fat, sugar and salt (FSS) have been the main targets of efforts to reduce obesity. From an excise design perspective, the key problem with targeting FSS foods is that they come in such diverse natural and non-natural forms as inputs or components of a wide variety of food products, that identifying exactly what should be taxed is challenging, if not impossible.

26. In this light, the GCC agreement focus on SSBs to tackle health issues has the appeal of providing an easier target than an excise on FSS in general. However, it appears that the tax being considered will be a function of sugar content and limited to high energy drinks only (i.e. sugar in excess of 5 grams per 100 ml). This is likely to raise little revenue given the (large) possibilities of substitution, while its health consequences are difficult to predict—and may be worse if, for example, consumers substitute in favor of more harmful products.

27. A better alternative would be to have an excise at moderate rates, that covers a broad category of SSBs packaged for final consumption. Such an approach is consistent with the practice in countries that have introduced successfully excises on soft drinks (mostly ad-valorem rates): France (Box 1), Tunisia (25 percent of value), countries of the West African Economic and Monetary Union (maximum of 20 percent of value under the union's excise tax directive), Mexico (about USD 0.08 per liter), and more recently some US states, to give a few examples.

Box 1. France: Excise Tax on Beverages

In January 2012, France started imposing an excise tax on all beverages with added sugar or artificial sweetener. The tax was initially meant to only apply to sodas, but was eventually extended to all beverages with added sugar or sweetener. Taxable items must meet the following four criteria: (1) fall under customs tariff classification codes for all packaged drinks, including water; (2) contain any amount of added sugar or artificial sweetener; (3) be packed into containers destined for retail; and (4) have an alcohol level less than 1.2 percent. In 2015, the specific rate was €7.50 per hectoliter (about USD 0.08 per liter). The tax is remitted by suppliers, whether producers, importers or wholesalers. Exports are exempt. In 2013, the tax generated €375 million in revenue against an initial objective of €280 million.

Source: Mansour, Mario, Patrick Petit, and Philippe Wingender, 2015, *Excises and Unhealthy Foods: An Edible Mix?* Unpublished Working Paper (Washington: International Monetary Fund).

28. In addition, the excise rate could be higher than in other countries given that the GCC VAT is likely to be introduced at a very low rate. A comparison with France and Mexico for example suggests that an ad valorem rate of 25 percent of import or manufacturing price is appropriate. A higher rate could be considered, but it is likely to create a greater impact on demand, and hence revenues.

The collection of the VAT and excises in the context of the GCC customs union

29. The proposed rules on the taxation of cross-border trade in goods within the GCC—i.e., trade originating from one-member state and destined to another—are complex.[9] These rules, which broadly rely on reverse charging the VAT in the destination country on business-to-business supplies and the taxation in the origin state of business-to-consumer sales will be administratively complex, require customs verification of goods traded within the common market, complicate potential future efforts to remove customs verification at borders (intra-GCC fiscal frontier) and deepen the customs union, and will also likely result in the loss of revenue for the destination state.

30. Alternatives are available. They extend from highly integrated models whereby GCC traders fulfill their VAT obligations in a single member country for VAT due in any member state (and these are distributed through a clearing house system similar to what has been accomplished for the common external tariff (CET) to more decentralized models whereby GCC traders must account for VAT in each member state in which they do business. These alternatives would ensure that VAT accrues to the destination member state. However, they would require two conditions that will take time to implement, namely a greater harmonization of the VAT tax base, and a country-by-country accounting and reporting at the taxpayer level and information sharing and cooperation between GCC tax administrations—which means greater harmonization in tax procedures and systems to enforce VAT.

31. Given the desired implementation date of 2018, a possible way forward that would avoid further delays in VAT implementation is to envisage a transition period. This would be limited to (say) three to five years, whereby the GCC countries introduce the VAT at the national level (but not necessarily fully aligned with the two conditions above and the long term objectives of the common GCC market). And, as countries gain experience with operating the VAT, they work together to harmonize their VAT systems (including tax base and tax administration procedures) to ensure that VAT accrues to the destination member state without breaking the VAT chain. The IMF given its substantial cross-country experience in VAT implementation is well positioned to advise on such alternative solutions.

Timing of Implementation

32. Introducing VAT in the GCC simultaneously could facilitate the implementation of the VAT common agreement, but is not necessary given other challenges and international experience. Since the VAT should accommodate regional integration, all members should implement it, as planned in the current VAT agreement. However, member countries face different fiscal challenges that require different sequencing for fiscal consolidation.

[9] Note that for trade with the rest of the world, the agreement adopts the standard rules of destination-based VAT. Tax is levied at the point of customs clearance for goods imported into the GCC, and reverse charged in the case of taxable services supplied to GCC businesses. Conversely, exports of goods and services are zero-rated. The Agreement presumes that tax is payable by non-GCC suppliers of taxable services to GCC consumers.

33. Moreover, international experience among sovereign states, and in federations, suggests that a non-simultaneous VAT adoption is manageable. It may even be desirable since the political and technical difficulties involved in a simultaneous approach may delay or preclude the introduction of the tax in some countries. However, the transition period over which countries adopt the VAT should be relatively short in order not to hinder the integration process.

Potential revenues from a VAT

34. The potential revenue raised from a VAT will depend primarily on the main design parameters, namely the rate and structure, the base, and the threshold. It will be also affected by other defining elements including tax exemptions, efficiency of the tax administration, tax-payer compliance, and more generally the ease and transparency of administration. Cross-country analysis also shows that VAT revenue increases with (i) the standard of living and literacy rate—as measures of development and of administrative capacity of taxpayers and tax collectors; (ii) the share of international trade in the economy (mainly imports) because it is easier to collect taxes at the border; and (iii) the VAT age or number of years since its adoption as revenue collection improves with experience and subsequent adjustments in design—such as raising the VAT rate, removal of exemptions, etc.

Table 5. Cross-Country Comparison of VAT Rates, VAT and Tax Revenues, and C-efficiency Ratios

	Consumption (percent of GDP)	Standard VAT rate	VAT Threshold (US$)	Tax Revenue (percent of GDP)	VAT Revenue (percent of GDP)	C-efficiency ratio
Oil Producing Countries						
Nigeria	82.4	5	...	8.2	0.1	0.02
Norway	62.5	25	8,192	31.5	7.8	0.50
Indonesia	65.8	10	65,966	12.1	3.4	0.52
Canada	77.5	5	26,951	26.6	4.0	1.03
Other Middle East Countries						
Algeria	54.9	17	1,420	33.6	3.7	0.39
Lebanon	99.6	10	33,167	15.1	4.9	0.49
Jordan	105.0	16	14,104	15.6	9.9	0.59
Other Comparator Countries						
Singapore	46.2	7	652,204	13.6	2.5	0.77
Japan	80.4	5	84,094	n.a.	2.7	0.67
New Zealand	77.3	15	28,478	27.5	9.7	0.84
Average	**75.2**	**11.5**		**20.4**	**4.9**	**0.58**

Source: IMF staff calculations

Note: Data is for the avergae of 2010 to 2015 or latest available.

35. The additional revenue from a VAT is likely to be significant for most GCC countries. The potential revenue that could be raised from a VAT in the GCC countries is estimated by taking the average C-efficiency ratio for a selected sample of non-GCC countries and applying this to the product of the VAT rate and consumption (as a percent of GDP) (Table 5). The C-efficiency ratio is a measure of how effectively the VAT taxes the consumption base. The estimates suggest that the potential revenue from a 5 percent VAT ranges from 1.2–2.1 percent of GDP depending on the

country (Table 6, Panel 1).[10,11]The differences in estimates across countries are driven by differences in the shares of consumption in GDP. Moreover, the potential revenue that could be raised in each country will be obviously impacted by the respective country's administration efficiency as well as all the additional factors discussed above.

Table 6. GCC Countries: Estimated VAT Revenue

		Using average C-efficiency ratio (0.58) of slected sample of countries with experience relavnt		Assuming the base=90 percent of private consumption	
	Year	**Share of final consumption in GDP**	**5% VAT rate % GDP**	**Share of private consumption in GDP**	**5% VAT rate % GDP**
Bahrain	2015	66.2	1.9	49.8	2.2
Kuwait	2015	72.5	2.1	47.7	2.1
Oman	2015	68.1	2.0	37.4	1.7
Qatar	2015	41.4	1.2	22.0	1.0
Saudi Arabia	2015	70.4	2.0	40.8	1.8
UAE	2015	67.0	2.0	47.4	2.1

Source: IMF staff calculations

Consequences of a VAT for inflation

36. The first round impact of the VAT on inflation is expected to be limited. Because the VAT is levied on the value added—thus there is no cascading–its maximum direct effect on the price level should not exceed the tax rate, although there could be second round effects if wages increase or sellers seek to use the introduction of the tax to raise prices more generally. Moreover, the zero-rating and/or exemption of certain groups of goods/services would reduce the inflationary impact. This is consistent with the findings of a 2011 simulation for Kuwait which estimated the impact of the introduction of a 5 percent VAT tax on inflation to be temporary and not to exceed 3.5-4 percent. While there may be some attempts by traders to use the introduction of the VAT to widen margins and a need for competition regulators to monitor market behavior carefully, cross country evidence shows that the introduction of the VAT generally has only a one-off effect on inflation.

E. Business Profit Tax

37. Taxation of business profits is an integral part of most tax systems. Generally, corporations are subject to a tax on corporate profits and individuals are subject to a tax on

[10] Very similar revenue estimates could be generated through an alternative simplified calculation which applies the VAT rate to 90 percent of private consumption (as a percent of GDP)—assuming a 10 percent loss due to small business threshold and compliance gaps (Table 6, Panel 2).

[11] Staff estimates for the 2016 Article IV consultations with Saudi Arabia found that a VAT at 5 percent would yield about 1.4 percent of GDP in revenue in 2018 given current staff's understanding of the likely exemptions and zero rating. Similar estimates for Qatar and UAE during the 2015 Article IV consultations found that the yields from such a VAT were 1.5 percent and 2.7 percent of non-hydrocarbon GDP, respectively.

(continued)

personal income that includes any profits from unincorporated businesses they own (such as sole proprietorships or partnerships). Taxation of business profits provides a significant revenue source for governments. For example, corporate tax revenues on average amounted to close to 3 percent of GDP and 10 percent of total tax revenues in the OECD economies in 2014 (OECD, 2015). Similar data on the income tax revenue from unincorporated business profits is not available, but some studies suggest that it may be substantial.[12]

38. An overhaul of the taxation of business profits in the GCC countries would contribute to improving non-oil tax revenue collection. As discussed in section B, in the GCC countries, non-oil corporate taxes apply for the most part to foreign companies only and range up to 20 percent in Saudi Arabia. Oman is the only country that has a broad-based business profit tax. The extension of these taxes to domestic businesses (incorporated and non-incorporated) can help capture part of the rent in the non-resource sector that accrues as a spillover from spending resource revenues (Mansour, 2015). In addition, an upgrade of the profit tax system, including its administration, would put the GCC countries in a better position to raise revenues once their economic diversification efforts start bearing fruit (Jewell et al., 2015).

39. A new tax on business profits could expand and streamline the current corporate taxation in the GCC and capture the profit income of individual businesses. Such a tax would be applied to both corporates and unincorporated businesses; otherwise, the profit tax base can be eroded by businesses shifting to unincorporated forms. A certain threshold for exemption should be considered for small businesses which, in addition to ensuring some allowance for individuals, will also limit the tax administration burden and related costs for both small taxpayers and the government.

40. Like the VAT, the business profit tax should start simple and be levied at a single (relatively) low rate for all businesses. This rate could be in the range of 10–15 percent (with allowance for the deduction of Zakat payment for businesses paying Zakat), a relatively low rate when compared globally.[13] A rate lower than 10–15 percent range is likely to yield too little revenue and may not be cost effective, while a rate higher than this range may make the GCC economies relatively less attractive as a business domicile. One option could be to set the rate at the higher end of the 10-15 percent range and at the same time eliminate the other levies that are imposed on business profits, except Zakat, thus further streamlining the tax system. The new business profit tax should apply to the profits of both foreign- and GCC-owned corporates and individual businesses.

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[12] The US income tax on business income was estimated at around half of corporate taxes in 2004 (see Plesko and Toder, 2013). Non-corporate business income in selected EU countries was estimated at around 45 percent of total business income in 2003 (European Union, 2008).

[13] Assuming hydrocarbon sector taxation regimes remain distinct, a single rate should be appropriate for the rest of the economy. Regarding the rate level, KPMG estimates that in 2015 the global average and the OECD average corporate tax rates were around 24 and 25 percent, respectively (KPMG, 2015). Current rates for (non-oil) profit taxes that GCC countries levy on foreign corporates range from 10 to 20 percent.

(continued)

For this tax to be effective, there will be need to minimize tax holidays, sector specific exemptions, and deductions and allowances.

41. The new tax could generate substantial revenues. If for example we assume a 15 percent rate, this could generate a business profit tax revenue of about 3 percent of GDP on average for the GCC countries.[14] However, the net revenue yield will likely be smaller, given that the GCC countries are already collecting some profit tax revenue from foreign companies and individuals. Further, the revenue from the new tax will likely vary across the countries in the GCC. It is expected to be higher in Bahrain, Oman, UAE, and Saudi Arabia, and somewhat lower in Qatar and Kuwait where the hydrocarbon sector has a larger share in GDP (Table 7). The revenue yield will also be affected by existing exemptions and deductions and will also depend on the effectiveness of the tax administration.[15]

[14] The revenue estimate of KD 845 million (4.5 percent of non-oil GDP) in the case of Kuwait is very close to a 2015 staff estimate, which found the profit tax to range from KD 500-800 million, with a midpoint of KD 650 million (about 4.2 percent of GDP) based on 2012 data.

[15] For the above calculation, it is assumed that only 60 percent of the potential tax base is collected. Fenochietto and Pessino (2013) put the tax effort estimate for the Middle East region countries at 58 percent.

Table 7. Revenue Estimates for a Proposed Business Profit Tax for GCC Countries

(In millions of national currency, unless otherwise noted)

	GVA in 2015	Oil GVA 1/	GVA non-hydrocarbon economy	Gross operating surplus in non-hydrocarbon economy 2/	Depreciation 3/	Business profit tax potential base	Hypothetical tax rate, percent	Potential revenue yield	Expected revenue yield at 60 percent tax effort	Expected revenue yield, in percent of 2015 GDP
	(1)	(2)	(3) = (1) - (2)	(4) = (3)*0.55	(5) = (3)*0.12	(6) = (4)-(5)	(7)	(8) = (6)*(7)/100	(9) = (8)*0.6	(10)
Bahrain	11,594	1,562	10,032	5,518	1,204	4,314	15	647	388	3.3
Kuwait	37,560	15,713	21,847	12,016	2,622	9,394	15	1,409	845	2.3
Oman	27,652	9,157	18,495	10,172	2,219	7,953	15	1,193	716	3.1
Qatar	597,498	219,991	377,507	207,629	45,301	162,328	15	24,349	14,610	2.1
Saudi Arabia	2,396,512	665,138	1,731,374	952,256	207,765	744,491	15	111,674	67,004	2.8
United Arab Emirates	1,328,186	319,257	1,008,929	554,911	121,071	433,839	15	65,076	39,046	2.9

Source: Haver; IMF WEO database; OECD; authorities; and Fund staff estimates.

1/ Oil GDP for Bahrain, Qatar, and UAE as oil GVA at basic prices not available.

2/ The assumption is that in the GCC countries on average gross operating surplus is 55 percent of the non-hydrocarbon GVA. As a comparison, the indicator was estimated at 45 percent of total GVA for the average of the EU countries in 2015.

3/ Assumed at 12 percent of the non-hydrocarbon GVA. The fixed capital consumption (used as a proxy for depreciation) is estimated at 10.5 percent for UAE and at 16 percent for Saudi Arabia in 2015. Note that depreciation proxied by fixed capital consumption from national accounts can differ substantially from financial accounting depreciation.

F. Other Taxes and Fees

42. Besides the VAT and business profit tax, some GCC countries are considering other forms of taxation. These include taxes on outward expatriate remittances, financial transaction taxes, and personal income tax on foreign workers. This section discusses the advantages and disadvantages of these taxes.

Taxes on outward remittances

43. The GCC region is one of the largest employers of foreign workers in the world, and consequently a large source of outward remittances. As of 2014, five out of the six GCC countries employed about 11.8 million foreign workers with over 90 percent working in the private sector.[16] Outward remittances from the GCC countries are estimated at $84.4 billion (Figure 4). Saudi Arabia is among the G-20 countries that has the lowest cost of migrants' remittances services.

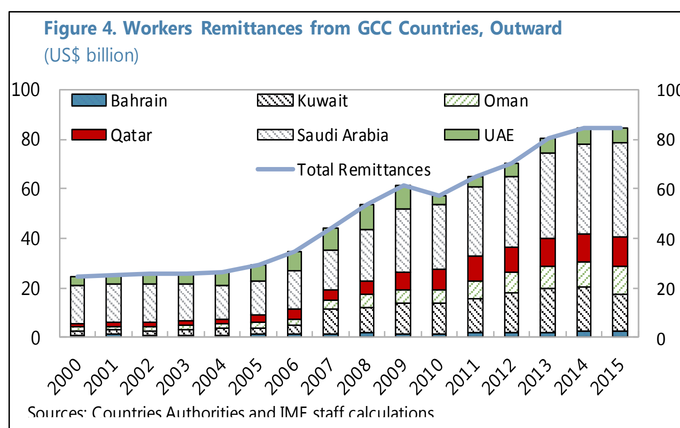

Figure 4. Workers Remittances from GCC Countries, Outward
(US$ billion)

Sources: Countries Authorities and IMF staff calculations.

44. Some GCC countries are considering levying a tax on outward remittances, although no specific proposals have been developed. For illustrative purposes, imposing a 5 percent remittance tax in all GCC countries would yield a maximum revenue of 0.3 percent of GCC GDP or $4.2 billion in 2015. This appears small relative to the needed fiscal adjustments in the region. In addition, imposing this tax would entail operational and administrative costs which would reduce further the net revenue gains.

45. The imposition of a remittance tax has a number of disadvantages, including:

- **Reputational risk.** Most of expatriate workers in the GCC have relatively low income, and remittances tax would be highly regressive as high-income and low-income workers would be taxed at the same rate. From an external perspective, imposing a remittance tax may therefore pose reputational risks for the GCC countries.

- **Competitiveness of the private sector**. The imposition of a remittance tax could raise production cost if it leads to higher pre-tax wages and production costs. This would lower competitiveness of the private sector, although it may improve the attractiveness of national labor by reducing the wage gap.

[16] Data is unavailable for UAE.

- **Financial disintermediation.** A remittance tax would be inefficient and difficult to administer as it would result in a migration of remittances out of the banking system and encourage financial disintermediation. This would result in deadweight losses as remittances are highly cost-elastic. To avoid being taxed, remitters would resort to unofficial channels of money transfers (cash transfers through friends, relatives or simply carrying money themselves).

- **Exchange restrictions and multiple currency practices (MCPs)**. The tax on remittances could have implications for a member's compliance with the IMF Articles of Agreement. Under Article VIII, Sections 2(a) and 3, a tax on remittances could give rise (i) to an exchange restriction if it increases the cost of making transfers for current international transactions and/or (ii) to a multiple currency practice if it results in a difference in effective exchange rates of more than 2 percent between foreign exchange that is remitted and foreign exchange that is not.

- **Conflict with international agenda on remittances**. Imposing a remittances tax could reduce the net income of migrants, given that nearly 80 percent of foreign workers in the GCC are low-skilled. This would conflict with the international agenda which aims at reducing the cost of remittance services in order to generate a net increase in income for migrants and their families. In 2011, the G20 committed to a "significant reduction in the cost of remittances services" and established a Development Action for Remittances.

46. International experiences show that taxes on remittances have been rare and short-lived. Colombia imposed tax on outward remittances of non-resident profits earned and retained in the country for less than five years, but was eventually phased out by the end of 2011. The tax gave rise to an exchange restriction and a multiple currency practice subject to Fund approval. Gabon imposed 1.5 percent tax on non-bank/wire outbound money transfers in 2008 to finance the government's expenditure on healthcare. The tax collections were negligible, about 0.03 percent of GDP, and this tax gave rise to an exchange restriction. In November 2013, Palau imposed 4 percent tax on outward remittances to finance the Civil Service Pension Fund. The tax collections were insignificant, and the tax was unpopular with many sectors in the country.

Taxation of foreign workers' income

47. Taxation of foreign workers' income has also been discussed in some GCC countries. Proponents have argued that foreign workers are using public goods and infrastructure and receive public services and should contribute to their costs. Imposing a personal income tax (PIT) on foreign workers would do this. Further, a progressive tax on higher paid foreign workers could boost opportunities for nationals to take those jobs as foreigners are likely to demand higher wages making these less competitive relative to similarly skilled nationals.

48. The revenue from a tax on foreign workers' income could be substantial. Expatriate household income as a share of GDP is significant in all GCC countries, ranging from 52 percent of

GDP in the UAE to around 7 percent of GDP in Saudi Arabia.[17] Assuming that a 15 percent tax on foreign workers' income is introduced without any allowance, it could generate substantial revenues, ranging from about 4.7 percent of GDP in the UAE to 0.6 percent of GDP in Saudi Arabia (Table 8). These estimates are, however, on the upper side as there will be basic allowance/threshold and compliance and efficiency issues.

Table 8. Revenue Estimates from Personal Income Tax of Foreign Workers[1/]

	Nominal GDP, 2015 (in billion, NC)	Total household income of foreign workers (share of GDP)	Flat income tax rate 2/	Estimated tax revenue (in billion, NC)	Estimated tax revenue at 60 percent tax effort (in billion, NC)	Estimated tax revenue at 60 percent tax effort (percent of GDP)
Bahrain	11.7	25.8	15	0.5	0.3	2.3
Kuwait	35.6	12.0	15	0.6	0.4	1.1
Oman	24.7	14.7	15	0.5	0.3	1.3
Qatar	607.5	15.9	15	14.5	8.7	1.4
Saudi Arabia	2,422.5	6.8	15	24.6	14.7	0.6
UAE 3/	1,359.9	52.1	15	106.4	63.8	4.7

Sources: Countries authorities and staff calculation.

1/ The estimates of household income are based on published "household expenditure and income survey" for each country.

2/ This tax rate is for illustrative purposes.

3/ The share of household income to GDP is based on Dubai "household expenditure and income survey, 2014". It might not be a good representative for the whole country but it gives a general guidance.

49. **However, an income tax on expatriate workers may reduce the region's attractiveness in the short term and breach double tax agreements.** An income tax would reduce the attractiveness of the GCC as a destination if it reduced take-home pay. This may be more of a concern in the case of higher-skilled workers who are likely to have more employment options. This could lead to a skills-shortage if nationals with similar skills are not available. In addition, if the tax results in higher gross wage levels, this would raise labor costs and could reduce the competitiveness of firms unless offset by higher productivity. Further, GCC countries have signed a range of double tax agreements, including with several guest worker origin countries. These agreements typically include a non-discrimination clause precluding the imposition of different income taxes on national and foreign workers, and therefore may prevent GCC countries from imposing an income tax only on foreign workers).

Financial Transaction Taxes

50. **Financial transaction taxes (FTTs) have gained popularity in recent years following the financial crisis**. Most G20 countries impose some sort of FTT. The most common form of this tax is ad valorem securities transactions tax (STT) on secondary market equity transactions at a rate of 0.1 to 0.5 percent. Such taxes are imposed in China, India, Indonesia, Italy, France, South Africa, South Korea and the United Kingdom on purchase and/or sale of stocks. Korea, Russia and Turkey impose

[17] These estimates are based on published household expenditure and income survey for each country. These estimates do not account for imputed rent on owner-occupied housing. However, it includes income from all sources, including employment, self-employment, business profits, interest, dividends, public pension and government transfer.

a tax on original issuance of equity. Among non-G20 members, Hong Kong, Switzerland, Singapore and Taiwan levy 0.1 to 0.3 percent taxes on stock transactions.

51. **Experiences with FTTs differ significantly across countries.** The success of FTTs in the United Kingdom has been due to the limited scope of the tax and the exemption of derivatives and market makers. The FTT tax rate is 0.5 percent and it applies to transfers/sales of domestic securities. The tax raises around 0.6 percent of total UK revenues per year (Burman, 2016). In contrast, the Swedish experience with FTTs ended quickly as it led to a substantial migration of trading Swedish stocks from Stockholm to London.[18] Several other countries went through similar experiences over the past several decades. The United Sates eliminated its stock transaction tax in 1966 and Germany in 1991. Japan, Australia, Italy, France and other countries followed suit in later years to boost the competitiveness of their domestic financial markets. Similarly, out of 13 FTT taxes imposed by Latin America and Asia during the 2000s, only eight were in force by 2009.

52. **FTTs impact the financial sector through different channels.** The imposition of FTTs reduces trading volume by increasing transaction costs; reduces market liquidity; has the potential to slow price discovery by introducing an information distortion; but reduces asset price volatility by lowering unproductive trading (Burman, 2016 and Matheson, 2011).[19]

53. **Given the desire to develop capital markets, using FTTs may not be the best way to help mobilize non-oil revenue for GCC countries**. Instead, GCC countries could consider one of the following alternatives, depending on the relevant needs and country circumstances:

- Financial stability contribution. While this does not mobilize revenue for general use, it would reduce the fiscal cost of any future government support to the financial sector, and would entail having financial institutions pay a levy at a flat rate on their balance sheets (and some off-balance-sheet times). It could be tailored to tax larger institutions more heavily since they pose greater risks to the economy. Alternatively, it could be applied to debt of financial institutions with the goal to reduce leverage in the financial sector (IMF, 2010).

- Financial activities tax. This is similar to value-added tax (VAT) on financial services firms. It aims to tax the net value of economic activity in the financial sector. Usually, VAT is not imposed on financial services because it is difficult to measure the value added in financial transactions. The FAT is levied on the sum of profits and remuneration of financial institutions (IMF, 2010), although the precise design would need to take into account whether a business profit tax is already in place or not.

[18] See Burman, 2016 and Matheson, 2011.

[19] Depending on the design, FTT may also raise issues of consistency with a country's obligations under Article VIII, Sections 2(a) and 3 of the IMF Articles of Agreement.

G. Policy Recommendations and Conclusions

54. In the face of the sharp decline in oil revenues and the emergence of large fiscal deficits, the GCC countries have intensified their efforts to diversify budget revenues as part of their broader fiscal consolidation strategies. Over the past year, countries have intensified negotiations to finalize the two GCC-wide agreements on the implementation of VAT and excise taxes on tobacco and sugar sweetened beverages. They have also been considering, and in some cases introducing, additional taxes and/or fees.

55. There is plenty of scope in the GCC countries to raise additional non-oil tax revenues to support their fiscal consolidation efforts. Tax collections from businesses and individuals are low in the region. Ensuring that the reforms are underpinned by the necessary tax infrastructure and are clearly explained and communicated will be essential to their long-term sustainability and success. This will all require careful prioritization and sequencing of the introduction of new taxes.

56. Tax reforms will take time to implement as the institutional capacity needs to be developed. It is important that tax reforms are implemented at a pace that allows businesses and individuals time to adjust and that is also consistent with administrative capacity. Experience from other countries shows that it takes time to build tax administrations or revenue agencies and to develop relationships with taxpayers that encourage self-compliance. This is why the reform process should be started as early as possible. Such efforts will require communication strategies at the national and regional levels to explain why taxation is needed with the aim to overcome any skepticism about the usefulness of establishing taxation systems in oil-rich countries.

57. The first priority for the GCC countries should be to successfully implement the planned VAT and excises taxes. While there are benefits to countries moving together in introducing these taxes, there is also scope to move separately or with a sub-set of countries given differing fiscal needs and status of preparations. On the VAT, if countries do move separately, they should decide on a reasonable transitional period (3-5 years) by the end of which the VAT would go into effect across the region. For the excises, there are no strong arguments for full harmonization across countries.

58. It is important to limit the scope of exemptions/zero-rated items for the VAT. The list of exemptions and the zero-rating of products in the current VAT draft agreement will undermine the VAT base and the revenue-raising objectives. It would be helpful if agreement is reached to limit the exemptions and harmonize (to the extent possible) them across the region to minimize the risks of price distortions and help achieve the intended revenue objective from the VAT reforms. Consideration should also be given to raising the VAT rate from 5 percent to 10 percent. The design of the system for dealing with inter-GCC trade will be important to ensure that it doesn't become unnecessarily complicated from an administrative standpoint or open up opportunities for tax avoidance.

59. With regard to the excises, these should be set at levels that balance the health and revenue goals of their introduction. Substitution across similar products will take place if the excise bases are not carefully designed and/or if the rates are set too high.

60. Over time, the GCC countries should also move to introduce or expand the tax on business profits. This, together with the VAT and excises will help ensure efficient and progressive tax systems and generate the bulk of non-oil tax revenues for most GCC countries' budgets. Implemented at a reasonable rate with limited exemptions, the tax on business profits should be relatively easy to administer and will have little or no efficiency costs to the economy. Staff estimates suggest that a VAT at 5 percent and a profits tax on domestic and foreign businesses at 15 percent would yield about 4.5 percent of GDP in additional tax revenues on average across the GCC countries.

61. Other revenue-raising proposals being considered in some countries have advantages and disadvantages. An income tax on foreign workers, while potentially raising significant revenues in some countries, may undermine the availability of particularly high-skilled foreign labor and raise business costs. Taxes on remittances and financial transactions would likely raise limited revenues while potentially having undesirable side effects.

Annex I. Main Characteristics of Tax Systems in the GCC Countries

Country	Companies and Businesses Profit and/or Income Taxes	Withholding Tax	VAT & Goods and Services Tax	Labor Tax/ Fees	Social Security Tax	Others
Bahrain	• No corporate income tax. • No capital gains tax. • No personal income tax. • 46% tax rate on hydrocarbon companies.	• No withholding tax.	• No VAT tax • 5% tourism levy on the gross income of Hotel, short-term lease apartment rents and certain restaurants. • 12% sales tax on gasoline.	• US$26.5 monthly fee per foreign worker (for the job training and job search assistance for nationals). • 3% employment insurance against injuries. • 1% unemployment insurance for nationals only.	For nationals only • 9% employer's contribution. • 6% employee's contribution.	• 10% on the monthly rental of residential and business property. • 5 % government levy on gross turnover of hotel services and entertainment. • 1.5% to 3% stamp duty on transfer of land and property.
Kuwait	• 15% flat tax rate on non-GCC companies and branches. • 15% tax rate on capital gains. • No personal income tax. • 1% tax rate on Kuwaiti shareholding companies to support the Kuwait Foundation for the Advancement of Science. • 1% tax rate as Zakat or contribution to the state's budget. • 15% tax rate on companies providing oil and gas services and undertaking exploration and production activities.	• No withholding tax. • 5% tax retention from each payment due to foreign companies until they present a tax clearance from the Department of Inspections and Tax Claims.	• No VAT or other taxes on sales of goods and services	• 2.5% tax on annual net profits of Kuwaiti companies listed on stock market (as national labor support tax).	For nationals only • 11.5% employer's contribution. • 8% employee's contribution	• None
Oman	• 12% flat tax rate for taxable income above OMR30,000 and on capital gains. • 12% tax on income in excess of OMR30,000 of Individual persons carrying on professional business in their individual capacities . • No tax for any business, Omani company or permanent establishment (i.e. foreign branch) on taxable income less than OMR 30,000. • 55% tax rate on companies engaged in petroleum exploration.	• 10% withholding tax of gross payments to foreign companies that have no taxable presence in Oman, including royalties, management fees, research and development, and the use, or the right to use, of computer software.	• 5% tax rate on hotels and restaurant bills. • 3% tax rate on annual rental of leased premises and cinema tickets. • 2% tax rate on electricity bills in excess of OMR 50.	• 7% levy on wages of foreign workers(for job training of nationals). • 1% insurance against risks of occupational injuries and diseases.	For nationals only • 10.5% employer's contribution. • 7% employee's contribution.	Municipal taxes in Muscat and Salalah. Muscat municipal taxes are: • 5% tax rate on hotel income. • 3% tax rate of property rents. • 10% tax rate on leisure and cinema income. • 10% tax rate on home owners using the drainage system. • 3% stamp duty on transfer of land and
Qatar	• 10% tax rate on non-GCC companies. • 10% tax rate on net business income of non-GCC individuals carrying on business as professionals or sole traders. • 35% tax rate on companies engaged in petroleum exploration.	• 5% of gross amount of royalties and technical fees. • 7% of gross amount of interest, commission, brokerage fees, director's fees, attendance fees, and other fees.	• No VAT or other taxes on sales of goods and services	• No tax or fee	For nationals only • 10% employer's contribution. • 5% employee's contribution.	• None
Saudi Arabia 1/	• 20% tax rate on income of non-Saudi and non-GCC national individuals carrying on business or professional activity. • 20% tax rate on capital gains. • 85% tax rate on entities engaged in oil and other hydrocarbon production. • 30 to 85% tax rate on companies engaged in natural gas investment activities based on internal rate of return.	• 5% on dividends and interest income. • 15% on royalties.	• No VAT or other taxes on sales of goods and services	• US$53.3 monthly fees per foreign workers on firms employing a majority of foreign workers (for job training of nationals). • 2% unemployment compensation tax on salaries of nationals in the private sector. • 2% occupational hazards insurance.	For nationals only • 9% employer's contribution. • 9% employee's contribution.	• None
UAE	• No federal income or capital gains taxes • Individual Emirates impose income tax for oil companies up to 55% on taxable income of bodies corporate (not enforced thus far). • 20% tax rate on foreign banks' taxable income in Abu Dhabi, Dubai, Sharjah and Fujairah. • 55% to 85% tax rates on oil companies.	• No withholding tax	• No VAT or other taxes on sales of goods and services	• Work permit fees (biannually) ranging from US$80 to 1350.	For nationals only • 15% employer's contribution. • 5% employee's contribution.	• Up to 10% tax rate on hotel services and entertainment. • 5% municipal tax on the annual rental income of residential property. • Property registration fee 2% for Abu Dhabi and 4% for Dubai.

Sources: Countries official resources, PKF Worldwide Tax Guide, and EY Worldwide Corporate Tax Guide.

1/ There is also Zakat tax , a religious levy imposed on individuals and companies at a rate of 2.5 percent. Zakat revenue is spent on eight categories specified by Islamic law.

Annex I. Table 1. GCC Countries Fiscal Balance and Tax Structure

	2012	2013	2014	2015	2012-2015	2012	2013	2014	2015	2012-2015
	In percent of GDP					In percent of non-oil GDP				
Fiscal Balance										
Bahrain	-3.2	-5.4	-5.8	-15.1	-7.4	-4.2	-7.2	-7.6	-17.4	-9.1
Kuwait	33.2	34.0	26.5	1.5	23.8	104.1	98.5	71.9	2.8	69.3
Oman	4.7	4.7	-1.1	-16.5	-2.0	11.9	10.9	-2.3	-27.1	-1.6
Qatar	11.0	22.2	15.0	5.4	13.4	25.5	49.1	30.6	8.5	28.4
Saudi Arabia	12.0	5.8	-3.4	-15.9	-0.4	24.4	10.9	-6.0	-22.3	1.8
United Arab Emirates	10.9	10.4	5.0	-2.1	6.0	17.9	16.6	7.5	-2.7	9.8
GCC	13.3	11.7	4.1	-8.2	5.2	30.6	26.2	10.2	-11.4	13.9
Revenue										
Bahrain	26.4	24.6	25.2	19.8	24.0	35.2	33.0	32.9	22.8	31.0
Kuwait	72.1	71.8	68.4	55.9	67.0	225.9	208.2	185.4	106.2	181.4
Oman	49.5	49.9	45.9	38.6	46.0	124.5	116.0	98.1	63.4	100.5
Qatar	41.4	50.0	47.7	46.4	46.4	96.2	110.7	97.6	72.7	94.3
Saudi Arabia	45.3	41.4	36.9	25.4	37.3	92.1	78.2	65.0	35.6	67.7
United Arab Emirates	40.1	40.8	37.3	28.5	36.7	66.1	65.0	56.8	37.2	56.3
GCC	46.4	45.7	41.9	31.8	41.5	101.6	94.1	80.7	47.4	81.0
Oil Revenue										
Bahrain	23.0	21.4	21.4	13.8	19.9	30.7	28.7	27.9	15.9	25.8
Kuwait	62.0	59.3	54.9	39.2	53.9	194.2	172.0	148.9	74.5	147.4
Oman	43.6	42.9	39.8	30.0	39.1	109.7	99.7	85.1	49.3	86.0
Qatar	35.1	42.1	40.2	37.3	38.7	81.6	93.2	82.1	58.4	78.9
Saudi Arabia	41.6	37.1	32.3	18.4	32.4	84.5	70.0	56.9	25.8	59.3
United Arab Emirates	28.9	28.1	24.6	14.3	24.0	47.6	44.8	37.5	18.6	37.1
GCC	39.8	37.9	33.9	21.8	33.4	87.7	78.5	65.8	32.8	66.2
Non-Oil Revenue										
Bahrain	3.4	3.2	3.9	6.0	4.1	4.5	4.3	5.0	6.9	5.2
Kuwait	10.1	12.5	13.5	16.7	13.2	31.7	36.2	36.5	31.6	34.0
Oman	5.9	7.0	6.1	8.5	6.9	14.8	16.2	13.0	14.0	14.5
Qatar	6.3	7.9	7.6	9.1	7.7	14.5	17.5	15.5	14.3	15.5
Saudi Arabia	3.7	4.3	4.6	7.0	4.9	7.6	8.2	8.2	9.8	8.4
United Arab Emirates	11.2	12.7	12.7	14.2	12.7	18.5	20.2	19.3	18.6	19.1
GCC	6.6	7.8	7.9	10.0	8.1	13.9	15.6	14.9	14.6	14.8
Non-Oil Tax Revenue										
Bahrain	1.0	1.0	0.6	0.7	0.8	1.3	1.4	0.8	0.8	1.1
Kuwait	0.7	0.8	0.8	1.1	0.9	2.2	2.2	2.2	2.2	2.2
Oman	2.7	2.6	2.9	3.7	3.0	6.8	6.1	6.2	6.0	6.3
Qatar	2.4	1.7	2.0	2.0	2.0	5.6	3.8	3.8	3.8	4.3
Saudi Arabia	1.2	1.2	1.3	1.7	1.4	2.5	2.3	2.4	2.3	2.4
United Arab Emirates	2.4	2.3	2.4	2.6	2.5	4.0	3.7	3.7	3.5	3.7
GCC	1.7	1.6	1.7	2.0	1.7	3.4	3.0	3.0	2.9	3.1

Sources: IMF WEO; and staff estimates.

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