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THE INTERNATIONAL TAXATION IN THE EGYPTIAN TAX LEGISLATION

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Introduction

When Egyptian Tax Law 91 was issued in 2005, it transformed the tax interactions between Egypt and the rest of the world. For the first time, international transactions between natural/juridical persons abroad and their counterparts in Egypt were regulated by Egyptian law, which also specified the conditions for imposing tax on the wealth of persons residing in and out of Egypt.

In order to do this, it was first necessary to clarify the difference between tax avoidance and tax evasion. Tax avoidance is a legitimate method by which domestic law and international conventions and agreements are used as a framework in tax planning, in order to realize the maximum legal tax benefits for oneself or one's client. In contrast, tax evasion uses illegal means, including hiding and/or failing to disclose one's own or the client's real income in order to avoid complying with the law.

Introduction

In this article, we will explore current tax law as it is applied in Egypt, as well as international law on the avoidance of double taxation.
The articles of Egyptian Tax Law 91/2005 and their corresponding articles in the International Avoidance of Double Taxation Treaty are as follows:

Subject	Egyptian Tax Law	Avoidance of Double Taxation Treaty Form
1. Resident	Article 2	Article 4
2. Permanent Establishment	Article 4	Article 5
3. Related Person	Article 30	Article 9
4. Royalties	Article 56	Article 12
5. Neutral Price	Article 1	Article 9
6. Interest	Article 56	Article 11
7. Service Fees	Article 56	Articles 14,15,16 and 17

1- Residence

The basic purpose of international tax law is to define the legal parameters within which different countries may exercise their sovereignty to impose taxes, while sparing the taxpayer from having to shoulder a double tax burden. The right of each sovereign state to impose tax within its national borders and upon its own citizens is recognized internationally. However, this has resulted in a wide diversity of tax laws and very different standards and definitions from country to country. As a consequence, a framework of international “geographical” and “citizenship” principles was devised for defining individual states’ rights to impose taxes. The first treats the person as an economic subject, while the second treats the citizen as a political subject. Recently, a third principle was added, “residence”, which defines the taxpayer in social terms.

Clear criteria are necessary to determine which state has the legal right to impose tax on which person(s). Thus, it was important to distinguish between a taxpayer’s “residence” and “nationality”. A person’s residence is the place in which he or she normally or actually lives, while his or her nationality is the place in which he or she is free to exercise his or her full civil and economic rights. Egyptian law uses residence as a basis for determining a natural person’s tax liability.

1- Residence

Article 2 of Law 91/2005 defines a resident in Egypt as follows:

1- A person who has a permanent home in Egypt;
2- A person who is present in Egypt for not less than 183 consecutive or non-consecutive days within twelve months;
3- A person who works outside Egypt, but whose income is derived from the Egyptian treasury.

As for juridical (non-natural) persons, Egyptian law equates “nationality” with permanent location to determine tax liability. A juridical (non-natural) person is determined to be permanently located in Egypt if the following conditions apply:

1- It was established according Egyptian law;
2- Its principal management headquarters are in Egypt;
3- It is a corporation in which more than 50% of its capital is owned by the Egyptian state or by one of its corporate entities.

1- Residence

Article 3 of the law also uses objective criteria for determining that an income or a capital good is subject to taxation in Egypt. These are:

1- Income from services provided in Egypt, including salaries.
2- Income paid by an employer resident in Egypt.
3- Income received by an athlete or artist for activities performed in Egypt.
4- Income received by a non-resident for work executed through a permanent establishment in Egypt.
5- Income from trade in movable goods by or on behalf of a permanent establishment in Egypt.
6- Income from the exploitation or trade of real estate located in Egypt.
7- Income from shares of companies located in Egypt.
8- Profit shares or dividends paid by companies located in Egypt.
9- Interest paid by the Egyptian government or Egyptian public corporate entity, or by any person resident in Egypt or by any permanent establishment in Egypt.
10- Rent or license fees or royalties paid by any resident of Egypt or by any permanent establishment in Egypt.
11- Income from any other activity performed in Egypt.

Definition of Residence in International Treaties

The first paragraph of Article 4 in the Organization of European Economic Development (OECD) form, as well as Article 4 in the form issued by the United Nations, states:

“The word ‘resident’ in a contracting state refers to any person subject to the tax laws of that state, imposed by virtue of the person’s citizenship or place of residence or management headquarters or any similar criteria.”

National states are free to define who is a resident within their own borders, and thus to define which persons located in their countries are subject to their sovereign tax laws. International law does not concern itself with the tax laws of individual states, except if they permit a person to be taxed multi-nationally twice or multiple times. Such cases can arise in cases where a person is residing in two or more countries and thus liable for tax purposes in more than one of them. Also, it is possible for double taxation to result from a situation in which the country where the revenue was realized is different from the country in which the beneficiary of that revenue resides.

As mentioned earlier, Egyptian tax law considers juridical persons to be Egyptian nationals if they meet the following criteria:

1- They were established in Egypt in accordance with Egyptian law;
2- Their main headquarters are located in Egypt;
3- More than 50% of their capital is owned by the Egyptian state or by an Egyptian public sector corporation.

In this way, Egyptian tax law is in full agreement with the corresponding criteria in international law.

Nationality of Multinational Companies for Tax Purposes

Multinational companies form subsidiaries abroad to carry out the company's activities in countries other than the one in which the mother company is located. This may not create any difficulties in defining the subsidiary's nationality for tax purposes, as long as the subsidiary is established in compliance with local laws. If, on the contrary, the mother company establishes the subsidiary in accordance with the laws and standards effective in its own country, or according to a combination of the laws and standards in the home country and the country in which the subsidiary is established, this may result in serious difficulties. In such cases, the supervisory and other powers that the mother company enjoys are not sufficient to define the subsidiary as having the same nationality as the mother company. This will depend on other important factors, including:

1- The degree to which the subsidiary's board of directors is independent of the mother company;

2- The country in which the subsidiary's managers personally reside, and their power to make important decisions for the company including those related to production, investment and marketing;

3- The extent to which the subsidiary's managers are obliged to defer important decisions to the company's headquarters.

Income Source as a Standard for Determining the Nationality of a Juridical Person

A juridical person’s economic dependence on activities in a certain country is internationally recognized as a determining factor in the right of a sovereign state to impose tax on the juridical person’s income.

According to Article 3 of the Egyptian tax law, the state has the right to require a foreign natural or juridical person to pay tax on income to the extent that this income was derived from activities in Egypt. This is related to the principle of ‘regionality’, which is determined according to the following guidelines:

1) Location of vital interests: the place where most of the person’s financial assets are located and where most professional income-generating activities are performed.

Income Source as a Standard for Determining the Nationality of a Juridical Person

2) Local execution of foreign projects: Article 3 of the Egyptian tax law renders profits from activities carried out within Egypt's national borders subject to taxation by the Egyptian state, to the extent that these profits originate in Egypt.
This agrees with Article 7 of the International Avoidance of Double Taxation Treaty.

3) The full business cycle: its location is used to evaluate economic dependence. It refers collectively to all the activities necessary to realize the profit.

4) Source of income: this refers to the income of individuals who are neither Egyptian nationals nor residents, which is subject to Egyptian tax to the extent that it was generated by activities carried out in Egypt.

2- Permanent Establishment

One priority of the international organizations in formulating international tax law was to find a way to reconcile contradictions between a taxpayer's nationality for tax purposes and the country in which the taxpayer mainly derives income. This led to the idea of the stable, revenue-generating institution, or "permanent establishment".

According to Article 4 of the Egyptian Tax Law, a permanent establishment is "a fixed place of business, through which are executed all or some of the projects of a person non-resident in Egypt." In this way, Article 4 of Egypt's tax law corresponds exactly with Article 5 of the International Avoidance of Double Tax Treaty, which specifies that the location of the following are used to determine whether a business activity constitutes a permanent establishment:

2- Permanent Establishment

1- Management headquarters.
2- Branches/subsidiaries.
3- Retail outlets.
4- Office facilities.
5- Manufacturing facilities, workshops.
6- Mines, oil and gas fields and wells, quarries or any other place where natural resources are extracted.
7- Farms or plantations.
8- Building sites or real-estate development projects or preparations and supervisory activities related to such projects.

A person is defined as representing a project's permanent establishment in cases where this person has the right to conclude contracts and ratify them on behalf of the project.

“Permanent Establishment” as Defined in International Tax Law

Egyptian tax law agrees with International law as formulated in the International Avoidance of Double Taxation Treaty about what constitutes a ‘permanent establishment’. A permanent establishment is one that:

- maintains suitable organizational facilities for supervising the business activities.
- engages in activities for the purpose of generating income.

- includes the presence of a person authorized to sign and approve contracts on behalf of the establishment.

-is continuous in the practice of its business activity.

3- Interest

Interest is defined for tax purposes as any revenue derived from documented debt obligations.

Therefore, if the documentation of a debt shows that it was signed between a debtor in one state (the state of origin, in which the debtor resides, or has a permanent establishment responsible for paying the debt and related interest), and another state, in which the debtor and beneficiary of the interest resides, then the payment of this debt and related interest are subject to international tax law so that double taxation is avoided.

According to the first clause of Article 56 of the Egyptian Tax Law, the revenue from interest paid by persons or permanent establishments resident in Egypt to any non-resident of Egypt is taxable at the rate of 20%, without any deduction of costs.

3- Interest

Exempted from this tax is any interest on loans or credit facilities acquired by government or local administrative councils and other public legal persons from sources outside Egypt. Loans and credit facilities to public sector companies, to the public sector as a whole and also to private sector companies are exempted from this tax on condition that the duration of the loan or credit facility is at least three years.

According to Article 69 of the Executive Regulations of the Egyptian tax law, all revenues produced by loans, credit lines, advances and debts of all kinds, including treasury bonds, are defined as interest under the first clause of Article 56 of the Egyptian tax law.

Article 73 of the Executive Regulations of the Egyptian tax law stipulates that in cases where such services are rendered in countries with which Egypt has signed an Avoidance of Double Taxation Treaty, the provisions of this treaty will be applied.

3- Interest

Thus, if Article 11 of the International Avoidance of Double Taxation is applied, as well as the criteria of nationality or economic dependence (income nationality):

1- The interest generated in one of two contracting states and paid to a person residing in the second contracting state is subject to tax in this second state.

2- Nevertheless, it is permissible for this interest to also be subject to tax in the contracting state where it was generated, according to the laws of that state, but only if the recipient of the interest revenue is the beneficiary/owner of the interest. In such cases, the tax imposed should not exceed 15% of the total value of the interest.

3- Interest

Affirming the importance of the principle of economic dependence (regionality of income) the fifth clause of Article 11 in the International Avoidance of Double Taxation Treaty states that the first and second clauses do not apply if the owner/beneficiary of the interest revenue is residing in one of two contracting states and at the same time supervising activities in the other contracting state, where the interest revenue is generated, through a permanent establishment there; or if the owner/beneficiary directs independent personal services via a permanent establishment in the country where the interest is generated, and the debt is associated with this permanent establishment. In such cases, the following articles will apply:

1- Article 7 – Commercial and Industrial Profits

2- Article 14 – Independent Personal Services.

3- Interest

Loans to natural or juridical persons in Egypt from agencies abroad must endure not less than three years in order to be exempted from the tax stipulated by Article 56 of Egyptian tax law. They must also be partially reimbursed on an annual basis during those three years, in order to reduce the interest burden on the loan at the end of the three-year period.

4- Royalties

Royalties are defined in the third clause of Article 12 of the International Avoidance of Double Taxation Treaty as payments of any kind made in exchange for the use or right to use copyrighted literary or scientific material, including films, patented inventions, brand names, designs, or confidential models, blueprints, processes or assemblies, or in exchange for the use or the right to use manufacturing, commercial or scientific equipment, or in exchange for information related to industrial or commercial or scientific expertise.

Egyptian tax legislation uses the same definition of royalties in Article 1 of the Egyptian tax law.

The State of Origin’s Right to Impose Tax on Royalties

The state is a source of royalties in the following cases:

1- If the payer of the royalties is the state itself or one of its juridical persons from the public sector;

2- If the payer is a resident of the state;

3- If the one who pays the royalty and bears the burden of payment of the royalty is a permanent establishment located in the state, regardless of the royalty user’s place of residence.

According to Article 56 of Egyptian tax law, royalty payments originating in Egypt are subject to tax at the rate of 20% without any deduction of costs being allowed, thus complying with the criteria of “regionality” and “economic dependence”, which support the right of the state in which the income is generated to impose tax on royalties at source.

The State of Origin's Right to Impose Tax on Royalties

In cases where the tax rate set by the Egyptian tax law differs from the rate specified in the Avoidance of Double Taxation Treaty signed with the state in which the owner or beneficiary of the royalties resides, then the applicable rate is the one specified by the Treaty.

In cases where there is no Avoidance of Double Taxation Treaty signed between the state where the royalty payments originate and the state where the owner/beneficiary of the royalties resides, then local tax laws apply.

There are two exceptions to the above. These, and their tax treatment, are:

1) In cases where the royalty is payable to a beneficiary engaged in commercial/industrial or professional activity through a permanent establishment: in such cases, the copyright or ownership of the royalty is effectively tied to this establishment. As a result, the applicable laws are those which govern profits generated by commercial, industrial or professional activities.

The State of Origin’s Right to Impose Tax on Royalties

2) In cases where the royalty payments are higher than they normally would be because of a special relationship between the debtor and the beneficiary: according to Article 12 of the International Avoidance of Double Tax Treaty, if the royalty payments exceed the amount that would have been payable without the existence of the special relationship between the beneficiary and payer of the royalties, then only the amount that would be normally paid is subject to the Treaty. The excess amount paid thus becomes subject to the legal tax on income and on corporate profits in both contracting states: those in which the beneficiary and the payer reside.

It should be noted that there is no precise definition of “special relationship”, however it is traditionally taken to refer to cases in which either the creditor or debtor dominates the other, or are both subject to a third party, or generally speaking, in which there is a unity of interests between the creditor and debtor.

5- Related Persons and transfer Prices

For the first time, Egyptian tax legislation defines the term “related persons” and mandates a neutral price for sales or purchases between them in accordance with the International Avoidance of Double Tax Treaty, in Volume 1, “General Provisions.

Related Persons include:

-Husbands and wives, or parents and their offspring;

-Financial companies and any person who owns 50% or more of their shares or their value or voting rights, directly or indirectly;

-Business partners;

-Two or more companies in which one person owns 50% or more of their value or stocks or voting rights.

5- Related Persons and transfer Prices

Neutral Price is defined as the minimum price that would normally be set for any equivalent sale or purchase between two unrelated persons, and it is determined according to existing market conditions.

Article 30 of the Egyptian Tax Law stipulates that if related persons conduct their financial or commercial transactions under conditions different from those that would normally apply in similar transactions between unrelated persons, for the purpose of modifying the taxable income or shifting the tax burden from one party who is subject to taxation to another who is not, then the taxable profit will be calculated based on “neutral price.

Article 39, in the executive regulations of Egyptian Tax Law, explains how to determine the neutral price which is mandated in Article 30:

-Through a survey of comparative free market prices.
-By calculating total cost of production and adding a standard profit margin.
-By calculating resale value in current market conditions.

5- Related Persons and transfer Prices

The second and third of these methods for determining the neutral price are given priority over the first. In case none of these methods are applicable, it is acceptable to use any of the methods listed in the OECD model.

Companies that are related to each other, either by common membership in an international group of companies or by belonging to a multinational corporation frequently have arrangements that permit earnings and losses to be distributed in a way that does not reflect reality. The purpose, for example, could be to maximize the earnings by the company in either the country where its headquarters or its subsidiary is located, depending on where the tax liability is less. At the same time, the purpose would also be to minimize earnings in the country where the tax liability is greater.

As a result, various governments make an effort to calculate the real value of transactions between mother companies and their international subsidiaries, using every method possible. These include a careful examination of the company's books and accounting ledgers, as well as estimations of the market value of goods and services exchanged between the related companies.

Other Criteria Used to Determine the Neutral Price

In addition to the methods mentioned earlier, tax authorities compare the type and cost of transactions between the related persons, with other transactions carried out by either party. They also compare the legal commitments borne by the related persons in transactions with each other, and those borne by either side in transactions with others. Regular market conditions are also examined, and compared to the conditions that govern transactions between the related persons.

Article 9 of the International Avoidance of Double Tax Treaty defines “Joint Ventures” as those in which:

-an enterprise in one of two contracting countries directly or indirectly contributes to the management or supervision or capitalization of an enterprise in the other country.

-the same individual or individuals contribute to the management or supervision or capitalization of companies in two or more contracting countries.

-commercial or financial conditions or obligations are enforced on the companies in two or more contracting countries that differ from the conditions or obligations that would normally apply to independent companies.

In such cases, it is permissible for contracting countries to impose tax on the profits that a company would have realized if these conditions or obligations had not been enforced, but did not as a result of these conditions or obligations. Therefore, if the company data available to the contracting country's tax authorities is insufficient to determine an enterprise's profits, then the tax authorities in question have the legal right to apply their local tax laws on the enterprise's documented or estimated profits, based on the information they do have.

6- Service Fees

Article 56 of Egypt’s tax law stipulates that all fees paid by owners of individual enterprises who are resident in Egypt, or by natural or juridical persons resident in Egypt, or by agencies that are not resident in Egypt but which have permanent establishments in Egypt, to non-residents in exchange for services, must be taxed at a rate of 20% without any deduction of costs.

In accordance with the International Avoidance of Double Taxation Treaty, these services include the following:

<u>Services Provided by Independent Persons</u>:

Specifically, these include scientific, cultural, technical, personal development and training and educational services provided by individuals, as well as professional services provided by medical doctors, lawyers, engineers, dentists, accountants, etc.

6- Service Fees

Income derived from the provision of these or any other professional or other independent services by an individual resident in one of two contracting countries is only subject to tax in the country of residence unless:

-He or she maintains and regularly controls a permanent facility in the other contracting country with the purpose of pursuing his/her professional activities. In that case, any income from that permanent facility is subject to tax in the other country.

-If he or she is present in the other contracting country for more than 90 days per year, the income derived from his or her activities in that other country becomes subject to that country's tax.

<u>Services by Non-Independent Providers</u>:

Article 15 of the International Avoidance of Double Taxation Treaty states that wages, salaries and bonuses earned by a resident from his or her employment in one of two contracting countries are taxable in that country only, unless the person also has another employment in the other contracting company. In that case, the income derived from the employment in the second country is also taxable there. An exception is made for bonuses earned by a resident of one contracting country for work performed in another, which are taxable in the first country alone, as long as:

6- Service Fees

-the person receiving the bonus was present in the second country for less than 183 days in a year;
-the ~~bonus was given with the knowledge or on behalf of the person's employer,~~ who is not a resident of the second country;
-the bonus was not paid by a permanent establishment or fixed place of business owned by the person's employer in the second country.

Egyptian tax law and the International Avoidance of Double Tax Treaty both rigorously apply the criterion of regionality or economic dependence (source of income). Article 17 of the Executive Provisions of Egypt's Tax Law stipulates that all income from goods and services exchanged between Egypt and any state with which Egypt has signed the International Avoidance of Double Tax Treaty will be subject to the provisions of that treaty. This includes the income of professional artists and athletes, which is subject to tax in the contracting state in which the artistic or athletic activities are performed, unless these are primarily or financed with public funds from the other state.

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