A Tax System for Micro, Small and Medium Enterprises (M/SMEs) in Egypt

International Models and Recommendations
Updated Version

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1. Introduction

The tax system in Egypt has passed through several phases since it started with law 14/1939 and continues with following laws. Along this period, successive laws were enacted to provide remedies to occurring drawbacks.

Notwithstanding, the Egyptian tax legislator didn’t specify special treatment for small and micro enterprises in spite of the importance of these types of enterprises and their impact on the development of national economy.

Different countries that are seeking to achieve (or have achieved) economic breakthrough – for example France, Canada, UK, Russia, Ukraine, Bulgaria and Latvia – have recognized the impact and importance of developing a specialized tax treatment for M/SMEs.

The Egyptian government is in the process of issuing a new modernized tax law that would help the country to achieve its economical and social objectives. Encouraging Micro, Small and Medium Enterprises (M/SME) is one of the main objectives of Egyptian government. Accordingly, the new tax law is expected to provide a preferable treatment to M/SMEs.

This paper describes different tax models and features adopted by countries worldwide for the purpose of providing tax incentives to M/SMEs. The international experience of applying these models is presented and different models are analyzed and compared.

A complete tax system to support M/SME is also presented providing a customized Tax Model for each category of enterprises; Micro, Small and Medium. The application of each model is presented with features and examples.

This paper is the outcome of efforts exerted by the following team:

Tarek Thabet, Team Leader
Tarek El-Kadeim, Tax Expert
Gamal Zaki, Researcher
Ashraf Assem, Editor
1.1. Why to Favor M/SME?

As we mentioned earlier, due to the importance and impact of M/SMEs on national economy, different countries are active in providing special tax regulations and legalization for M/SMEs. Such activity is driven by several factors, which are:

- **M/SMEs Importance in the National Economy:** M/SMEs usually form about 85% to 95% of the total business magnitude in any country. As well, these enterprises represent the future of the country’s economy, as they have potential for transiting into higher levels until they become large enterprises.

- **A Solution to Unemployment:** as they would absorb most of unemployed manpower.

- **Development of New Communities:** there is no doubt that the perfect start to develop new communities is to attract small and micro enterprises, especially when offering certain advantages to encourage young entrepreneurs to establish their small and micro enterprises in these areas.

- **Enlargement of the Supply Chain for Large Industries:** M/SMEs play an important role as feeding industries to large industries, providing them with locally-produced cost-effective components.

1.2. Objectives of the M/SME Tax System

**Support M/SMEs**

As explained earlier, M/SMEs play an important role in the national economy. Thus, a specialized Tax system should be a catalyst that encourages entrepreneurs to start their own micro and small businesses.

**Encourage informal sector to join the formal economy**

One of the reasons behind the tendency of micro and small business to work informally is the complexity of the taxation procedures and requirements. Therefore, the existence of a simplified tax system for M/SMEs would encourage entrepreneurs to establish their M/SME Enterprises in a formal manner.

The incentives and benefits offered by the M/SME tax system will also encourage informal M/SME owners to pay their taxes and join the formal economy in order to enjoy such benefits. They will compare the risks they may encounter as informal entities with the benefits they would gain by joining formal economy.

**Reduce the Cost of Collection**
The cost of collecting taxes in any proposed M/SME tax system should be lower than the cost of tax collection under the main tax law. Cost of tax collection from M/SMEs should also be lower than the expected revenues from them. Thus, the methods to be used for estimating taxes should be as simple as possible so that applying them would not cost much time, effort and manpower for the tax authority.

**Broadening the Tax net**

This is done through the expansion of tax base and encouraging M/SMEs to grow and transit from their current level to a higher level, in addition to attracting informal business to join the formal tax system.

**Eliminate Personal Judgment of Tax inspectors**

One of the main objectives that an M/SME tax system must fulfill is to reduce personal judgment of tax inspectors, which is a tool that is sometimes misused. The system should achieve tax equity through narrowing the space for personal judgments and estimates.

**Reduce Compliance Cost for Taxpayers**

The system should reduce the compliance cost for taxpayers by simplifying different requirements (books, documents and data) that form a time and financial burden on M/SMEs.

**Increase Tax Revenues**

This is not the main objective of the M/SME tax system; yet, international experiences claim that simplified tax systems for M/SMEs increase the government tax revenue. Encouraging informal businesses to legalizing their status and join formal economy would increase the government tax revenue.
2. International Experience

2.1. Definitions of Micro, Small and Medium Enterprises for Tax purposes

The rationale behind any special tax system for M/SMEs could only be understood in light of the exact definition of M/SMEs as used by tax authority in each country. In most countries, M/SME definition used in the tax system is different than the definition used for other M/SME support activities.

The following table lists and compares the definition of M/SME as being used by tax laws/systems in different countries:\(^1\)

<table>
<thead>
<tr>
<th>Country</th>
<th>Micro</th>
<th>Small</th>
<th>Medium</th>
</tr>
</thead>
<tbody>
<tr>
<td>All figures are in US$ 1,000</td>
<td>Revenue</td>
<td>No of Employees</td>
<td>Special Condition</td>
</tr>
<tr>
<td>Albania</td>
<td>14</td>
<td>-(^2)</td>
<td>-</td>
</tr>
<tr>
<td>Armenia</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Australia</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Belarus</td>
<td>-</td>
<td>-</td>
<td>SO(^3)</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>22.2</td>
<td>-</td>
<td>CA(^4)</td>
</tr>
</tbody>
</table>

---

\(^1\) Figures are converted into US$ from local currencies for comparison purposes according to exchange rates published on 09/01/2005

\(^2\) Parameter not used

\(^3\) Single Owner

\(^4\) Certain Activities
### Table 1 – International Definitions of M/SMEs for Tax Purposes

<table>
<thead>
<tr>
<th></th>
<th>Micro</th>
<th></th>
<th></th>
<th>Small</th>
<th></th>
<th></th>
<th>Medium</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Revenue</td>
<td>No of Employees</td>
<td>Special Condition</td>
<td>Revenue</td>
<td>No of Employee</td>
<td>Special Conditions</td>
<td>Revenue</td>
<td>Asset</td>
</tr>
<tr>
<td>France</td>
<td>100 Trading</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>GS 35 Services</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Georgia</td>
<td>11</td>
<td>-</td>
<td>CA⁵</td>
<td>-</td>
<td>-</td>
<td>CA</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>34.3</td>
<td>15</td>
<td>-</td>
<td>68.5</td>
<td>25</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Kosovo</td>
<td>6.6</td>
<td>-</td>
<td>-</td>
<td>40</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>-</td>
<td>-</td>
<td>SO⁶</td>
<td>63</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Latvia</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>461</td>
<td>25</td>
<td>Assets = 161.5</td>
<td>461</td>
<td>-</td>
</tr>
<tr>
<td>Lithuania</td>
<td>26</td>
<td>-</td>
<td>-</td>
<td>130</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Moldova</td>
<td>-</td>
<td>-</td>
<td>SO</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Romania</td>
<td>130.6</td>
<td>10</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Russia</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>325</td>
<td>20/50/100⁷</td>
<td>-</td>
<td>325</td>
<td>-</td>
</tr>
<tr>
<td>Turkmenistan</td>
<td>14</td>
<td>10</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Ukraine</td>
<td>95</td>
<td>10</td>
<td>-</td>
<td>190</td>
<td>50</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>-</td>
<td>-</td>
<td>SO</td>
<td>-</td>
<td>-</td>
<td>CA</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

⁵ Certain Activities
⁶ Single Owner
⁷ Based on Activity
### 2.2. Models of Different Tax Regimes for M/SME

During the last ten years, several countries have designed and implemented different models of specialized tax systems for M/SMEs. These models were refined and modified according to the experiences gained from implementation. Some countries have changed their M/SME tax system from one model to another based on the implementation feedback.

Studies conducted by different governments as well as international institutions show that there is no one magic model to be implemented. Instead, it is up to the government of each country to select and modify the model that best suits its economical and culture environment.

Existing Tax models for M/SMEs could be categorized into the following:

**The Discounted System**

**The Simplified Presumptive systems**
- a. The Revenue Based System
- b. The Business Indicators Based System
- c. The Patent System
- d. The Lump Sum System

**The Unified Tax System**

Additional incentives
- a. M/SME fund
- b. Entrepreneur Exemption Period
- c. Accounting on Cash Basis
- d. Chartered Accountant is Optional
- e. Tax incentives for special areas

It should be also noted that most of the countries have adopted different models for Micro, Small and Medium Enterprises

In the following sections, different models and incentives systems that have been adopted by different countries are presented. Each model is explained with its specific implementation characteristics in different countries and its advantages and disadvantages based on its implementation. Then, a comparison is made between the different models to facilitate proper recommendations for Egyptian context.
2.3. The Discounted System

2.3.1. Definition

Discounted Systems grant special discounts to enterprises in order to reduce tax paid. Such discounts could be direct or indirect. Direct discounts mean less tax rates for M/SMEs. Indirect discounts include the following:

1. Capital Gain: Exempting a percentage of Capital equal to the current interest rate for trusts deposited in commercial banks

Loan Interests: Deducting paid interests for loans related to business activities from the taxable revenue/profit.

Assets Depreciation: Increasing the percentage of Assets depreciation to encourage upgrading production assets and increasing productivity.

2.3.2. International Experience

<table>
<thead>
<tr>
<th>Country</th>
<th>Discount on Tax Rate</th>
<th>Applied for</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>50%</td>
<td>Micro, Small and Medium</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>20%</td>
<td>Micro and Small</td>
</tr>
<tr>
<td>France</td>
<td>35% : 70%</td>
<td>Micro</td>
</tr>
<tr>
<td>Latvia</td>
<td>20%</td>
<td>Micro, Small and Medium</td>
</tr>
<tr>
<td>Moldova</td>
<td>35% (only first 2 years)</td>
<td>Micro and Small</td>
</tr>
<tr>
<td>Netherlands</td>
<td>Fixed Amount + Percentage</td>
<td>Micro</td>
</tr>
<tr>
<td>Russia</td>
<td>15%</td>
<td>Micro, Small and Medium</td>
</tr>
<tr>
<td>Serbia</td>
<td>30%</td>
<td>Micro and Small</td>
</tr>
<tr>
<td>Turkmenistan</td>
<td>20% : 40%</td>
<td>Micro and Small</td>
</tr>
</tbody>
</table>

Table 2 – The Discounted System (Direct Discounts)

<table>
<thead>
<tr>
<th>Better Tax depreciation ratios</th>
<th>UK (100%) and Netherlands (27%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan interests discounted from</td>
<td>Hungary and Australia</td>
</tr>
<tr>
<td>taxes (investments in assets)</td>
<td></td>
</tr>
</tbody>
</table>

Table 3 – The Discounted System (Indirect Discounts)
2.3.3. System Evaluation

2.3.3.1. Advantages of the System

1. No need to develop a new law. It could be implemented by adding an article to the Executive regulations.

As in normal tax law, the discounted tax system achieves maximum tax equity as it is applied to the net profit resulting from enterprise activities according to accounting standards and enacted law provisions. The system applies the tax on net profit which is calculated based on actual revenues and actual expenses. In other words, it is not a presumptive system.

The implementation of discounted system is exactly that of the normal system. The difference lies only in the rates and discounts. This achieves harmonization in taxation and accordingly, easier execution by tax authority.

2.3.3.2. Disadvantages of the system

1. The requirement for annual reports (financial statements, income statements, declarations) needs extra resources for the enterprise, both internally (accounting department) and externally (chartered accountant), the thing that would add to the management and financial burdens of the enterprise. In other words, high compliance cost to the enterprise.

Due to the difficulty in complying with different requirements, tax inspectors would have to make subjective personal judgments. This would lead eventually to disputes between tax authority and taxpayers.

High inspection cost compared to the expected revenue.

Some of the existing enterprise may choose to fragment their business into several smaller companies to benefit from discount rates. At the same time, small enterprises might be discouraged to grow into medium and large enterprises for the same reason.
2.4. The Simplified Presumptive Systems

Developing countries have generally moved to implement simplified systems for hard-to-tax taxpayers. The main motive behind such move is to decrease the burden of accounting compliance for the enterprise, the inspection subjectivity and cost of tax collection.

Different simplified models vary in their simplicity and equity. Systems which are simpler in implementation are either less fair or more complex in design.

2.4.1. The Revenue Based Systems (R)

2.4.1.1. Definition

A number of transition countries use Revenue instead of Net Profit as a base for calculating tax liability of small businesses. To assure the same tax equity as in Profit based systems, the tax rates of revenue based systems are being calculated using profit based rate with a fixed estimation for total expenses. In other words, revenue based tax system is a profit based tax system with fixed presumptive (estimated) expenses.

Revenue based systems can be structured in different ways. One alternative is to apply the same Revenue tax rate to all businesses, irrespective of business activity. This approach fails to consider that profit margins can be substantially different in different business activities.

The second choice is specify a Revenue tax rate for each one of the following business activities:

- Commercial
- Services
- Non-Commercial

More complex systems could be derived by further categorizing business activities based on the sector or the type of goods or services.
2.4.1.2. International Experience

<table>
<thead>
<tr>
<th>Country</th>
<th>Tax Rate on Revenue</th>
<th>Applied on</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>3%:10%</td>
<td>Micro and Small</td>
</tr>
<tr>
<td>Armenia</td>
<td>4% traders 7%:12%</td>
<td>Micro and Small</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>2%</td>
<td>Micro, Small and Medium</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>NP</td>
<td>Micro</td>
</tr>
<tr>
<td>Georgia</td>
<td>NP</td>
<td>Micro</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>4% : 13%</td>
<td>Micro and Small</td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>5% : 8%</td>
<td>Micro and Small</td>
</tr>
<tr>
<td>Romania</td>
<td>1.50%</td>
<td>Micro and Small</td>
</tr>
<tr>
<td>Russia</td>
<td>6%</td>
<td>Micro, Small and Medium</td>
</tr>
<tr>
<td>Serbia</td>
<td>2%</td>
<td>Micro and Small</td>
</tr>
<tr>
<td>Ukraine</td>
<td>6%</td>
<td>Micro and Small</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>25% trading 10% production</td>
<td>Micro and Small</td>
</tr>
</tbody>
</table>

Table 4 – The Revenue Based System

2.4.1.3. System Evaluation

**Advantages of Revenue Based System compared to Normal System**

1. Solving many tax disputes resulting from the disapproval of reported costs/expenses.

Revenue based taxes are more predictable by taxpayer than profit based taxes.

Requires minimal accounting expertise, thus permits taxpayer to handle and calculate his taxes without the need for external resources.

Could be easily reported and paid on quarterly basis which provides a continuous stream of tax revenues to the government. This means better cash flow and predictability of cash flows.

Revenue based system narrows the space for judgment by tax inspector.

**Disadvantages of the System**

1. Does not recognize or permit losses, as the tax is a percentage of revenue with no consideration to expenses or profits.

Less tax equity, as it treats all activities equally and does not consider the type of goods or services provided.

---

*Limit=300 times tax exempted payroll
*Data not published
Might lead to fragmentation of businesses into smaller companies to benefit from the system advantages.

Expenses are not officially reported to tax authority, which encourage enterprises not to ask for invoices for their expenses. The lack of such invoices hinders tax authority from double checking the tax net.

2.4.2. The Business Indicators Based Systems (BI)

2.4.2.1. Definition

Unlike revenue based systems which only presume expenses of the enterprise, the business indicators based systems presume both revenue and expenses. These systems use business indicators like location, business type, size, no. of employees and no. of production units as the base for revenue and profit presumptions. Accordingly, tax is calculated as a certain amount of money based on these indicators.

However, this brings up a clear conflict of objectives; the objective to tax true potential profit of the small business conflicts with the objective to design a simple and transparent system. Policy-makers in transition countries face considerable difficulties designing indicator-based systems that establish an acceptable balance between these contradicting objectives. Such systems require continuous updates so that they represent the actual indicators of the business.

2.4.2.2. International Experience

Presumptive systems based on Business Indicators are mainly used in transition countries.

<table>
<thead>
<tr>
<th>Country</th>
<th>No. of Group activities</th>
<th>Depend on location</th>
<th>Size of Enterprise</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgaria</td>
<td>43</td>
<td>Y</td>
<td>Micro</td>
</tr>
<tr>
<td>Georgia</td>
<td>5</td>
<td>N</td>
<td>Micro and Small</td>
</tr>
</tbody>
</table>

Table 5 – The Business Indicators Based System

2.4.2.3. System Evaluation

Advantages of the System

1. Solving more tax disputes resulting from disapproval of reported costs/expenses as the tax obligations are already defined and known, which increases predictability.

Eliminates the need for using accounting books and special accounting expertise. It also suits all educational levels.

Could be easily reported and paid on quarterly basis which provides a continuous stream of tax revenues to the government. This means better cash flow and predictability of cash flows.
Encourages young entrepreneurs to establish micro enterprises and leads to reducing unemployment.

Business indicators based systems are more predictable by taxpayer than revenue and profit based tax systems.

Business indicators based system narrows the space for judgment by tax inspectors more than revenue based tax systems.

Disadvantages of the System

1. Does not recognize or permit losses, as the tax is a certain amount of money with no consideration to expenses or profits.

Less tax equity, as it presumes revenue and profit.

Might lead to fragmentation of businesses into smaller companies to benefit from the system advantages.

Needs constant review by tax authority to ensure that the taxpayer complies with the enterprise size conditions.

Expenses are not officially reported to the tax authority, which encourage enterprises not to ask for invoices for their expenses. The lack of such invoices hinders the tax authority from double checking the Tax net.

2.4.3. The Patent Systems (P)

2.4.3.1. Definition

The micro-business patent tax system is similar to the business indicator system since they both estimate revenue and profit. However, the Patent system does not use any business indicators for calculating the profit potential of the business. The amount of patent depends only on the kind of business and the business location. Some countries use trade area as a limitation for the system. The patent value is published to the public.
2.4.3.2. International Experience

Some countries apply a general patent scheme for the taxation of micro businesses.

<table>
<thead>
<tr>
<th>Country</th>
<th>Size of Enterprise</th>
<th>Type of Business</th>
<th>Patent Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Armenia</td>
<td>Micro</td>
<td>Hairdresser, gas stations, commercial fishing and trading activities &lt; 30 m²</td>
<td>NP&lt;sup&gt;10&lt;/sup&gt;</td>
</tr>
<tr>
<td>Belarus</td>
<td>Micro and Small</td>
<td>Shops &lt; 25 m²</td>
<td>NP</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>Micro</td>
<td>All</td>
<td>NP</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>Micro and Small</td>
<td>Gambling</td>
<td>NP</td>
</tr>
<tr>
<td>Kosovo</td>
<td>Micro and Small</td>
<td>All</td>
<td>$200</td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>Micro and Small</td>
<td>All</td>
<td>NP</td>
</tr>
<tr>
<td>Latvia</td>
<td>Micro</td>
<td>NP</td>
<td>NP</td>
</tr>
<tr>
<td>Lithuania</td>
<td>Micro</td>
<td>25 industrial, 13 services &amp; 6 trade activities</td>
<td>$37:2200</td>
</tr>
<tr>
<td>Moldova</td>
<td>Micro and Small</td>
<td>All</td>
<td>NP</td>
</tr>
<tr>
<td>Ukraine</td>
<td>Micro and Small</td>
<td>All</td>
<td>$ 3.7:18.6 per point</td>
</tr>
</tbody>
</table>

Table 6 – The Patent System

2.4.3.3. System Evaluation

Advantages of the System

In addition to the advantages of Business Indicators Systems, the patent system has the following advantages:

1. Patent based systems are more predictable by the taxpayer than Business Indicators, Revenue and Profit based tax systems.

Patent based system narrows the space for judgment by tax inspector more than the Business Indicators based tax systems.

The system achieves minimal cost of tax collection.

Disadvantages of the System

In addition to the disadvantages of the Business Indicators Systems, the Patent system has the following disadvantage:

1. Less tax equity as the tax amount is only based on location, business activity and size (trade area).

---

<sup>10</sup> Data not published
2.4.4. The Lump Sum System (L)

2.4.4.1. Definition

The Lump Sum system is similar to the Patent system except that tax amount is a fixed amount for all businesses irrespective of the business type. This fixed amount is not based on any indicator of profit potential of the business. In some countries it depends on the geographical district. Some countries put a size (Trade area) limitation for the lump sum system.

2.4.4.2. International Experience

The following countries apply a Lump Sum scheme for the taxation of micro businesses.

<table>
<thead>
<tr>
<th>Country</th>
<th>Enterprise Size</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>Micro</td>
</tr>
<tr>
<td>Croatia</td>
<td>Micro and Small</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>Micro and Small</td>
</tr>
<tr>
<td>Hungary</td>
<td>Micro and Small</td>
</tr>
<tr>
<td>Latvia</td>
<td>Micro</td>
</tr>
<tr>
<td>Macedonia</td>
<td>Micro and Small</td>
</tr>
<tr>
<td>Poland</td>
<td>Micro and Small</td>
</tr>
<tr>
<td>Serbia</td>
<td>Micro</td>
</tr>
<tr>
<td>Slovak Republic</td>
<td>Micro</td>
</tr>
<tr>
<td>Turkmenistan</td>
<td>Micro</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>Micro and Small</td>
</tr>
</tbody>
</table>

Table 7 – The Lump Sum System

2.4.4.3. System Evaluation

Advantages of the System

In addition to the advantages of the Patent Systems, the Lump sum system has the following advantage:

1. The simplest system in terms of design and implementation.

Disadvantages of the System

In addition to the advantages of the Patent Systems, the Lump sum system has the following advantage:

1. The least tax equity as the tax amount is fixed for all business types.
2.4.5. The Unified Tax System

2.4.5.1. Definition

The unified Tax system groups all types of taxes to be applied to the enterprise into a single tax. In other words, the unified tax represents all tax obligations of the enterprise, thus the enterprise is only subject to one tax. The unified tax covers payroll tax, income tax and other taxes (like fiscal stamp duties). As for VAT/ sales tax, some countries include it within the unified tax, others do not include it, while the rest treats this inclusion as an option.

Usually, the unified tax is applied as an additional incentive to any of the simplified presumptive systems (Revenue, Business Indicators, Patent or Lump Sum). In case of Patent, Lump Sum, or Business Indicators systems, which are used for micro enterprises, all additional taxes (excluding VAT) could be calculated within the presumptive tax value or equation. As for VAT, micro enterprises are usually below the VAT registration limit in most of the countries and accordingly are not subject to VAT.

2.4.5.2. International Experience

The following table lists the countries that adopt unified tax system as part of their M/SME tax revenue presumptive system. The table shows the rate of tax as being calculated from the revenue of enterprises with exclusion of VAT.

<table>
<thead>
<tr>
<th>Country</th>
<th>Unified Tax rate</th>
<th>Unified Tax rate including VAT</th>
<th>Size of Enterprise</th>
</tr>
</thead>
<tbody>
<tr>
<td>Georgia</td>
<td>4%</td>
<td>7%</td>
<td>Small and Micro</td>
</tr>
<tr>
<td>Hungary</td>
<td>NP(^{11})</td>
<td>NP</td>
<td>Small and Micro</td>
</tr>
<tr>
<td>Russia</td>
<td>6%</td>
<td>NP</td>
<td>Micro, Small and Medium</td>
</tr>
<tr>
<td>Ukraine</td>
<td>6%</td>
<td>10%</td>
<td>Small and Micro</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>3-5% trading</td>
<td>25% trading</td>
<td>Micro</td>
</tr>
<tr>
<td></td>
<td>7-10% services</td>
<td>10% production</td>
<td></td>
</tr>
</tbody>
</table>

Table 8 – The Unified Tax System

2.4.5.3. System Evaluation

Advantages of the System

1. Reduces financial and tax burdens.

Encourages M/SMEs to employ more employees and declare their actual salaries.

Reduces cost and efforts exerted by tax authority in collecting stamp duties from M/SMEs especially when the collection cost might exceed actual collected taxes.

\(^{11}\) Data not Published
Disadvantages of the System

1. Difficulty of defining and designing the tax rate to include all types of taxes. Mixing general-tax revenues with the revenues of other tax types.

Provide a chance for certain employees to skip paying payroll taxes in spite of their high salaries

Discourage small enterprises from transiting into medium enterprises in order to retain the advantages of the system.

2.4.6. Other Special Incentives

Different countries are encouraging entrepreneurs to establish Micro, Small and Medium Enterprises on formal basis through granting them several other incentives.

2.4.6.1. M/SME Fund

Definition

A special fund to be financed with a percentage of the taxes paid by M/SMEs; Countries that established M/SME fund use it as a pension fund to be paid to entrepreneurs as a sort of one-payment pension. This would provide security as well as an incentive to establish these enterprises within the formal procedure.

International Experience

The M/SME fund is implemented in Netherlands, Sweden and Uzbekistan.

System Evaluation

Advantages of the System

1. Tangible benefit to encourage entrepreneurs to establish their M/SMEs formally.

A fund-policy of level-based remuneration that would encourage these enterprises to transit to the higher level (e.g. from Micro to Small and from Small to Medium).

Disadvantages of the System

1. Administrative burden on tax authority as it would be responsible for establishing the fund both organizationally and administratively.

Could be misused if not designed and regulated properly.

2.4.6.2. Entrepreneurship Exemption Period

Definition

Some countries provide micro enterprises with an "Entrepreneurship Exemption Period" for a defined period (e.g. first 1:2 years) to encourage the establishment of this type of
enterprises. During this period, entrepreneurs enjoy a tax holiday. This incentive is applied only to micro enterprises.

**International Experience**

The Entrepreneurship Exemption Period is implemented in Armenia, Belarus, Bulgaria, Hungary, Macedonia, Moldova, Romania and Turkmenistan.

**System Evaluation**

It was proven that tax exemption systems are not the right instrument to give tax benefits in the small business sector. Having a small exemption period might encourage M/SMEs to close their business after exemption period and start a new one.

2.4.6.3. **Accounting on Cash Basis**

**Definition**

Some countries allow the adoption of cash basis as an accounting principal instead of accrual basis. Cash basis is simpler to implement especially for cash trading businesses that are using cash registers. This incentive is only applicable as an additional option for Revenue based tax systems.

**International Experience**

Accounting on cash basis is an option for micro/small enterprises in USA, Germany, Ukraine, Uzbekistan, Hungary and France.

2.4.6.4. **Chartered Accountant is Optional**

**Definition**

Accrediting financial and income statements by a chartered accountant is a common practice internationally. However, some countries accept the business owner accreditation to tax report requirements. This is specifically valid for reporting under the Revenue, Patent or Business Indicator Based Systems.

**International Experience**

Business owner accreditation of tax reports is accepted for micro enterprises in Germany, Ukraine, Uzbekistan, Hungary and France.
2.4.6.5. Tax Incentives for Special Areas

Definition

The term "Special Areas" refers to either an under-developed area that the government is targeting for development, a Special Economic Zone or a New Community.

Different countries encourage business owners (of all sizes) to establish new business in special areas with the purpose of creating an attraction factor that would help in developing this area. One of the incentives offered by governments is special tax deduction regardless of the tax system applied.

International Experience

Special areas still receive some tax incentives in several countries including Jordan and India.
2.5. **International Experience Comparison**

The following two tables summarize the complete international experience in terms of different tax systems presented.

### 2.5.1. M/SME Tax Systems Comparison

<table>
<thead>
<tr>
<th>Tax System</th>
<th>Tax is related to</th>
<th>Requirements</th>
<th>Inspection</th>
<th>Equity</th>
<th>Design</th>
<th>Implemented in</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discounted on Tax Rate</td>
<td>Net Profit</td>
<td>5</td>
<td>5</td>
<td>1</td>
<td>1</td>
<td><strong>Developed Countries:</strong> Canada, UK, France, Netherlands, Belgium, Australia and South Africa. <strong>Medium in Developing Countries:</strong> Lithuania, Latvia, Serbia, Bulgaria, Moldova, Russia, Turkmenistan and Uzbekistan.</td>
</tr>
<tr>
<td>Revenue Based</td>
<td>Revenue</td>
<td>4</td>
<td>4</td>
<td>2</td>
<td>4</td>
<td><strong>Small &amp; Micro in Developing Countries:</strong> Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Kazakhstan, Romania, Russia, Ukraine and Serbia</td>
</tr>
<tr>
<td>Business Indicators</td>
<td>Business Indicators</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>5</td>
<td><strong>Small &amp; Micro in:</strong> Bulgaria and Georgia</td>
</tr>
<tr>
<td>Patent</td>
<td>Activity, District</td>
<td>2</td>
<td>2</td>
<td>4</td>
<td>3</td>
<td><strong>Micro in Developing Countries:</strong> Belarus, Bulgaria, Kazakhstan, Kosovo, Kyrgyzstan, Lithuania, Moldova and Ukraine</td>
</tr>
<tr>
<td>Lump Sum</td>
<td>District</td>
<td>1</td>
<td>1</td>
<td>5</td>
<td>2</td>
<td><strong>Micro in Developing Countries:</strong> Albania, Croatia, Czech Republic, Hungary, Macedonia, Poland, Slovakia, Turkmenistan, Uzbekistan and Serbia</td>
</tr>
</tbody>
</table>

Table 9 – M/SME Tax Systems Comparison Table

Requirements, Inspection and Design: 1:5, 1 is the "Best/Easiest" and 5 is the "Worst/Most Difficult"  
Equity: 1:5, 1 is the “Highest Equity” and 5 is the "Lowest Equity"
2.5.2. Country/Tax Model Matrix

The following table summarizes the international experience in terms of Country/Tax model matrix:

<table>
<thead>
<tr>
<th>Country</th>
<th>Micro</th>
<th>Small</th>
<th>Medium</th>
<th>Exemption period</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>L</td>
<td>R</td>
<td>N</td>
<td></td>
</tr>
<tr>
<td>Armenia</td>
<td>P</td>
<td>R</td>
<td>N</td>
<td>Y\textsuperscript{12}</td>
</tr>
<tr>
<td>Australia</td>
<td>D</td>
<td>D</td>
<td>D</td>
<td></td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>R</td>
<td>R</td>
<td>R</td>
<td></td>
</tr>
<tr>
<td>Belarus</td>
<td>P</td>
<td>P</td>
<td>N</td>
<td>Y\textsuperscript{13}</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>R/BI/P</td>
<td>D</td>
<td>N</td>
<td>Y\textsuperscript{14}</td>
</tr>
<tr>
<td>Croatia</td>
<td>L</td>
<td>L</td>
<td>N</td>
<td></td>
</tr>
<tr>
<td>Czech Republic</td>
<td>L</td>
<td>L</td>
<td>N</td>
<td></td>
</tr>
<tr>
<td>France</td>
<td>D</td>
<td>N</td>
<td>N</td>
<td></td>
</tr>
<tr>
<td>Georgia</td>
<td>R, U/BI, U</td>
<td>BI, U</td>
<td>N</td>
<td></td>
</tr>
<tr>
<td>Hungary</td>
<td>L, U</td>
<td>L, U</td>
<td>N</td>
<td>Y\textsuperscript{15}</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>R/P</td>
<td>R/P</td>
<td>N</td>
<td></td>
</tr>
<tr>
<td>Kosovo</td>
<td>P</td>
<td>P</td>
<td>N</td>
<td></td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>P</td>
<td>R</td>
<td>N</td>
<td></td>
</tr>
<tr>
<td>Latvia</td>
<td>P/L</td>
<td>D</td>
<td>D</td>
<td></td>
</tr>
<tr>
<td>Lithuania</td>
<td>P</td>
<td>D</td>
<td>N</td>
<td></td>
</tr>
<tr>
<td>Moldova</td>
<td>D/P</td>
<td>D/P</td>
<td>N</td>
<td>Y\textsuperscript{16}</td>
</tr>
<tr>
<td>Macedonia</td>
<td>L</td>
<td>L</td>
<td>N</td>
<td>Y\textsuperscript{17}</td>
</tr>
<tr>
<td>Netherlands</td>
<td>D</td>
<td>N</td>
<td>N</td>
<td></td>
</tr>
<tr>
<td>Poland</td>
<td>L</td>
<td>L</td>
<td>N</td>
<td></td>
</tr>
<tr>
<td>Romania</td>
<td>R</td>
<td>R</td>
<td>N</td>
<td>Y\textsuperscript{18}</td>
</tr>
<tr>
<td>Serbia</td>
<td>L</td>
<td>D/R</td>
<td>N</td>
<td></td>
</tr>
<tr>
<td>Slovak Republic</td>
<td>L</td>
<td>N</td>
<td>N</td>
<td></td>
</tr>
<tr>
<td>Turkmenistan</td>
<td>L</td>
<td>D</td>
<td>N</td>
<td>Y\textsuperscript{19}</td>
</tr>
<tr>
<td>Ukraine</td>
<td>P, U</td>
<td>BI, U</td>
<td>R, U</td>
<td></td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>R, U/L, U</td>
<td>R, U/L, U</td>
<td>N</td>
<td></td>
</tr>
</tbody>
</table>

\textit{Legends}

- D: Discounted
- R: Revenue
- BI: Business Indicator
- P: Patent
- L: Lump Sum
- U: Unified
- N: Normal Tax Law

\textsuperscript{12} Only FDI
\textsuperscript{13} Only 50\% discount
\textsuperscript{14} Only 20\% discount for medium for Small
\textsuperscript{15} Only 35\% discount and 50\% for FDI
\textsuperscript{16} Only FDI
\textsuperscript{17} Only reinvested profit & FDI
\textsuperscript{18} Only 30\% discount for small & 10\% for medium

Table 10 – Country/Tax Model Matrix
3. Recommendations

After studying the different tax models for M/SMEs, we are in a better position to make recommendations for a complete tax solution for M/SME in Egypt. As in the international study, this section starts by the suggested tax definitions for the M/SMEs.

3.1. Definition of Micro, Small and Medium Enterprises for Tax purposes

<table>
<thead>
<tr>
<th>Size of Enterprise</th>
<th>Activity</th>
<th>Revenue (LE)</th>
<th>Type of taxpayers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro</td>
<td>Commercial (Trade/ Industrial) Professional</td>
<td>150,000 (1) 50,000</td>
<td>- Physical Person</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>- Partnership companies (Physical Persons only) (3)</td>
</tr>
<tr>
<td>Small</td>
<td>Commercial (Trade/ Industrial) Professional</td>
<td>150,000:250,000 (2) 50,000:75,000</td>
<td>- Physical Person</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>- Partnership companies (Physical Persons only) (3)</td>
</tr>
<tr>
<td>Medium</td>
<td>Commercial (Trade/ Industrial) Professional</td>
<td>250,000:1,000,000 75,000:100,000</td>
<td>- Physical Person</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>- Partnership companies (Legal persons up to 25%) (5)</td>
</tr>
</tbody>
</table>

Table 11 – Recommended Definitions of M/SMEs

1. The revenue of 150,000 is defined as the upper limit for Micro Enterprises as it represents the lower limit for registration for sales taxes. For enterprises having revenue higher than this limit, sales tax authority obliges them to keep certain accounting records. The same applies to professional activities having revenue more than 50,000.

The revenue of 250,000 is defined as the upper limit for Small Enterprises as it represents the limit for keeping accounting books and records as provided by the new tax law. The revenue of 75,000 for professional activities is the reasonable limit and also corresponds to the net profit of 20,000. It is also stated in the law as the limit for keeping regular books and records.

The revenue of up to 1,000,000 is defined as the upper limit for Medium Enterprises. This estimate is based on international experience in similar developing countries especially in Eastern Europe. The same applies to the limit of 100,000 for professional activities.
The definition of Micro and Small Enterprises is restricted to Physical Persons, whether in sole proprietorship or partnership companies, to encourage entrepreneurial activities against employment. This restriction is applied worldwide.

Legal entities are allowed as partners in Medium Enterprises with a maximum of 25% to give Medium enterprises an access to financial resources that might not be easily available to Physical Persons. Countries like France are adopting the same concept.
3.2. An Overview of the Recommended Solution

The recommended solution is based on designing a different tax system for each enterprise size: Micro, Small and Medium. One might think that such a solution is too sophisticated to design, but:

- Several countries, after several experiments, are now implementing different systems for different enterprise sizes. Please refer to the Country/Tax Model matrix above.
- Usually, A tax solution needs to have a sophisticated design in order to be simple to implement and to preserve tax equity among different enterprises at the same time.

The following table gives a general overview of the suggested tax solution and the characteristics of each sub-system.

<table>
<thead>
<tr>
<th>Applied on</th>
<th>Tax System Applied on</th>
<th>Reports</th>
<th>Tax Rate</th>
<th>Calculation Method</th>
<th>Tax Period</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro</td>
<td>Patent Business, Location BI&lt;sup&gt;19&lt;/sup&gt;</td>
<td>Fixed amount</td>
<td>Fixed</td>
<td>Q&lt;sup&gt;20&lt;/sup&gt;</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Business Indicators Presumptive Revenue BI</td>
<td>A calculated amount based on revenue rate</td>
<td>Presumptive</td>
<td>Q</td>
<td></td>
</tr>
<tr>
<td>Small</td>
<td>Revenue Based Tax Actual Revenue RR&lt;sup&gt;21&lt;/sup&gt;</td>
<td>Trade: 2% Industrial: 2% Professional: 9% Vocational: 4%</td>
<td>Actual</td>
<td>Q</td>
<td></td>
</tr>
<tr>
<td>Medium</td>
<td>Discounted Tax Rate Actual Net Profit FS&lt;sup&gt;22&lt;/sup&gt;</td>
<td>Trade: 15% Industrial: 10% Professional: 15% Vocational: 15%</td>
<td>Actual</td>
<td>A&lt;sup&gt;23&lt;/sup&gt;</td>
<td></td>
</tr>
<tr>
<td>Large</td>
<td>New Tax Law Actual Net Profit FS</td>
<td>20%</td>
<td>Actual</td>
<td>A</td>
<td></td>
</tr>
</tbody>
</table>

Table 12 – Recommended Solution

The proposed solution allows enterprises in each category to use the system of higher category(s) as long as the request to do so is made at proper timing. This rule is in harmony with the Constitution allowing enterprise to choose the most favorable system.

It is understood that due to the present time urgency, or some other reason, this proposed solution might not be implemented as a whole. Individual recommended sub-systems could be separately implemented for any of the Micro, Small or Medium Enterprises. In

<sup>19</sup> Business Indicators  
<sup>20</sup> Quarterly  
<sup>21</sup> Revenue Report  
<sup>22</sup> Financial Statements  
<sup>23</sup> Annually
such case, small adjustments are needed to assure proper boundaries between the new set of sub-systems and the main tax system.

In the following sections, each system is discussed in details. As well, recommendations for rates and other proposed features are provided for each system. These rates and features are based on the main objectives of the M/SME tax system as mentioned at the beginning of this report. They are calculated based on the data available to the team about tax system in Egypt. These rates could be refined and made more accurate using statistics, for the last few years, about the distribution of collected taxes among different sectors, sizes and business activities.
3.3. Micro Enterprises

For this type of enterprises, we suggest to apply either the "Business Indicators" or the "Patent" tax systems depending on the following criteria;

1. **Business Indicators Tax System:** To be applied on activities where real indicators could be measured and in the same time does not lead to tax inequity.

**Patent System:** To be applied on activities where real indicators are hard to be measured, e.g. Groceries, Patisseries and Plumbers.

Several countries, as mentioned in the Country/Tax model matrix, are using both systems for the same size of enterprises.

It should be also noted that both systems are very similar. They both presume the revenue and accordingly the profit of the enterprise. They only vary in the level and complexity of indicators used to categorize different business activities. The patent system only uses the business activity and geographical district as means to calculate taxes. On the other hand, a Business Indicators system uses more indicators to size the business revenue and profit. Area, number of employees, number of production units, location and the exact activity type are among the indicators used in such system.

In the next sub-sections, implementation of each system is discussed in details with examples given for illustration purposes

3.3.1. Basis of the Proposed System

A Business Indicators Tax System to be applied on activities where real indicators could be measured and in the same time does not lead to tax inequity.

3.3.1.1. Example:

The following examples are developed for some professions in Egypt. These examples are included in the report to give a sense of possible indicators to be used in the system and the methodology for presuming revenue and hence profit based on these indicators.

If the "Business Indicators" tax system is implemented, similar tables for other professions should be developed.
A Tax System for Micro, Small and Medium Enterprises (M/SMEs) in Egypt

### Daily Revenue

<table>
<thead>
<tr>
<th>Law class areas</th>
<th>Middle class areas</th>
<th>Upper-Middle class areas</th>
<th>High class areas</th>
<th>Work days</th>
<th>Profession (Doctors)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>Cases</td>
<td>Unit Price</td>
<td>Revenue</td>
<td>Cases</td>
<td>Unit Price</td>
</tr>
<tr>
<td>40</td>
<td>4</td>
<td>10</td>
<td>80</td>
<td>8</td>
<td>10</td>
</tr>
<tr>
<td>80</td>
<td>4</td>
<td>20</td>
<td>160</td>
<td>8</td>
<td>20</td>
</tr>
<tr>
<td>60</td>
<td>3</td>
<td>20</td>
<td>120</td>
<td>6</td>
<td>20</td>
</tr>
<tr>
<td>75</td>
<td>3</td>
<td>25</td>
<td>150</td>
<td>6</td>
<td>25</td>
</tr>
<tr>
<td>80</td>
<td>4</td>
<td>20</td>
<td>160</td>
<td>8</td>
<td>20</td>
</tr>
</tbody>
</table>

Table 13 – Example for Business Indicators Tax System (Medical Doctors)

<table>
<thead>
<tr>
<th>Law class areas</th>
<th>middle class areas</th>
<th>Upper middle class areas</th>
<th>High class areas</th>
<th>Work days</th>
<th>Profession (Professional)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Daily Revenue</td>
<td>Customers</td>
<td>Unit Price</td>
<td>Daily Revenue</td>
<td>Customers</td>
<td>Unit Price</td>
</tr>
<tr>
<td>20</td>
<td>4</td>
<td>5</td>
<td>50</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>Shop Space</td>
<td>15</td>
<td></td>
<td>Shop Space</td>
<td>20</td>
<td></td>
</tr>
<tr>
<td># of sewing machines</td>
<td>20</td>
<td></td>
<td># of sewing machines</td>
<td>30</td>
<td></td>
</tr>
</tbody>
</table>

Table 14 – Example for Business Indicators Tax System (Different Professions)

A similar system is already applied in Egypt where revenue and profit of Taxi drivers are estimated based on the model and age of the car.

#### 3.3.1.2. Tax Rate
Revenue is presumed based on indicators as in the above example. Expenses are also presumed. Then, taxes are designed using the same rates applied on Small Enterprises (System is described later in this document, Page 32). Finally, the table is published allowing enterprises to calculate their taxes based on the values of their business indicators.

3.3.2. Basis of the Proposed System

A Patent system to be applied on activities where real indicators are hard to be measured, e.g. Groceries, Patisseries and Plumbers.

3.3.2.1. Example – Grocery:

Tax calculation is based on:

- Space
- Geographical District
- Size of the shop

In the following example, Geographical districts are categorized into 5 levels and points are given to each level.

<table>
<thead>
<tr>
<th>Location</th>
<th>Points</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. High level area in large cities</td>
<td>6</td>
</tr>
<tr>
<td>b. Medium Level area in large cities or High level area in small cities</td>
<td>5</td>
</tr>
<tr>
<td>c. Medium level area in small cities or at villages</td>
<td>4</td>
</tr>
<tr>
<td>d. Law level area in all cities</td>
<td>3</td>
</tr>
<tr>
<td>e. Under-developed area</td>
<td>2</td>
</tr>
</tbody>
</table>

- A fixed basic unit of LE 5 is defined as the base for all calculations. This could be recalculated annually based on market conditions.
- The patent Tax could be calculated based on the following table.
A Tax System for Micro, Small and Medium Enterprises (M/SMEs) in Egypt

<table>
<thead>
<tr>
<th>Area</th>
<th>Space</th>
<th>Due Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>District (1)</td>
<td>Space (2)</td>
</tr>
<tr>
<td>District A</td>
<td>10 M</td>
<td>6</td>
</tr>
<tr>
<td>District A</td>
<td>30 M</td>
<td>6</td>
</tr>
<tr>
<td>District B</td>
<td>10 M</td>
<td>5</td>
</tr>
<tr>
<td>District B</td>
<td>30 M</td>
<td>5</td>
</tr>
<tr>
<td>District C</td>
<td>10 M</td>
<td>4</td>
</tr>
<tr>
<td>District C</td>
<td>30 M</td>
<td>4</td>
</tr>
<tr>
<td>District D</td>
<td>10 M</td>
<td>3</td>
</tr>
<tr>
<td>District D</td>
<td>30 M</td>
<td>3</td>
</tr>
<tr>
<td>District E</td>
<td>10 M</td>
<td>2</td>
</tr>
<tr>
<td>District E</td>
<td>30 M</td>
<td>2</td>
</tr>
</tbody>
</table>

Table 15 – Example for Patent System

Note:

In the previous example, we considered space as the main measuring factor, but one may consider using other factors for other activities, e.g. in industrial activities, the factor could be the number of workers or production capacity of the machinery.

3.3.2.2. Tax Rate

Fixed amount to be defined for each activity based on the geographical district. This fixed amount is calculated based on the factors as in the above example.

3.3.3. Tax Report Requirements

Business activity details form of the activity with all needed details: location, space, production machinery and production capacity.

3.3.4. Submission and Payment

Quarterly

3.3.5. Inspection

Random inspection is only needed to review the updated activity/ size of the enterprise

3.3.6. Rationale

Considering the real-life status in Egypt, we believe that this is the most suitable model for Micro Enterprises, where the owner prefers to predict his/her financial obligations in a clear constant way. The previous experience of Tax authority in terms of fixed taxes has proven to be a success (the taxis example).
3.4. **Small Enterprises**

3.4.1. **Basis of the Proposed System**

A Revenue Based System to be applied for all Small enterprises

3.4.2. **Revenue Tax Rate**

The following table illustrates the recommended revenue tax rate. It also shows the conversion methodology for calculating revenue tax from profit tax. If needed, such tables could be used to declare "revenue based tax" in the form of "Profit Based Tax with Presumptive Expenses". Such declaration might be needed for political considerations.

One of the main objectives for having a specific tax treatment for small enterprises is to encourage individuals to establish their own enterprises instead of waiting to be hired as employees. Accordingly, we are using payroll taxes in the new tax law as the basis for calculating revenue taxes for small enterprises. In other words, we are trying to achieve tax equity between employees and small enterprises.

<table>
<thead>
<tr>
<th>Nature of Activity</th>
<th>payroll Tax rates in the new law</th>
<th>Presumptive Cost Ratio</th>
<th>cost valuation technique</th>
<th>Net profit (100%-Cost)</th>
<th>Revenue Tax equivalent (1 X 4)</th>
<th>Suggested Revenue Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Professional</td>
<td>10-20%</td>
<td>10%</td>
<td>Stated by law</td>
<td>90%</td>
<td>9%:18%</td>
<td>9%</td>
</tr>
<tr>
<td>Commercial</td>
<td>10-20%</td>
<td>80%</td>
<td>Conventional</td>
<td>20%</td>
<td>2%:4%</td>
<td>2%</td>
</tr>
<tr>
<td>Industrial</td>
<td>10-20%</td>
<td>75%</td>
<td>Conventional</td>
<td>25%</td>
<td>2.5%:5%</td>
<td>2.5%</td>
</tr>
<tr>
<td>Services</td>
<td>10-20%</td>
<td>60%</td>
<td>Conventional</td>
<td>40%</td>
<td>4%:8%</td>
<td>4%</td>
</tr>
<tr>
<td>Other income</td>
<td>10-20%</td>
<td>-</td>
<td>No costs</td>
<td>100%</td>
<td>10%:20%</td>
<td>10%</td>
</tr>
</tbody>
</table>

Table 16 – Example for Revenue Based Tax System

3.4.3. **Tax Report Requirements**

Simple standard form for Revenue with supporting documents (i.e. invoices and/or cashier slips).

3.4.4. **Submission and Payment**

Quarterly, under the condition of not being subject to discounted system.

3.4.5. **Inspection**

International Models and Recommendations

A Tax System for Micro, Small and Medium Enterprises (M/SMEs) in Egypt
Depending on Sales Tax statements and sales tax inspection

3.4.6. Rationale

Although this system achieves a medium level of tax equity, it does not require more documents than a clear statement of revenues, which suit small enterprises, noting that small enterprises are obligated by the sales tax law to present this revenue statement. This avoids adding new burdens on small enterprises, in the mean time grant them an easy to calculate tax obligation based on rate per sales unit.
3.5. Medium Enterprises

Few countries have a dedicated system for medium enterprises. Most of the countries consider that medium enterprises are mature enough to be treated under the general Tax law. The accuracy of such statement depends mainly on the definition of medium enterprises.

If the higher limit of medium enterprises definition is relatively low, as in the definition adopted in this paper, then a specialized system might be needed. In all cases, the need for specialized Tax system/incentives for medium enterprises is less urgent than that for micro and small enterprises. However, it is provided in this paper to have a complete tax solution.

3.5.1. Basis of the Proposed System

Discounted tax rate calculated based on profit to be applied for all medium enterprises

3.5.2. Tax Rate

<table>
<thead>
<tr>
<th>Category</th>
<th>percentage as per New Tax Law</th>
<th>Suggested percentage for medium enterprises</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Net profit</td>
<td>Commercial activity</td>
</tr>
<tr>
<td></td>
<td>20%</td>
<td>15%</td>
</tr>
</tbody>
</table>

Table 17 – Example for Discounted Tax System

The suggested rates are based on international experience to be close to tax rates for small enterprises.

3.5.3. Tax Report Requirements

Accounting books, records, balance sheets, income statements and filings as stipulated by new tax law

3.5.4. Submission and Payment

As stipulated by new tax law.

3.5.5. Inspection

As stipulated by new tax law.

3.5.6. Rationale

This system suits Medium Enterprises in terms of "cost of compliance", which is within the financial capabilities of this size of enterprises. As well, it achieves maximum equity as taxes are calculated on actual profits defined according to international accounting standards.
3.6. General Incentives

3.6.1. M/SME Fund

We suggest developing a special fund for Small and Micro Enterprises, financed by a constant percentage of their paid taxes (e.g. 15:25%). This fund would finance different benefits, for example:

- Provide loans with low interest rate to finance production assets.
- Pay a pension to the entrepreneur on the conclusion of enterprise life as a one-payment pension. (Netherlands experience)
- Provide technical assistance to M/SMEs enterprises in the form of training, studies, exhibitions, sales outlets, etc.
- Support transition of enterprises to a higher level by discounting tax dues for the first 4 years after transition with an amount equal to the total (or part of) share that the enterprise paid/ have in the fund before making the transition. For example, if the enterprise paid a total taxes of LE. 10,000 during its life time as a micro enterprise, 20% of this amount will be fed into the fund (LE. 2000). When the enterprise makes the transition to be a small enterprise, it is entitled to an annual tax discount of LE 500 from its tax dues in the first 4 years after transition.

3.6.2. Accounting on Cash Basis

Allow the adoption of cash basis as an accounting principal instead of accrual basis. The cash basis is simpler to implement especially for cash trading businesses that are using cash registers. This incentive is only applicable as an additional option for Revenue based tax systems (Small enterprises). This incentive could be applied on fast food restaurants, trade shops and some professions.

3.6.3. Chartered Accountant is Optional

Accept the accreditation of business owners on tax reports submitted by micro and small enterprises.

3.6.4. Tax Incentives for Special Areas

A special tax discount (25% for example) could be offered as an incentive to encourage the establishment of M/SMEs in special areas. This could last for certain period (2:3 years).

3.6.5. National Projects

To encourage M/SMEs for participating in projects with national importance (e.g. the initiative of “A PC in each house”), the concept of special tax discount could be applied.
3.7. Unified Tax System

This system is applied in many different countries in order to simplify the taxation process, and it adopts the concept of applying a unified tax rate that includes all other taxes (i.e. payroll, income, fiscal stamp duties, etc.) Some countries also include Sales tax in the unified tax.

Our recommendation is to apply a unified tax system on income tax, payroll tax and fiscal stamp duties for both micro and small enterprises.

The proposed unified tax system has the following advantages:

- Decrease financial and tax burdens.
- Prevent avoidance of employing workers and declaring their actual salaries for payroll tax.
- Reduce time and efforts spent in collecting fiscal stamp duties from M/SMEs where the collection cost may exceed actual collected taxes.

It should be noted that implementing the unified tax will not seriously affect the total collected taxes since:

- The current collection of fiscal stamp and payroll taxes are very low. Collection procedures from micro and small enterprises are not adequate.
- Micro and Small Enterprises are not familiar with the use of accounting systems, thus they do not keep proper documents and records. Such enterprises are subject to fiscal stamp duty, which is estimated presumptively as per the individual tax inspector opinion. However, the major percentage of fiscal stamp duties collected (approximately 70% of the total duties paid) is imposed on "Name Billboards", this estimate could be verified by reviewing actual ration of stamp duties collected. Fiscal stamp duties collected on "Name Billboards" represent a "Double Taxation" situation, as municipalities collect duties on the same "taxed" billboards.
- Micro and Small Enterprises do not need high-wage manpower, and in the case of using such workers, their actual salaries are not declared to avoid payroll taxation.
3.8. General Considerations

3.8.1. Defining enterprise size

In order to prevent confusion in categorizing different enterprises, a clear definition must be used, so that a small enterprise would not be considered as micro or a medium enterprise considered as small.

The above suggested definition is totally based on the revenue of the enterprise which is reported by the enterprise itself. This report, as in new tax law assumes that all tax reports made by the enterprise are correct and honest unless proven otherwise.

However, certain objective measures could be developed by tax authority to prevent clear cases of enterprises declaring smaller sizes. The main factors in measuring the size of the firm should be considered. These factors are:

- Business activity
- Location
- Space
- Production Capacity
- Manpower

Other indicators could be specified by tax authority. In all cases, it should not be left to the individual tax personnel to develop such limitations for individual cases.

3.8.2. Transition from a smaller size to a higher one

Enterprises should be encouraged to grow, thus making the transition from one level to the next, e.g. from a micro to a small enterprise or from a small to a medium enterprise. To achieve this objective, the following issues could encourage such transition:

- Losses are not recognized in micro and small enterprises.
- Utilization of the special M/SME fund to support enterprises in transition to higher levels, whether in the form of loans or by financing a part of taxes due after transition.
- Taxation of small enterprises is based on actual reported revenue, as opposite to micro enterprises (presumptive). This would achieve higher tax equity for small enterprises than that for micro ones and may encourage micro enterprises to transit to next level.

3.8.3. Tax boundaries between different sizes

An enterprise should not be subject to a tax amount that is equal or more than that if considered as a bigger enterprise. For example, taxes for a micro enterprise should not exceed what is paid for small enterprises. The maximum profit of any micro enterprise is LE 150,000, thus taxes paid for micro enterprises should not exceed the amount of LE 3,000 (150,000*2%).
4. Conclusion and Recommendations for Further Work

- In this Report, different models for M/SMEs tax systems were presented with their pros and cons. Implementations in different countries were presented with their features and characteristics. A comparison was made between different models.

- A complete Tax solution for M/SME in Egypt was proposed based on both the international experience and the Egyptian economical and social characteristics. The proposed solution recommends different models to be implemented for Micro, Small and Medium Enterprises. Examples were made to illustrate the implementation of different models.

- Due to time limitation, the proposed solution might not be implemented as a whole. It could be implemented on phases. Individual recommended sub-systems could be separately implemented for any of the Micro, Small or Medium Enterprises. In such case, small adjustments will be needed to assure proper boundaries between the main tax system and the sub-systems.

- In case of implementing the "Business Indicators/Patent" Systems for micro enterprises, a comprehensive study should be conducted to define appropriate business indicators for each type of business activities as in the examples listed in this study and to agree on this basis with different syndicates.

- For each of the recommended systems for micro and small enterprises, a complete set of standard reporting forms should be designed. For example:
  - Forms for activity size definition
  - Forms used to follow-up different enterprises to verify their size.
  - Forms for revenues in case of small enterprises

- In case of implementing all or part of the recommended solution presented in this report, a comprehensive study could be conducted to accurately confirm the proposed tax rates based on the available statistics on the paid taxes by different business activities, different locations and different sizes of enterprises. Using the same statistics, the impact on tax revenue could be accurately estimated.

- An option for implementing the "Unified Tax" system could involve the inclusion of sales tax. This needs a specialized study to assure tax equity. The study should also cover procedures and requirements of collecting the unified tax.

- In case of implementing the "M/SME Fund", a comprehensive plan should be developed that benefit from the international experience for establishing such funds. The plan should include objectives, structuring, resources and uses of the fund and the management authority of this fund. A detailed action plan should be also developed.