The Simplified Tax Regime for Micro and Small Enterprises in Egypt: An Analysis of the Theoretical and Implementation Issues

Mahmoud M Abdellatif,* Binh Tran-Nam** and Boumediene Ramdani***

Abstract

Unlike previous studies focusing on the tax regimes of small and medium enterprises ('SMEs'), this article examines and analyses simplified tax regimes for micro, small and medium enterprises ('MSMEs'). Very recently, a simplified MSME tax regime was introduced in Egypt under the Micro, Small and Medium Enterprises (MSMEs) Law No 152 of 2020. This article employs an analytical and positive approach to assess these tax measures against the criteria of a good tax system and also evaluates the related implementation issues. The new tax measures include granting conditional tax exemption for capital gains and a dividend tax. Further, a separate MSME tax regime was introduced replacing the income tax provisions under the Income Tax Law No 91 of 2005. The MSME tax regime imposes a lump sum tax on micro businesses and an annual turnover tax at progressive rates on small businesses. The theoretical analysis and assessment of the MSME tax regime reveals the following: (i) the regime satisfies the economic efficiency criterion as it reduces the tax burden on SMEs, thus allowing to them to compete with larger businesses; (ii) it simplifies tax compliance procedures but is limited only to MSMEs registered with the MSME authority; (iii) the regime is inequitable as it discriminates between registered and non-registered MSMEs, and it does not consider their heterogeneity; (iv) there will be a decline in tax revenue collected from MSMEs, which represents a tax expenditure arising from the MSME regime; (v) there is a need for coordination of the regime with the Value-Added Tax Law; and, (vi) it is critical to establish measures that minimise resistance to the new system.

Keywords: micro and small enterprises, tax

* Assistant Professor and Director of the Centre for Entrepreneurship, College of Business and Economics, Qatar University, Doha, Qatar. Correspondence via email at m.abdellatif@qu.edu.qa.

** Professor, School of Accounting, Auditing and Taxation, UNSW Sydney, Australia, and Adjunct Professor, School of Business and Management, RMIT University Vietnam, Ho Chi Minh City, Vietnam. Correspondence via email at b.tran-nam@unsw.edu.au.

*** Assistant Professor (Research), Centre for Entrepreneurship, College of Business and Economics, Qatar University. Correspondence via email at b.ramdani@qu.edu.qa.

The authors would like to thank Lapo Bigazzi for his editorial assistance.

I INTRODUCTION

Designing a simplified tax regime for micro and small enterprises ('MSEs') is a common practice in many developed countries, as governments generally endeavour to stimulate the expansion of micro, small and medium enterprises ('MSMEs') through specific policies that include developing a friendly business environment, streamlining access to finance, and designing specific tax measures.[1] The overall tax burden on MSMEs includes both the legal tax liability and the tax compliance costs. Countries are keen to achieve the dual objectives of reducing the legal tax liability through preferential tax measures for MSMEs and simplifying tax compliance to minimise the tax compliance costs which are known to be regressive for MSMEs.[2] Some countries find that designing a specific tax regime for MSMEs may help to serve both objectives. These tax measures often deal with income tax and consumption tax (e.g., Value-Added Tax ('VAT') or Goods and Services Tax ('GST')) which are the main taxes for most countries. Furthermore, the specific tax regimes for MSMEs are often imposed separately from the regular tax measures of the tax system.

Recently Egypt ratified the new Micro, Small and Medium Enterprises (MSMEs) Law No 152 of 2020 ('MSME Law 2020'), which sets out comprehensive legislation covering a range of matters including registration, finance, and taxation. The new tax measures under the MSME legislation deviate from the standard income tax measures under Income Tax Law No 91 of 2005 ('ITL 2005'), raising the following research question: 'does the new MSME tax regime in Egypt align with the principles of a good tax system and are there any specific implications arising from its provisions?' This article seeks to answer this question through an analytical and positive approach which includes: (i) assessing the MSME tax regime against the principles of good tax system (e.g., efficiency, equity, simplicity, and revenue adequacy); and, (ii) identifying the implementation challenges of the new regime. Accordingly, this article will review previous research on MSME tax regimes, explain the new MSME tax regime in Egypt, analyse and assess the new regime against the principles of a good tax system, identify the implementation challenges of the new regime, and, in light of this analysis, provide specific policy recommendations to enhance the effectiveness of the new tax regime.

The remainder of this article is set out as follows. Part II briefly reviews previous studies on MSME tax regimes. Part III then discusses the new MSME tax regime in Egypt. In Part IV, an analysis and assessment of the new MSME tax regime in Egypt and its challenges is provided. Then Part V concludes with some summary remarks.

[1] This article builds upon a previous study conducted by the first two authors entitled 'The Tax Treatment of SMEs in Developed and Developing Countries: A Comparative Analysis of Australia and Egypt', which those authors are currently also seeking to have published in another taxation journal.

[2] Evans et al, 'Small Business and Tax Compliance Costs: A Cross-Country Study of Managerial Benefits and Tax Concessions' (2016) 12(2) *eJournal of Tax Research* 543.

II Brief Literature Review

A *Previous Studies*

Designing a preferential tax treatment for MSMEs has attracted the attention of many scholars from different perspectives.[3] The preferential tax treatment for MSMEs deviates from the normal tax treatment for business taxpayers and therefore often requires strong justification. As a result, researchers have sought to provide specific reasons for deviating from the regular tax rules to provide preferential tax treatment for MSMEs.

In the above context, most studies have focused on the tax treatment of SMEs, under which micro enterprises are included within the small business category. Nevertheless, it is important to explicitly consider micro businesses, because they include self-employed activities and micro family businesses which make a significant contribution to job creation, especially in developing countries.

It has been argued that taxes may have either a positive or negative impact on MSMEs, influencing their business activities in different ways.[4] A negative perception of taxes will generally have an impact on starting a new business, discouraging entrepreneurs and start-ups from launching new businesses.[5] Moreover, a recent study by the International Monetary Fund ('IMF') considers taxation to be one of the main factors discouraging the conduct of a business through formal channels.[6] On the other hand, taxes may have a positive impact on MSMEs through provision of preferential tax treatment, representing an incentive to start new businesses which can in this way encourage more new businesses to be launched.[7]

Tax researchers have identified that a higher cost burden (e.g., tax) on MSMEs can result from number of factors. The first of these is uneven market competition with large businesses which may result in the failure of MSMEs in the market. The second relates to barriers to obtaining loans from banks due to the lack of sufficient collateral and the lack of accounting records in their early stage. Therefore, the majority of MSMEs use equity finance rather than debt which does not provide them with a privilege of deducting interest from taxable income. This in turn increases the MSMEs tax burden and can be

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3 For further discussion relating to the taxation of SMEs, see, eg, E Gordon Keith, 'The Impact of Taxation on Small Business' (1959) 24(1) *Law and Contemporary Problems* 98; Douglas Holtz-Eakin, 'Should Small Business Be Tax-Favoured?' (1995) 48(3) *National Tax Journal* 387; William Gale and Samuel Brown, 'Small Business, Innovation, and Tax Policy: A Review' (2013) 66(4) *National Tax Journal* 871; Philip Lignier, Chris Evans and Binh Tran-Nam, 'Tangled Up in Tape: The Continuing Tax Compliance Plight of the Small and Medium Enterprise Business Sector' (2014) 29(2) *Australian Tax Forum* 217.

4 Gale and Brown (n 3).

5 Burçin Bozdoğanoğlu, 'Factors that Effect Taxation of Small and Medium Sized Enterprises (SMEs)' (2016) 4(2) *International Journal of Humanities and Management Sciences* 176, 177.

6 Leandro Medina and Friedrich Schneider, 'Shadow Economies Around the World: What Did We Learn Over the Last 20 Years?' (International Monetary Fund Working Paper WP/18/17, January 2018) 34–35 <https://www.imf.org/en/Publications/WP/Issues/2018/01/25/Shadow-Economies-Around-the-World-What-Did-We-Learn-Over-the-Last-20-Years-45583>.

7 Bozdoğanoğlu (n 5) 176.

considered as a form of market imperfection.[8] Thirdly, MSMEs do not enjoy economies of scale in the same way as large business which also reflects the market failure issue.[9]

The second dimension of the tax burden on MSMEs of tax compliance costs has also attracted the attention of many authors, including Hansford and Hasseldine,[10] Lignier, Evans and Tran-Nam,[11] Engelschalk and Loeprick,[12] Mahangila,[13] and Eichfelder and Hechtner.[14] Hansford and Hasseldine examined the tax compliance costs of SMEs in the United Kingdom through circulating a questionnaire among professional accountants. They found that SMEs bear high compliance costs relative to their size, confirming the regressive nature of tax compliance costs.[15] Lignier, Evans and Tran-Nam carried out a similar study to assess SME tax compliance costs in Australia during the period 1995 to 2012. They found that tax compliance costs are increasing, and are estimated to be, on average, around 9% of a business's annual turnover. They attributed the increasing compliance costs to the complexity of tax legislation which requires business taxpayers to hire professional tax advisers and maintain accounting records to comply with tax law provisions.[16] Mahangila conducted another study to assess the tax compliance costs and compliance behaviour of SMEs in developing countries in 2017. In that study, SME tax compliance costs in Tanzania were examined through an experimental method. The author found that tax compliance costs are regressive for SMEs, and negatively affect their tax compliance behaviour. The high compliance costs were attributed to a number of factors including: (i) the complexity of tax law; (ii) insufficiency of resources to hire a professional for obtaining a professional advice; and, (iii) high costs for maintaining accounting records.[17]

The above factors encourage governments in developed and developing countries to introduce specific measures to simplify tax legislation, in order to improve tax compliance

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8 Saša Petković, Clemens Jäger and Boban Sašić, 'Challenges of Small and Medium Sized Companies at Early Stage of Development: Insights from Bosnia and Herzegovina' (2016) 21(2) *Management* 45.

9 Martin Bergner et al, 'The Use of SME Tax Incentives in the European Union' (ZEW Discussion Papers 17-006, ZEW- Leibniz Centre for European Economic Research, 2017) 2–3.

10 Ann Hansford and John Hasseldine, 'Tax Compliance Costs for Small and Medium Sized Enterprises: The Case of the UK' (2012) 10(2) *eJournal of Tax Research* 288.

11 Lignier, Evans and Tran-Nam (n 3).

12 Michael Engelschalk and Jan Loeprick, 'MSME Taxation in Transition Economies: Country Experience on the Costs and Benefits of Introducing Special Tax Regimes' (World Bank Group WPS/449, 2017) <https://documents1.worldbank.org/curated/en/399741468197376971/pdf/WPS7449-REVISED-MSME-taxation-in-transition-economies.pdf>.

13 Deogratius Ng'winula Mahangila, 'The Impact of Tax Compliance Costs on Tax Compliance Behaviour' (2017) 3(1) *Journal of Tax Administration* 57.

14 Sebastian Eichfelder and Frank Hechtner, 'Tax Compliance Costs: Cost Burden and Cost Reliability' (2018) 46(5) *Public Finance Review* 764.

15 Hansford and Hasseldine (n 10).

16 Lignier, Evans and Tran-Nam (n 3) 246–47.

17 OECD, *Taxation of SMEs in OECD and G20 Countries* (OECD Tax Policy Studies No 23, OECD Publishing, 2018) 90–91 <http://ifuturo.org/documentacion/taxation%20of%20smes.pdf>.

among SMEs. Furthermore, international institutions such as the World Bank, IMF and the Organisation for Economic Co-Operation and Development ('OECD') have all issued guidelines for designing specific tax measures for SMEs.[18]

B *Specific MSME Tax Measures*

1 *Overview*

Many developed and developing countries provide specific tax measures for MSMEs in order to reduce their tax burden. As previously discussed, there are two sources of costs contributing to a high tax burden on MSMEs, namely, the legal tax liability and the tax compliance costs, which require designing specific tax measures for MSMEs that mainly cover income tax and consumption tax (e.g., GST and VAT). Governments are often concerned to design specific tax measures for MSMEs addressing both liability and compliance cost issues through either preferential tax rules, or simplified tax measures.[19]

2 *Preferential Tax Measures*

Preferential tax measures for MSMEs involve tax incentives aimed at minimising the tax burden of MSMEs whether embodied in the income tax law or other laws. Bergner et al. have classified these types of tax incentives into three types: (i) tax incentives for the business entity or its owners, where the former type entail granting tax incentives to a business entity regardless of its legal form — for example, whether it is an unincorporated or incorporated business entity — while the latter entail tax incentives are available to a business's owner, such as a self-employed person or sole proprietor; (ii) tax incentives that influence tax liability and/or tax compliance, the former including various incentives aimed at mitigating the tax burden, and the latter including specific measures which simplify tax compliance; and, (iii) input-based tax incentives and output-based tax incentives,[20] where input-based tax incentives are incentives that affect the tax base and consequently minimise a business's taxable income, such as investment tax allowances, accelerated depreciation, and tax credits, and output-based tax incentives minimise the tax due through implementing a reduced tax rate or providing tax exemption or a tax holiday.[21]

The tax incentives for MSMEs in many developed countries often take the form of input or output tax incentives which aim to minimise the tax burden. For example, Belgium, Germany, the United Kingdom and France grant input tax incentives including accelerated depreciation, investment allowances, and tax credits. Further, Belgium, France, and Spain provide output tax incentives including reduced tax rates and tax exemption.[22] In the

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18 Engelschalk and Loeprick (n 12).

19 Marco Marchese, 'Preferential Tax Regimes for MSMEs: Operational Aspects, Impact Evidence and Policy Implications' (International Labour Organization Working Paper No 33, 17 June 2021) 11 <https://www.ilo.org/global/publications/working-papers/WCMS_803925/lang--en/index.htm>.

20 Bergner et al (n 9) 4–5

21 Ibid.

22 Petković, Jäger and Sašić (n 8).

Oceania region, Australia's *Income Tax Assessment Act 1997* (Cth) and related legislation provides for reduced tax rates on small corporations which represent output tax incentives. Furthermore, a conditional research and development ('R&D') tax offset is also provided.[23] Researchers have found that developed countries often provide preferential tax treatment (tax incentives), while developing countries often provide specific tax regimes for SMEs.[24] As a specific instance of the latter case, this article will in Part III review and assess the specific tax regime which has been enacted in Egypt.

3 *Simplified Tax Measures for MSMEs*

Simplified tax measures for MSMEs are an important channel for minimising the tax burden and simplifying tax compliance for MSMEs, thus encouraging them to conduct their business as part of the formal economy.[25] Many developed and developing countries alike use such measures to stimulate the creation and growth of MSMEs. In addition, international institutions such as the World Bank and IMF always recommend simplification of tax measures for countries facing a low level of MSME tax compliance since these countries do not have the administrative capabilities to implement the more complex and unsimplified tax measures.[26] Simplified tax measures include, for example, presumptive taxes, cash accounting taxes and VAT special measures, each of which is discussed further in turn below.[27]

(a) Presumptive Income Tax

Many tax researchers have reviewed and assessed the presumptive taxes for MSMEs that have been enacted by many developing countries and also by a few developed countries such as Austria, Belgium and Italy.[28] A presumptive tax is a system that is used in place of the regular income tax rules to assess tax liability based on specific criteria or indicators.[29] Engelschalk has classified presumptive tax systems into four types, namely: (i) lump sum taxes; (ii) turnover taxes; (iii) indicator-based taxes; and, (iv) agreement-based taxes.[30] A

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[23] Board of Taxation, *Review Of Small Business Tax Concessions: A Report to The Treasurer* (Report, March 2019) 25 <https://taxboard.gov.au/sites/taxboard.gov.au/files/migrated/2019/12/RSBTC-report.pdf>.

[24] OECD (n 17) 64–65.

[25] Jacqueline Coolidge and Fatih Yılmaz, 'Small Business Tax Regimes', *Viewpoint* (World Bank Group Note, February 2016) <https://openknowledge.worldbank.org/bitstream/handle/10986/24250/Small0business0tax0regimes.pdf?sequence=1&isAllowed=y>.

[26] Ibid.

[27] Michael Engelschalk, *Designing a Tax System for Micro and Small Businesses: Guide for Practitioners* (World Bank Group, 2007) 43–58 <http://documents.worldbank.org/curated/en/980291468158071984/Designing-a-tax-system-for-micro-and-small-businesses-guide-for-practitioners>.

[28] Valeria Bucci, 'Presumptive Taxation Methods: A Review of the Empirical Literature' (2020) 34(2) *Journal of Economic Surveys* 372.

[29] OECD (n 17) 93.

[30] Engelschalk (n 27) 58–61.

similar classification was provided by the OECD in 2015.[31] Further details in relation to each of these types of taxes can be noted as follows:

1) *The lump sum tax/patent*: this is a simple tax regime that imposes a fixed amount of tax on eligible businesses based on specific criteria. It is also called a patent system, which often targets micro businesses with annual turnover not exceeding a specific threshold. Coolidge and Yılmaz studied this regime in a number of developing countries and found that more than 90% of businesses in many of the countries involved use such a system.[32] Engelschalk and Loeprick have also found that many transition countries in Eastern Europe and Central Asia (such as Albania, Hungary, Georgia and Kosovo) have lump sum taxes in place. These countries use a number of indicators to assess the annual turnover threshold, such as the area of the business, business location, etc. Further, these indicators are often subject to review in order to minimise abuse.[33]

2) A lump sum tax regime achieves three objectives which governments endeavour to achieve: it causes no behavioural distortions, can facilitate a low tax burden and entails low tax compliance costs. Nevertheless, there are risks involved in using such systems relating to: (i) possible abuses by ineligible businesses as they may also seek to use the system to minimise their tax burden; (ii) adverse effects in deterring micro businesses from growth, as growth may cause them to be required to migrate to the regular tax system; and, (iii) the possible negative impact on collected tax revenues.[34]

3) *The turnover-based tax*: this is the most common type of presumptive tax system and is used by many countries, both developing and developed,, such as France, Germany, Latvia, Armenia, Belarus, etc.[35] There are two methods for imposing a turnover tax; the first method subjects the annual turnover to tax under a flat or progressive tax rate schedule up to a specified turnover threshold, while the second method calculates the taxable income through first multiplying the annual turnover by a specific profit margin and then calculating the tax due by applying flat or progressive tax rates to that amount.[36] The simplest form of turnover tax is based on imposing a flat tax rate on a business's annual turnover under a specified threshold. This is also the most common method and is used by many countries in Eastern Europe and Central Asia.[37] The single flat rate of turnover tax is generally applicable to all business sectors, irrespective of the differences in profit margin from one industry to another, and the heterogeneity of small businesses. Thus, sectors with a low profit margin will be disadvantaged. Further, if the tax rate (as

31 OECD (n 17) 93–99.

32 Coolidge and Yılmaz (n 25) 1–2.

33 Engelschalk and Loeprick (n 12) 24–28.

34 Coolidge and Yılmaz (n 25) 2–3.

35 OECD (n 17) 96–97; Engelschalk and Loeprick (n 12) 34–35.

36 OECD (n 17) 96.

37 Engelschalk and Loeprick (n 12).

a percentage of annual turnover) is high, it may discourage many businesses from enrolling in the system or properly complying.[38] For instance, Indonesia imposed a turnover tax on MSMEs at an annual tax rate of 1% in 2013 and, because of the low compliance rate, reduced the turnover rate to 0.5% in 2018.[39]

4) *The indicator-based tax*: this system involves using a specific indicator to work out business income and consequently the tax base and the resulting tax liability. The indicators include, for example, number of employees, electricity/water usage (e.g., for workshops), business area (e.g., restaurant area and number of tables). It is essential to set a good indicator which is easy to verify and difficult to manipulate and comprises a good measure of income. This system is implemented by many countries such as Spain, Italy and Argentina.[40]

5) *The agreement-based tax*: this tax is based on concluding an agreement between a tax authority and a taxpayer. This system typically applies to businesses of a specific nature. However, there is a high probability of corruption which may increase the compliance costs or may negatively affect government revenue.[41]

(b) Cash Accounting

Accounting systems normally apply on an accrual basis in the measurement of income and expenses. Such systems are complex and require professional accountants to implement, and are thus difficult and costly for MSMEs to use. For this reason, a country's tax legislation may allow small businesses to use a cash accounting system as a simple alternative to accrual accounting. Cash accounting systems use gross takings and payments in cash to measure business income. In this way, the use of cash accounting differs from application of a presumptive tax as it will still depend on the normal tax rules for determining income, as measured on the basis of cash inflow/outflow. This system is again implemented by many countries, both developed and developing, such as Austria, Canada (farming sector), Chile, Sweden and Turkey.[42]

(c) VAT Measures for MSMEs

The VAT now represents the main indirect tax in most countries around the world. The design of the VAT implies that the ultimate consumer bears the VAT burden through the following mechanism: (i) businesses pay VAT to suppliers on their purchases of goods and services (input tax); (ii) businesses also charge VAT on their sales of goods and services to customers (output tax); and, (iii) businesses deduct input tax from output tax and remit the difference to tax authority, or claim a refund where input tax exceeds output tax. This mechanism theoretically entails that businesses (including MSMEs) do not bear the

[38] Coolidge and Yılmaz (n 25) 2–3.

[39] Herni Kurniawati and Septian Bayu Kristanto, 'The Taxation Constraints and Potential Solutions for Indonesian MSMEs' (2021) 15(4) *International Journal of Innovation, Creativity and Change* 968.

[40] Engelschalk (n 27) 68.

[41] Ibid 72–74.

[42] OECD (n 17) 99–100.

burden of the VAT.[43] Thus, it is expected that MSMEs will not pay VAT but will work as intermediaries between consumers and the tax authority.[44] This role as an intermediary raises a compliance issue, and as VAT compliance has been considered a critical challenge facing MSMEs a number of studies to date have focused on methods for simplifying this MSME tax compliance role in order to minimise the compliance costs involved.[45]

In the above context, governments employ a number of measures to mitigate the VAT compliance burden on MSMEs. One such measure involves setting a high threshold for registration to bring a business within the VAT system so as to exclude SMEs from the VAT net, an approach that is implemented by many countries such as France, Ireland, Poland and the United Kingdom.[46] In this situation, unregistered businesses pay VAT on their inputs but do not charge VAT on their sales of goods and services, and as a result VAT is considered as a normal cost element, which raises the prices of their goods and services.[47]

A number of other approaches can also be taken to simplify VAT compliance for MSMEs such as simplified bookkeeping systems, use of cash accounting, reduced filing frequency, etc. These mechanisms may overlap with simplification of compliance with regard to income tax, which will be discussed in detail in the Egyptian case in the next Part.

III The Egyptian MSME Tax Regime

A *Main Features of the MSME Tax Regime*

1 *MSME Definition*

The starting point for providing preferential tax treatment or designing a specific tax regime for MSMEs is to establish a definition of the MSMEs that are to be eligible for the preferential rule or subject to the specific regime. Countries employ a number of criteria for defining MSMEs, such as paid-in capital, annual turnover and number of employees. These criteria may be implemented differently among countries or as between one industry and another within a particular country. Furthermore, there may be different definitions of an MSME for different purposes in the one country, as there may be a definition for statistical purposes and another for tax purposes.[48]

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43 Alan A. Tait, *Value Added Tax: International Practice and Problems* (International Monetary Fund, 1988).

44 I. Dickson, 'The New Zealand GST Policy Choice: An Historical and Policy Perspective' in Richard Krever and David White (eds), *GST in Retrospect and Prospect* (Thomson Brookers, 2007) 45–48.

45 OECD (n 17).

46 For further discussion about the setting of an optimal VAT and GST threshold, see Yige Zu, 'VAT/GST Thresholds and Small Businesses: Where to Draw the Line?' (2018) 66(2) *Canadian Tax Journal* 309.

47 Tait (n 43) 53–58.

48 OECD (n 17) 18.

In Egypt's case, the new MSME Law 2020 and the executive regulations made under it provide a specific definition of MSMEs, as set out in Article 1 of that Law. This definition of MSMEs is based on two alternative criteria of paid-in capital or turnover, the application of which also varies across different industrial activities. Table 1 below summarises this definition of MSMEs for Egyptian tax purposes.

TABLE 1: MSME CLASSIFICATIONS

BUSINESS SIZE	BUSINESS TYPE	PAID-IN CAPITAL (EGP)	ANNUAL TURNOVER (EGP)
Micro	Non-Industrial	less than 50,000	Less than 1,000,000
	Industrial	50,000	
Small	Non-Industrial	50,000 – 3,000,000	1,000,000 – 50,000,000
	Industrial	50,000 – 5,000,000	
Medium	Non-Industrial	3,000,000 – 5,000,000	50,000,000 – 200,000,000
	Industrial	5,000,000 – 15,000,000	

Source: MSME Law 2020 (Egypt).

The MSMEs that meet the criteria in Table 1 above are required to register with the MSME authority in accordance with Article 54 of the MSME Law 2020. The annual registration fees for businesses in each size category are as follows: (i) micro businesses, up to EGP 500; (ii) small businesses, up to EGP 2,000; and, (iii) medium businesses, up to EGP 5,000. Article 20 of the executive regulations provides further details about registration fees for each size of business based on their paid-in capital.

2 *Tax Incentives for MSMEs*

The MSME Law 2020 provides a number of tax incentives for MSMEs as set out in Articles 27 to 31. These tax incentives are:

1) MSMEs are exempted from stamp duties, business registrations fees, and contract registration fees for informal businesses, when they become registered as a formal business in accordance with Article 27. MSMEs are required to obtain a certificate from the MSME authority granting the abovementioned exemption according to Article 80 of the executive regulations.

2) Plant and machinery items imported by MSMEs are subject to 2% customs tariffs in accordance with Article 28. It is expected that the Minister of Finance will issue a decree stating the terms for enjoying this reduced customs tariff according to Article 81 of the executive regulations.
3) Capital gains derived by MSMEs from the sale of capital assets are exempt from income tax when the sale proceeds are used in acquiring other capital assets pursuant to Article 29. Nevertheless, an eligible business is required to keep a regular account book in accordance with Article 82 of the executive regulations. If the business fails to satisfy this condition, its capital gains will be taxable according to the normal income tax provisions.
4) Dividends paid by one-person companies are exempt from income tax according to Article 31.

Furthermore, Article 83 of the executive regulations states that an eligible business is required to keep regular account books to enjoy any of the abovementioned incentives. The required account books are: (1) general journal; (2) stocktaking book; (3) sales book; and, (4) purchasing book. MSMEs are allowed to use a computerised accounting system to maintain these books.

B *The Specific Tax Regime for MSMEs*

The MSME Law 2020 introduces a specific tax regime for MSMEs replacing the income tax provisions under the Income Tax Law 2005. The specific tax regime for MSMEs imposes a lump sum tax on micro businesses and turnover tax on small businesses.

1 *Lump Sum Tax on Micro Businesses*

According to Article 93 of the MSME Law 2020, micro businesses with an annual turnover of less than EGP 1 million are classified into three categories based on the annual turnover and each category pays a lump sum tax based on the annual turnover amount. The lump tax for each category is shown in Table 2 below.[49]

TABLE 2: LUMP SUM TAX ON MICRO BUSINESSES (EGP)

BUSINESS TURNOVER		ANNUAL LUMP SUM
1	Less than 250,000	1,000
2	From 250,000 to less than 500,000	2,500
3	From 500,000 to less than 1 million	5,000

The lump sum tax is imposed on micro businesses based only on annual turnover which deviates from the definition of micro business provided by Article 1 of the MSME Law 2020 setting out both paid-in capital and annual turnover criteria. As the MSME tax regime provides tax treatment to micro businesses and small businesses which have

[49] MSME Law 2020 (Egypt).

annual turnover less than EGP 10.0 million, small businesses which will have a turnover more than the thresholds in Table 2 are excluded from the lump sum tax as well as medium businesses.

2 *Annual Turnover Tax for Small Businesses*

The turnover tax is imposed on small businesses with annual turnover of less than EGP 10.0 million and is imposed at progressive rates. In this context, Article 93 of the MSME Law 2020 imposes a turnover tax on small business in three categories as follows:

- a business with turnover of EGP 1.0 million or more and less than EGP 2.0 million is subject to a turnover tax at 0.5% of annual turnover;
- a business with a turnover of EGP 2.0 million or more and less than EGP 3.0 million is subject to a turnover tax at 0.75% of annual turnover; and
- a business with a turnover of EGP 3.0 million or more and less than EGP 10.0 million is subject to a turnover tax at 1.0% of annual turnover.

As a result of the above provisions, small businesses with annual turnover of EGP 10.0 million or more are not eligible to apply the turnover tax (even though the main definition of small business under Article 1 of the MSME Law 2020 includes all businesses with a turnover of EGP 1.0 million or more and less than EGP 50.0 million).

3 *General Provisions of the MSME Tax Regime*

The MSME Law 2020 has specific provisions for determining the annual turnover of eligible businesses (taxpayers). Article 95 states that the annual turnover is determined based on one of the following measures:

- the last tax assessment year's income tax liability issued by the Egyptian Tax Authority (ETA);
- the reported annual turnover amount disclosed in the first tax return filed by a taxpayer at the date of enactment of the law; and
- the amount in an annual tax return filed after enactment of this law.

The annual turnover under this specific tax treatment will be used as a basis for the tax assessment of eligible businesses for a period of five years subject to the outcome of a tax audit that is carried out by the ETA.

The MSME tax regime exempts eligible MSMEs from keeping regular accounting books and related documents according to Article 97 of the MSME Law 2020. Nevertheless, the Minister of Finance has the right to issue a simple bookkeeping system requirement that is suited to their specific nature.

An eligible taxpayer (eg, micro, or small business) is allowed to terminate their operations using the MSME tax regime and start implementing the provisions of the ITL 2005 according to Article 98 based on the following terms:

1) if a taxpayer realises losses during the taxable period; or

2) if a taxpayer finds that its tax liability is going to be lower under the ITL 2005 provisions compared with the MSME tax regime.

In either of the abovementioned cases, a taxpayer may exit the MSME tax regime after notifying the ETA. However, a taxpayer cannot then return to the MSMEs tax regime for at least five years.

IV ASSESSING AND ANALYSING THE MSME TAX REGIME

A *Overview*

The MSME Law 2020 introduces new tax measures which deviate from the ITL 2005. In order to assess the specific tax regime for MSMEs, it is essential to shed light on the main differences between these measures and the ITL 2005. There are four main such differences:

1) The MSME tax regime imposes a lump sum tax on micro businesses and turnover tax on small businesses irrespective of their legal form, whether self-employed, sole proprietor, partnership, etc. However, the ITL 2005 differentiates between individual taxpayers and taxpayers taking other legal forms ('legal persons') such as partnerships, a limited liabilities companies, corporations, etc.
2) The ITL 2005 imposes progressive tax rates on individual taxpayers and a flat tax rate on legal persons. According to Law No 26 of 2020, amending the ITL 2005, individual tax rates apply starting from a 0.0 rate on income bracket EGP 1.0 to EGP 15,000 and rising to 25% on income above EGP 1.0 million. Legal persons are subject to a flat tax rate of 22.5%.[50]
3) Dividends paid by legal persons are subject to withholding tax at a 10% rate according to Article 56a of the ITL 2005. However, as noted previously dividends paid by a one-person company (e.g., micro, small businesses), are exempt from tax according to Article 31 of the MSME Law 2020.
4) Individuals or legal persons who are subject to the MSME Law 2020 are exempt from the bookkeeping requirements under the ITL 2005. According to Article 78 of the ITL 2005, all legal persons are required to keep regular accounting books. Furthermore, business taxpayers conducted by individuals with either paid-in capital of at least EGP 50,000, or with an annual turnover of at least EGP 250,000, are also required to keep regular accounting books.

B *Assessing Egypt's MSME Regime Against the Criteria of a Good Tax System*

1 *Economic Efficiency*

As highlighted in Part IIA, MSMEs face a number of challenges specific to them including market failure and market imperfection issues which require government intervention through corrective measures in order to achieve economic efficiency. In general, it has

[50] Income Tax Law No 91 of 2005 (as amended) (Egypt).

been established that taxation creates distortions which reduce economic efficiency. However, in a case of market failure/imperfection which is attributed to negative or positive externalities, taxation can play an important role to correct such market failure through corrective tax measures, which are known as Pigouvian taxes.[51] The MSME tax regime in Egypt introduces new measures, which aim to minimise the tax burden on micro and small businesses, as discussed in Part IIIB. These new tax measures impose a lump sum tax on micro business, which satisfies the economic efficiency criterion of a good tax system.[52] Furthermore, small businesses with a turnover of EGP 1 million or more and less than EGP 10 million are subject to low progressive tax rates on their annual turnover compared with tax rates under the regular ITL 2005 as will be explained later in this Part and in Table 4. This reflects the interest of policymakers to address the specific nature of small business and the need to minimise their tax liability through imposing a low tax rate, which satisfies the Pareto efficiency requirement.[53] Accordingly, the MSME tax regime satisfies the economic efficiency criterion. We also note that the lump sum tax imposed on micro businesses is known to be highly efficient as it does not distort taxpayers' behaviour.

2 *Equity/Fairness*

The modern equity criterion means that a tax system imposes tax liability on taxpayers according to their ability to pay. More specifically, there are two types of equity, namely vertical and horizontal. Vertical equity means that taxpayers who differ in their ability to pay should bear a different tax burden through a progressive tax schedule. Horizontal equity implies that taxpayers with a similar ability to pay should bear the same tax burden.[54]

The equity criterion in the case of the MSME tax measures implies that businesses of a similar size (in terms of turnover, number of employees, etc.) should bear the same tax burden. Nevertheless, the tax system may, in many cases, indirectly favour specific type of MSMEs, while disadvantaging other types of MSMEs. This results in a lack of fairness or equity in taxing some types of MSMEs.

In order to analyse the MSME tax regime in Egypt from an equity perspective, it can be noted that there are a number of situations in which the new MSME tax regime lacks equity, as set out further here.

1) The ITL 2005 has specific provisions for measuring taxable income arising from commercial activities. Nevertheless, there are different measures between individuals and legal person taxpayers, especially relating to the tax rate. The new

51 Alan Randall, 'The Problem of Market Failure' (1983) 23(1) *Natural Resources Journal* 131.

52 Alan J. Auerbach and James R. Hines Jr, 'Taxation and Economic Efficiency' in Alan J. Auerbach et al (eds), *Handbook of Public Economics* (North-Holland, 1985–2013) vol 3, 1347.

53 Brito et al, 'Pareto Efficient Tax Structures' (1990) 42(1) *Oxford Economic Papers* 61.

54 Richard M. Bird and J. Scott Wilkie, 'Designing Tax Policy: Constraints and Objectives in an Open Economy' (International Center for Public Policy Working Paper 12–24, Andrew Young School of Policy Studies, Georgia State University, April 2012) <https://icepp.gsu.edu/files/2015/03/ispwp1224.pdf>.

MSME regime applies to micro and small business irrespective of their legal forms, as demonstrated in scenario 1 below.

2) Further, in order to implement the MSME tax regime, micro or small businesses are required to register with the MSME authority and pay the registration fees. As a result, if there are two businesses with the same turnover, one may be registered with the MSME authority and the other not.[55] The former is going to pay tax in accordance with the MSME tax regime, while the latter will be subject to the ITL 2005. Therefore, the registered business will bear a lower tax burden compared with unregistered business. Further, if the unregistered business is a legal person paying tax under the ITL 2005 it is going to bear a high tax burden. This indicates a lack of horizontal equity, as scenario 1 below demonstrates.

3) Thirdly, small businesses are heterogeneous as they work in different industries with different profit margins. Accordingly, if there are two businesses in two different industries, the first may be a business with a high profit margin and the second a business with a low profit margin. As a result, the first will have a high taxable income and it will pay a high tax liability under the ITL 2005 and the second will have a low taxable income and consequently it will pay a low tax liability under the ITL 2005. Nevertheless, under the new MSME tax regime both will pay the same lump tax or turnover tax. This indicates that the new system lacks vertical equity. This will be elaborated in scenario 2.

(a) Scenario 1: Lump Sum Tax

i) Assume that we have businesses of three different sizes (based on annual turnover), and that the businesses of each size are also in the following three situations (A, B, and C) respectively (for a total of nine businesses): A is a micro business eligible to apply the MSME tax regime; B is an individual taxpayer subject to the ITL 2005, and C is a legal entity that is subject to the ITL 2005.

ii) Assume further that for all of situations A, B and C, annual turnover is EGP 200,000 for three of the businesses and the profit margin is 10%; taxable income is then going to be EGP 20,000. As a result, according to the MSME Law, business A is subjected to a lump sum tax and the other two cases (B and C) are going to pay tax based on their taxable income according to the ITL 2005. These outcomes are set out in row 1 of Table 3.

iii) Next assume the annual turnover is EGP 400,000 for the three cases and the profit margin is 10%, so that taxable income is going to be EGP 40,000. According to the MSME Law business A is subject to a lump sum tax (micro business) and the other two (B and C) cases are going to pay tax based on their taxable income according to the ITL 2005; see row 2 of Table 3.

[55] Initially, any micro or small business can formally conduct its business through obtaining commercial registration and a tax file number on the basis of its existence at the time. Nevertheless, registration with the MSME authority is necessary to obtain various services or enjoy incentives granted by the MSME Law 2020.

iv) Then assume annual turnover is EGP 900,000 and the profit margin is 10%, so that taxable income is EGP 90,000. According to the MSME Law business A is subject to the lump sum tax and the other two cases (B and C) are going to pay tax based on their taxable income according to the ITL 2005; see row 3 of Table 3 below.

TABLE 3: COMPARATIVE TABLE OF TAX PAYABLE UNDER THREE CASES, LUMP SUM TAX AND ITL 2005 (EGP)

SIZE CATEGORY	ANNUAL TURNOVER	CASE A (MSME LAW)	CASE B (ITL 2005, INDIVIDUAL)	CASE C (ITL 2005, LEGAL PERSON)
1	200,000	1,000	125	4,500
2	400,000	2,500	625	9,000
3	900,000	5,000	6,375	20,250

Table 3 above shows that the MSME Law imposes a lower tax burden in case (A) compared with the ITL 2005 in case (C) for all turnover amounts. However, for individual taxpayer (B), the tax burden is lower under the ITL 2005 in rows 1 and 2 compared with the MSME tax regime in case (A). However, the tax burden of case A in row 3 is lower under the MSME regime compared with the ITL 2005 in cases B and C in row 3. This indicates the MSME tax regime has advantaged the legal person in all cases and has disadvantaged individual taxpayers (B) with an annual turnover less than EGP 500,000. This scenario generally reflects a lack of horizontal equity as between MSME legal entities eligible for the MSME tax regime and legal entities subject to the ITL 2005. In addition, the system lacks vertical equity as a result of the heterogeneity of MSMEs and different profit margins between industries as previously explained.

(b) Scenario 2: Turnover Tax

i) Assume there are further businesses of different size categories which are individual and legal person taxpayers. Under each size, there are the three possibilities D, E and F: micro/small business (D) is eligible to the MSME tax regime, individual taxpayer (E) earns income from professional services, and legal entity (F) is subject to the ITL 2005.

ii) Assume further that the annual turnover is EGP 1,500,000 for the three cases and the profit margin is 10%, so that taxable income is EGP 150,000. According to the MSME Law, business D is subject to tax of 0.5% on turnover and the other two cases (E and F) are going to be taxed according to the ITL 2005; see row 1 of Table 4.

iii) Next assume that the annual turnover is EGP 2,000,000 for the three cases and the profit margin is 10%, so that taxable income is EGP 200,000. According to the MSME Law, business D is subject to tax of 0.75% on turnover and the other two (E and F) cases are going to pay tax based on their taxable income according to the ITL 2005; see row 2 of Table 4.

iv) Then assume that the annual turnover is EGP 6,000,000 for all three cases and the profit margin is 10%, so that taxable income is EGP 600,000. According to the

MSME Law, business D is subject to tax of 1.0% on turnover and the other two cases are going to pay tax based on their taxable income according to the ITL 2005; see row 3 of Table 4 below.

TABLE 4: COMPARATIVE TABLE OF TAX PAYABLE UNDER THREE CASES, TURNOVER TAX AND ITL 2005 (EGP)

SIZE CATEGORY	ANNUAL TURNOVER	CASE D (MSME LAW)	CASE E (ITL 2005, INDIVIDUAL)	CASE F (ITL 2005, LEGAL PERSON)
1	1.5 million	7,500	22,125	33,750
2	2.0 million	15,000	32,125	45,000
3	6.0 million	60,000	12,7125	135,000

Table 4 above indicates that the micro/small businesses of all three sizes are going to pay less tax under the turnover tax (column 3) compared with the taxpayers subject to the ITL 2005 provisions (columns 4 and 5). This reflects the lack of horizontal equity where taxpayers earning the same income are not bearing the same tax burden. Further, as previously discussed, vertical equity is not attained due to the heterogeneity of MSMEs.

Based on the above-mentioned analysis, the MSMEs is generous, which is reflected in the low levels of the lump sum tax and rates of turnover tax has resulted in creation of a regime that is inequitable as between different types of taxpayers and is also unproductive in terms of revenue collected. As a result, it is necessary to consider the equity criteria and tax expenditures relating to the system, which will require frequent assessment of the system in terms of its costs and benefits.

3 *Simplicity*

Simplicity is an essential criterion of a good tax system since it plays a critical role for tax compliance and enforcement of tax law. It refers to legal provisions and regulations which are unambiguous and comprehensible by taxpayers, professionals, and tax administrators. Thus, simplicity helps taxpayers to minimise their compliance costs and the tax authority to minimise tax collections costs, which together result in lower operating costs of a tax system.[56]

(a) Legal Simplicity

The MSME tax regime aims to simplify tax compliance for MSMEs through introducing new measures for both micro and small businesses to work out their tax base and pay their tax liability. This implies reducing the number of procedures for assessing the tax

[56] Chris Evans, Philip Lignier and Binh Tran-Nam, 'Tax Compliance Costs for the Small and Medium Enterprise Business Sector: Recent Evidence from Australia' (Tax Administration Research Centre Discussion Paper No 003-13, University of Exeter Business School, 2013) https://tarc.exeter.ac.uk/media/universityofexeter/businessschool/documents/centres/tarc/publications/discussionpapers/13_09_24_Evans_Tax_compliance_costs_in_SMEs_Exeter.pdf>.

liability for micro and small businesses so as to achieve procedural simplicity.[57] Furthermore, it is expected that the assessment of tax liability under the new regime will be simple as there is a clear-cut indicator for imposing tax on annual turnover. This will result in reduction of tax disputes and encouragement of MSME growth. Further, tax assessments of micro or small business will be applicable for five years, minimising both tax compliance costs and tax collection costs, and as a result lowering the operating cost of the tax system.[58]

Nevertheless, the MSME tax regime does not meet the criteria for legal simplicity in relation to the requirements to obtain tax incentives under Articles 27 to 31, as previously discussed in Part IIIB. MSMEs are required to maintain regular accounting books according to Article 38 of the MSME Law and the executive regulations if they wish to claim tax exemption for capital gains or dividends. These conditions do not contribute to meeting the simplicity criterion, and it may be difficult for MSMEs to satisfy such conditions which would also make the tax incentives ineffective.

(b) Accessing the System

Generally, the new system eliminates several procedures involved in tax assessment and reduces the number of procedures for working out taxable income and tax liability. Nevertheless, in order to implement the MSME special regime, a taxpayer needs to register with the MSME authority, even though it may already be operating as part of the formal economy. So, requiring registration with the MSME authority for existing businesses is going to complicate the system, and discriminates between registered and non-registered taxpayers as discussed in Part III.B above.

To sum-up the MSME tax regime needs to be accessible by all micro and small businesses through the ETA, when they meet the turnover condition. It is also important that the tax authority be given full control in managing the system without intervention from a third party in order to minimise any potential complexity of the system and reduce the scope for tax disputes.

(c) E-Filing

In 2019, legal person taxpayers commenced lodgement of their VAT and income tax returns online using the ETA's online platform. From January 2021, all individual taxpayers, regardless of their business size or type, are required to lodge their tax return online according to Minister of Finance Decree No 296 of 2020. Pursuant to Article 29 of the Unified Tax Procedures Law No 206 of 2020, all taxpayers are obliged to use e-filing for their income tax or VAT return. This reflects the interests of ETA to simplify the process of tax compliance for all taxpayers including MSMEs. Nevertheless, technological illiteracy represents a challenge to e-filing of tax returns, especially for MSMEs. A report issued by USAID/Egypt in 2020 identifies that technological illiteracy is a critical

[57] Chris Evans and Binh Tran-Nam, 'Managing Tax System Complexity: Building Bridges Through Pre-Filled Tax Returns' (2010) 25(2) *Australian Tax Forum* 245, 249.

[58] Evans, Lignier and Tran-Nam (n 56).

challenge for financial inclusion and digital transformation of MSMEs.[59] Therefore, the ETA is required to provide support for micro and small businesses to use online filing in order to effectively simplify their tax compliance. Furthermore, taxpayers will pay registration fees for using the ETA's online platform according to Minister of Finance Decree No 21 of 2021. This is going to increase tax compliance costs and will impose a further burden on micro and small businesses. Thus, it is recommended that free access be provided to the ETA online platform for micro and small businesses.

To sum-up, implementation of e-filing of tax returns should take into account the technological illiteracy of many MSME owners and managers, and the difficulty for them in using online services, forcing them to use professional services and consequently increasing their tax compliance costs. As a result, it is necessary for new ways to be found to help MSMEs to comply smoothly with the regime at a minimum cost.

4 *Revenue Adequacy*

An important function of a tax system is to collect targeted revenues to finance government expenditures, which reflects the productivity of a tax system. Sneed has stated that revenue adequacy is an important criterion of a good tax system, revenue adequacy referring to the productivity of the tax system in terms of collected revenues.[60] Revenue adequacy is affected by both the design of the tax law and the rates of tax. As a result, it is expected that the design of the MSME tax regime will have an impact on tax revenue in Egypt and therefore also the government expenditures financed by that revenue. This impact can be assessed through comparing the tax burden of MSMEs under the ITL 2005 and the new MSME tax regime. Referring to the two scenarios previously discussed in Part IVB2, it can be seen that there is a significant reduction of the tax due from the micro and small business legal person taxpayers under the MSME tax regime compared with the regular ITL 2005 (as illustrated in Tables 3 and 4). A similar outcome arises for individual taxpayers in a case of a business with a high turnover under the lump sum tax and businesses under the three categories of size for the turnover tax as also illustrated in Tables 3 and 4. This indicates that the MSME tax regime will have a negative impact on tax revenues. Therefore, under the new system the collected taxes are going to be lower than was the case under the regular ITL 2005.

The reduction in tax revenue as a result of implementing the MSME tax regime can be considered as a kind of subsidy to MSMEs, known generally as a tax expenditure.[61] As a result, the revenue adequacy criterion for assessing the MSME tax regime is less important than considering the potential positive externalities from MSMEs and related spill over effects. Nevertheless, it is important to assess the tax expenditure results from this type of tax incentive in order to assess its effectiveness to stimulate MSMEs in the future.

[59] USAID/Egypt, *Private Sector Landscape Assessment* (USAID/Egypt, October 2020) 40–41 <https://www.integrallc.com/portfolio-item/egypt-private-sector-landscape-assessment/#top>.

[60] Joseph T. Sneed, 'The Criteria of Federal Income Tax Policy' (1965) 17(4) *Stanford Law Review* 567, 569–570.

[61] Lanre Kassim and Mario Mansour, 'Tax Expenditures Reporting in Developing Countries: An Evaluation' (2018) 26 *Revue D'Économie du Développement* 113.

To sum up, it is necessary to make tax assessment under the regime an annual process in view of the scope for changes in circumstances of individual businesses, overall economic changes, and inflation rates. This ensures that tax revenues collected will be pro-cyclical with economic and business circumstances and that acceptable levels of tax revenues can be secured from micro and small businesses.

C *Implementation Issues of the MSME Tax Regime*

1 *MSMEs under the VAT Law*

The MSME Law of 2020 provides specific definitions for the three business sizes, namely, micro, small and medium, as was discussed in Part IIIB1. Micro businesses are those businesses with annual turnover less than EGP 1 million, which are subject to the lump sum tax. Accordingly, they are not required to maintain regular accounting books according to the ITL 2005. By contrast, the VAT as introduced by Law No 67 of 2016 ('VAT Law 2016')[62] has a registration threshold of EGP 500,000 for any business whether it provides goods or renders services in accordance with Article 16 thereof. The registration threshold implies that a micro business with an annual turnover EGP 500,000 is required to be VAT registered with ETA according to Article 16 of the VAT Law 2016. Thus, they must fulfil the VAT compliance requirements which include three main commitments: (1) issuing an invoice for each sale transaction in accordance with Article 12 of the VAT Law 2016; (2) keeping regular accounting books in accordance with Article 13 of the VAT Law 2016; and, (3) filing monthly VAT returns in accordance with Article 14 of the VAT Law 2016. These are ongoing commitments under the VAT Law which are inconsistent with the MSME tax regime, especially for micro businesses, and as a result greater coordination between the MSME Law and VAT Law is required. Such coordination could include the following: (1) increasing the VAT registration threshold to EGP 1.0 million so as to exclude micro businesses from the VAT net and consequently minimise their compliance burden; (2) imposing a unified measure for bookkeeping requirements for VAT and income tax with regard to small businesses with turnover of EGP 1.0 million or more; and, (3) minimising the filing frequency for small businesses so that returns are only required on a quarterly basis.

2 *Inherited Practice Issues*

There are a number of inherited practices developed prior to enactment of the tax MSME regime which may negatively influence the implementation of that regime, as set out further below.

1) The first type of inherited practices relates to poor administrative practices which led to the failure of implementation of self-assessment as specified by Article 89 of the ITL 2005. As a result, Article 94 of the law was amended in 2013 by Law No 11 of 2013 in order to authorise the tax authority to conduct tax audits of all taxpayers, except those taxpayers who maintain regular accounting books.

[62] The VAT Law No 67 of 2016 abolished the former sales tax which was imposed under General Sales Tax Law No 11 of 1991.

Accordingly, all taxpayers who do not have regular accounting books are audited, but as a result of the very large number of micro and small taxpayers,[63] the conduct of tax audits is arbitrary and consequently there is an increasing number of disputes between the tax authority and taxpayers. This indicates the need to improve the tax practices of the tax officers irrespective of any tax legislation. This entails focusing more on improving tax compliance and developing a tax compliance strategy for MSMEs.

2) The second type of such practices relates to the 'losers' from implementing the new system, that may include tax professionals. According to the ITL 2005, there are many procedures involved in tax compliance, from filing the tax return, through to tax audits and possible tax disputes which increases the tax compliance costs borne by MSMEs. However, simplifying the system may reduce the payments to tax professionals and increase the resistance of enrolling in the new system.

3) The third type of such practices relates to the possible resistance that may arise from corrupted officers given that greater complexity of the tax system increases the discretionary power of tax officials and leads to an increased opportunity of corruption. Thus, simplifying the tax system will reduce the corruption opportunity, which may result in resistance to proper implementation from corrupted officers.[64]

Overcoming the negative impacts of inherited practices requires finding new approaches to bring about the following changes: (1) bureaucratisation of the mindset for drafting administrative rulings; (2) inclusion of tax professionals within the change process to minimise their resistance to change; and, (3) as an essential matter, gaining the support of tax officials and minimising corruption through developing proper measures for rewarding such officers financially based on increased MSME tax compliance.

To sum-up, a critical element for the successful implementation of any new tax legislation, including an MSME tax regime, is building the capacity of the tax authority and developing a strategic plan for improving MSME tax compliance.

V Concluding Remarks

Numerous tax researchers have identified the distinctive nature of MSMEs and the importance of designing favourable policies and drafting specific legislation to support them. This includes, for example, designing a specific tax regime or other tax measures to stimulate MSME growth and minimise their tax burden and tax compliance costs. Accordingly, many developed and developing countries have ratified specific MSME tax measures or regimes targeting micro and small businesses. In this context, in late 2020 Egypt introduced comprehensive legislation for stimulating micro, small and medium

[63] According to the OECD, there were 3.8 million micro and small enterprises in Egypt in 2017. For further detail, see OECD, *The Mediterranean Middle East, and North Africa 2018: Interim Assessment of Key SME Reforms* (OECD Publishing, 2018) 97 (ch 7, 'Egypt').

[64] OECD, *OECD Investment Policy Reviews: Egypt 2020*, OECD Investment Policy Reviews (OECD Publishing, 2020) 23.

enterprises under Law No 152 of 2020. That Law introduces various measures governing MSMEs including tax and non-tax incentives and a specific tax regime for MSMEs.

This article assesses Egypt's MSME tax regime against the principles of a good tax system and identifies the potential implementation challenges. It utilises a positive and analytical approach to assess the new MSME tax regime. Based on that approach, the following results are obtained:

1) The MSME tax regime is designed to serve the specific nature of MSMEs and to help them to overcome the market failure and market imperfection issues they face. In doing so, the MSME tax regime provides a number of tax incentives. Moreover, a specific MSME tax regime was introduced including a lump sum tax and turnover tax replacing for MSMEs the income tax provisions under the ITL 2005. It is known that the lump sum tax is an efficient form of tax and does not create economic distortions, and the tax on annual turnover also applies at a low rate. Accordingly, both the tax incentives and new tax measures are going to minimise the tax burden on MSMEs, thus satisfying the economic efficiency criterion.

2) The lump tax and turnover tax are also important tools for simplifying a tax system. Use of these taxes will minimise MSME tax compliance costs. Nevertheless, in order to broaden the scope of the new MSME tax regime, the requirement for registration with the MSME authority should be removed and the system made available to all micro and small businesses when they satisfy the turnover condition. This can be directly implemented by the ETA and will further minimise tax compliance costs. Also, the ETA should be responsible for managing all elements of the system in order to avoid any potential legal issues which may result from a tax audit. For example, a small business taxpayer may obtain a certificate from the MSME authority that it is eligible to implement the MSME tax regime. However, when the ETA conducts a regular tax audit, it may find that the taxpayer's turnover is above the MSME tax regime threshold and it is subject to the regular tax provisions of the ITL 2005. In such a situation, a tax dispute will arise between taxpayer and the ETA. Therefore, the ETA should have full control of the MSME tax regime.

3) Assessing the system from an equity perspective indicates that the system favours micro and small businesses registered with the MSME authority irrespective of their legal form as against other businesses which are not so registered, which does not satisfy the horizontal equity criterion. There is also vertical inequity due to the fact that the tax is imposed based on annual turnover regardless of the industry in which the taxpayer operates, while profit margins will differ from one industry to another. As a result, micro and small businesses in industries with a high profit margin are advantaged and vice versa.

4) Assessing the system from the perspective of revenue adequacy (productivity) indicates that the tax liabilities of micro and small business taxpayers will be lowered which result in a significant reduction in taxes paid taxes and consequently tax revenue collected. The reason for this anticipated decline in tax revenue relates to the low level of the lump sum tax and low rates of turnover tax, which reflect the substantial scale of the tax incentives to micro and small businesses. In this context, it is essential that the tax expenditure made through

implementing the MSME tax regime is measured so that the cost of the regime can be compared with the benefits.

5) A further issue affecting revenue adequacy relates to the provision for assessments of the tax liability of eligible micro and small businesses to be used for a period of five years, which ignores two important facts, namely the potential growth of businesses during that period which increases their annual turnover so that it may exceed the eligibility threshold, and the annual rate of inflation in the economy. As the annual inflation rate in Egypt has averaged around 10% over the period 2011–2020,[65] meaning that the tax burden of eligible micro and small businesses is declining in real terms under the MSEs tax regime. While government expenditures are increasing annually, tax revenue from micro and small business is declining.

6) Assessing the MSME tax regime from a practical perspective indicates the need for coordination of the regime with the VAT Law 2016. This implies increasing the VAT registration threshold to EGP 1 million in order to exclude micro business from the VAT net, as it is known that the bulk of micro business are owned by self-employed individuals or family businesses which are resource-constrained in complying with VAT requirements. For small businesses with a turnover EGP 1 million or more and less than EGP 10 million, minimising the frequency of filing VAT returns so as to be quarterly instead of monthly is also recommended. Also, the bookkeeping requirements should be unified under MSME tax regime and VAT Law 2016.

7) In order to minimise the resistance of tax professionals to the new system, it is essential that they be involved specific mechanisms developed to secure their support. In the meantime, any potential revenue losses from the implementation of the new system need to be minimised. In addition, it is necessary to handle any expected resistance resulting from corruption, through setting a financial reward system to tax officers based on an increased rate of MSME tax compliance.

[65] More information about the inflation rate in Egypt is available here, see Central Bank of Egypt, 'Inflation Historical' (Web Page, 2021) <https://www.cbe.org.eg/en/EconomicResearch/Statistics/Pages/Inflationhistorical.aspx>.

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