VAT as a Possible Revenue Source Funding Economic Development in MENA Countries

With over 150 countries in the world currently operating a value added tax (VAT) to generate revenues, a number of MENA countries, including members of the Gulf Cooperation Council (GCC), are exploring the implications of introducing a VAT in their jurisdictions.

The 5th meeting of the MENA-OECD Investment Programme's Working Group on Taxation, held on 1-2 June 2010 in Manama, Bahrain, brought together over 60 senior experts from thirteen countries to discuss the tax policy and tax administration consequences of introducing a VAT, with special attention to the implications of a VAT in GCC countries.

To help determine what could be a suitable VAT system for MENA/GCC countries, the meeting examined the different VAT systems applied throughout the world. The EU form of VAT, while widely employed, has an average standard rate across the 27 EU Member states of close to 20 per cent, with some countries having a rate as high as 25 per cent – considerably higher than what might be suitable when introducing a VAT in a MENA/GCC country. At the same time, the EU model also tends to have a multiplicity of reduced rates including zero rates, and exemptions, that make for increased complexity, higher administration costs as well as higher compliance costs for business. For this reason, Working Group experts pointed to VAT as applied in Singapore and Switzerland, which apply simpler systems, potentially more appropriate for GCC countries.

A main conclusion of the meeting was that the case for the introduction of a VAT in GCC countries has yet to be firmly made. Further analysis is required of the potential yield, with regard to data on domestic consumption,registration/collection thresholds and compliance. One aspect that might be usefully explored is the introduction of a VAT with a relatively high threshold, to ease administration and compliance demands and costs, followed by a gradual reduction of the threshold, as taxpayers become accustomed to the operation of the tax, to generate increased VAT revenues.

Another key aspect for further study is how best to address effects of a VAT on income distribution, with distribution effects depending on the chosen set of rate(s) and exemption(s). In countries that do not levy personal income tax, or operate benefit programs, public policy options and mechanisms to redress income distribution are more limited.

A number of other issues could also be further explored in relation to the operation of a VAT in a customs union. For example, where VAT rates differ in countries that border MENA/GCC countries, it would be necessary to address incentives for cross-border shopping that might arise. Transitonal aspects and measures are also important, including the question of an appropriate lead-in time for the introduction of a VAT, taking into account resources and time required for legislative design, the need to build tax administration capacity, and carry out a programme of business consultation and taxpayer education, to ease implementation.

The Working Group agreed to resume its discussions of key VAT issues at its next meeting, to take place in early 2012. Other topics of interest likely to be discussed include the taxation of foreign source income, and the operation of controlled foreign company (CFC) provisions.